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Economic Studies and Analyses
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Vysoká škola finanční a správní

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MOJMÍR HELÍSEK

Research should be one of the most important activities at any university. University of Finance and Administration (Vysoká škola finanční a správní - VŠFS) can show a number of results in that field.

During 2003 – 2011, we have received support from funds of the Czech Science Foundation for six projects with the total budget of 7.9 million CZK. In 2007, the Internal Grant Agency VŠFS (IGA) started operation; its main mission is to support creation of projects, publishing work, and to form research teams. Within IGA, so far 21 projects have been concluded with total support exceeding 4.2 million CZK. Also important is engagement in three projects of the Research Institute of Labour and Social Affairs. VŠFS also accepts invitations to international competitions for research support, like for example projects of the 7th EU Framework Programme, international workshops of the European Science Foundation, support of researchers exchange Mobilita, and others.

In 2006, the Centre for Economic Studies and Analyses (CESTA) was founded at VŠFS which successfully participates in research projects, organizes discussion seminars and publishes. Since 2007, a scientific periodical ACTA VŠFS has served for presentation of research findings which was included in 2009 by the Research and Development Council into the list of reviewed, non-impacted periodicals published in the Czech Republic.

VŠFS regularly organizes several conferences with the themes for example on Human Capital, Financial Markets, and Knowledge Economy. The professional public has also been attracted by the conference Ten Years of Private Higher Education (2009), Changes in Businesses Management (2010) or Pension Reform – Future (2011). Since 2006, VŠFS is a collective member of the Czech Economic Society. Besides financial support of the society, we organize 1 – 2 specialized seminars for the general public every year.

Development of creative environment is supported by the background in the form of the Centre for Library Services. The library offers around 27 thousand publications and 60 periodicals, it has access into full-text databases Proquest 5000 International and Newton MediaSearch.

A qualitative improvement in development of VŠFS was when it achieved the status of a university through granting the accreditation for doctoral studies in spring 2009. Although only the second year of the studies is under way, our doctoral students have published a number of publications and presentations at domestic, as well as foreign conferences.

VŠFS also supports research activities of young scientists through the competition for the Award of prof. František Vencovský, with the main grant of 200 000 CZK with the related scientific conference. The third conference will be organized in autumn 2011. We will inform you about its results in one of the next editions of ACTA VŠFS.

Výzkum by měl na každé vysoké škole představovat jednu ze stěžejních činností. Vysoká škola finanční a správní (VŠFS) může v této oblasti vykázat řadu výsledků.

V letech 2003 – 2011 jsme získali podporu z prostředků Grantové agentury ČR pro šest projektů, jejichž celkový rozpočet činí 7,9 mil. Kč. V roce 2007 zahájila činnost Interní grantová agentura VŠFS (IGA), jejímž hlavním posláním je podporovat tvorbu projektů, publikační činnost a formovat výzkumné týmy. V rámci IGA bylo doposud uzavřeno 21 projektů s podporou více než 4,2 mil. Kč. Významné je také zapojení do tří projektů Výzkumného ústavu práce a sociálních věcí. VŠFS reaguje i na výzvy mezinárodních soutěží o podporu výzkumu, jako jsou např. projekty 7. rámcového programu EU, mezinárodní workshopy European Science Foundation, podpora výměny výzkumných pracovníků Mobilita a další.

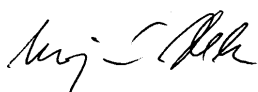
V roce 2006 bylo na VŠFS založeno Centrum pro ekonomické studie a analýzy (CESTA), které úspěšně participuje na výzkumných projektech, organizuje diskusní semináře a publikuje. K prezentaci výsledků výzkumu slouží od roku 2007 vědecký časopis ACTA VŠFS, který byl v roce 2009 zařazen Radou pro výzkum, vývoj a inovace na seznam recenzovaných neimpaktovaných periodik vydávaných v České republice.

VŠFS pravidelně pořádá několik konferencí na témata např. Lidský kapitál, Finanční trhy a Znalostní ekonomika. Odbornou veřejnost zaujaly také konference Deset let soukromého vysokého školství (2009), Změny v řízení podniků (2010) nebo Důchodová reforma – jak dál (2011). Od roku 2006 je VŠFS kolektivním členem České společnosti ekonomické. Kromě finanční podpory této společnosti pořádáme každoročně 1 – 2 odborné semináře pro širokou veřejnost.

K rozvíjení tvůrčího prostředí přispívá zázemí v podobě Centra knihovnických služeb. Knihovna nabízí okolo 27 tis. svazků a 60 periodik, má přístup do plnotextových databází Proquest 5000 International a Newton MediaSearch.

Kvalitativním posunem ve vývoji VŠFS bylo získání univerzitního statusu udělením akreditace doktorského studia na jaře 2009. Přestože probíhá teprve druhý ročník tohoto studia, vykazují naši doktorandi již řadu publikací a vystoupení na domácích i zahraničních konferencích.

VŠFS také podporuje výzkumné aktivity mladých vědeckých pracovníků soutěží o Cenu prof. Františka Vencovského, s hlavní odměnou 200 000 Kč, s navazující vědeckou konferencí. Na podzim 2011 se můžeme těšit již na třetí ročník této konference. O výsledcích vás budeme informovat v některém z dalších čísel ACTA VŠFS.



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The Role of Governance in Pension Systems

Úloha governance v penzijních systémech

JAROSLAV VOSTATEK

Abstract

Contemporary pension systems consist of more pillars and are administered also by very different providers. Corresponding governance systems are also very different, reacting to different interests of stakeholders pushing through their interests. In the interest of alignment of these interests the governance codices are issued, the OECD playing an important role in it. The governance cannot replace the basic defects of the pension pillars, of the quality of pension institutions supervision, nor the annuity markets failures, nor the imperfect competition in this sector. A mission of the World Bank played an important positive role in the formulation of the role of the governance and supervision of the Czech supplementary pension insurance. Lobbyists' pressures have a negative influence, mainly in the form of proposals for the reform of the public pension pillar and of the existing pension funds and their products, as well as in refusing the full implementation of the EU Pension Directive. By contrast the governance theory and practice highlights the interests of the clients of the pension institutions, with the exception of the private insurance companies where the general corporate governance model applies also in the world. The state support of the pension products may have a substantial role in the promotion of the clients' interests.

Keywords

public governance, corporate governance, pension reform, pension pillar, pan-European pensions, pension fund, life insurance company, social insurance

Abstrakt

Moderní penzijní systémy se skládají z více pilířů a jsou spravovány i velmi rozdílnými poskytovateli. Tomu odpovídají i značně odlišné systémy governance, reagující na rozdílné zájmy aktérů, prosazujících své zájmy. V zájmu sladění těchto zájmů jsou vydávány kodexy governance, s významnou úlohou OECD. Governance nemůže nahradit zásadní nedostatky penzijních pilířů, kvality dohledu nad penzijními institucemi, ani selhání penzijních trhů či nedokonalou konkurenci v tomto sektoru. Významnou pozitivní roli ve formulaci úlohy governance a regulace v českém penzijním připojištění sehrála mise Světové banky. Negativní vliv v Česku mají lobbistické tlaky, projevující se nejvíce v návrzích na reformu veřejného penzijního pilíře a na reformu stávajících penzijních fondů a jejich produktů, jakož i v odmítání úplné implementace Penzijní směrnice EU. Teorie a praxe governance naproti tomu staví do popředí zájmy klientů penzijních institucí, s výjimkou soukromých pojišťoven, kde se i ve světě uplatňuje obecný model corporate governance. Zásadní úlohu při prosazování zájmů klientů může mít státní podpora penzijních produktů.

Klíčová slova

public governance, corporate governance, penzijní reforma, penzijní pilíř, panevropské penze, penzijní fond, životní pojišťovna, sociální pojištění

Introduction

The origin and development of public pension systems in the 19th and 20th century was part of the increasing role of the state in the area of social security, this not only in this field. Although it is possible to see a number of general development tendencies in the social pension security, for example in the developed countries, there still have been and still are important differences between individual countries which can be attributed to existence and development of different social models (welfare regimes) in the most general meaning, as well as different parameters of the models in individual countries. During the recent decades, also the pension systems have strongly differentiated, as a rule into 3 (or even more) pension pillars, while the public pillar even is not always considered to be the basic pillar. In addition to the voluntary private pension pillar, resp. the pillar of corporate pensions and the pillar of individual pensions, the obligatory private pillar has been applied and is applied in many countries, requiring all fundamental public regulation. Individual pillars have quite different systems of operation, this even in comparison of the same or similar pillars in different countries.

The public regulation, as well as internal mechanisms of individual pension institutions operation are, or may be, relatively complicated and the resulting effects of the whole system, its pillars, as well as individual institutions usually depend much on activities and interests of individual involved parties which usually stress also their personal interests. The hierarchic structure and operation of the pension system, as well as individual institutions is generalized at the theoretical level by the agency theory – with its mandators or principals and executors or agents. Rectification of the mentioned entities is done not only through laws, decrees, but also by public governance and corporate governance which include also the corresponding provisions of laws and decrees. Considering the very quantity of publications, governance plays strongly different role in individual pension models and pension pillars.

1 Corporate Governance in Private Insurance Companies

Developing of the theory and practice of corporate governance was originally relatively simple in private life insurance companies which usually provide also private pensions – personal, as well as corporate. In those pension institutions, the general variant of corporate governance was originally applied in which the shareholders are considered to be the decisive involved entities (stakeholders). The most general objective of corporate governance in this concept is to generate “added value” to those entities. The generally conceived corporate governance pays special attention to protection of interests of minority shareholders in companies listed on the stock exchange.

Generally speaking, corporate governance differentiates between a number of stakeholders, in classification to internal and external involved entities (stakeholders). R. E. Freeman (1984) ranges among internal stakeholders the owner, the managers and employees and

among external stakeholders customers, shareholders, creditors, the government, the society and suppliers. Acts of those stakeholders are regulated by the state, in the insurance business it has always applied in a strongly higher extent resulting from the nature of products and the industry.

Regulation of the private insurance business in the EU is based on the EU directives which are implemented through laws and decrees of individual EU member states; the regulation includes also supervision over the private insurance companies operation. In this country, the key laws include the insurance business law (regulation of insurance companies), the law on insurance policy (regulation of products) and the law on insurance mediators and independent liquidators of insured events.

1.1 OECD Principles

Corporate governance has achieved more importance in the world in the recent decade. This fact was reflected, among other things, in issuing of the new Principles of Corporate Governance by OECD in 2004, following the principles of 1999. In individual OECD countries, new national codes are issued. Let us mention for example the Austrian Corporate Governance Codex containing 83 points (and 4 appendices), differentiated to obligations resulting from laws (L), to rules of "comply or explain" type which must be complied with or a variation from them must be explained (C) and recommendations (R). The Austrian codex was amended in 2010 with view of experience with the world economic crisis; among other things, it includes also prohibited provision of so called "golden parachute". The codex does not include special rules for banks and insurance companies. Pensions are not mentioned in the codex. In this country, the Securities Committee produced in 1999 the Companies Administration and Management Codex based on OECD Principles with fundamental cooperation of the British Know How Fund. In 2004, the codex was reworked based on OECD Principles of 2004.

In private insurance companies therefore the general principles of corporate governance applied, without any specific link to pensions provided by those insurance companies. Clients of the insurance companies who concluded voluntarily the pension insurance were not given any special support by corporate governance, except for annual reports of insurance companies produced, however, usually for the purpose of shareholders, supervision and possibly also in reduced marketing version for clients. Clients definitely were not perceived as important stakeholders in corporate governance of private insurance companies.

Times have, however, changed in many aspects. In 2005, OECD Board approved the directive for governance of insurance companies which is based on the fact that even in highly regulated sectors (like for example in the insurance industry) the regulation itself cannot achieve good practice necessary for integrity and efficiency of the sector. Also the companies themselves must develop internal rules and systems to achieve those objectives while governments and international institutions can be of assistance in creation of the rules and systems. The following are mentioned as the two main objectives: complementary development of protection of policyholders or shareholders (over the scope of the existing regulation and the present supervision) and complementary development of the general corporate governance for the purpose of the insurance sector. At the same time,

OECD endeavoured to take into account also conflicts of interests specific for the sector (agents and principals) and the big importance of insurance mathematics. The structure of OECD guidelines has 12 partial points structured into three blocks, all of this on 6 print pages. None of the partial points covers explicitly pensions. The opening comment to the partial points only mentions differences between life and non-life insurance, for example as to utilization of the insurance mathematics.

Evaluation of corporate governance in the Czech insurance business was performed by the team of the World Bank in 2005 upon request from the Czech government (WB, 2006). This document identified three distinct weaknesses of corporate governance of Czech insurance companies: excessive space for transactions and transfers of funds between linked companies, weak role of supervisory boards and audit committees in many insurance companies and absence of an efficient separation of life and non-life insurance in composite insurance companies. The overall concept of corporate governance, applied upon this mission of the World Bank, complies with the above mentioned OECD guidelines; however the document of the World Bank is, of course, much more specific and in fact directly applicable in amending of legislation and creation of the governance system for the industry and individual companies.

1.2 Influence of the Financial Crisis

The practical importance of corporate governance in the insurance business has been emphasized by the financial and economic crisis in recent years which broke forth at the time of final works on the new system of assessment of insurance companies' solvency (Solvency II). The main idea of Solvency II is to facilitate sufficient capital of insurance companies so that the probability of the insurance company bankruptcy in a specific year is lower than 0.5%. Simultaneously, legislation for insurance and the insurance business in the EU is almost permanently amended.

In this country, an entirely new insurance business law was adopted with effectiveness from 2010, implementing in particular the EU guideline on facilitation and the guideline on acquiring and increasing of ownership interest in the financial sector. The new law, however, includes also new important provisions which comply with the principles of corporate governance: these cover, among other things, the obligation to inform the supervision (CNB) about separation of activities with important nature, to produce (and discuss) annual reports of responsible actuary, to notify CNB of the insurance company's auditor.

The linked CNB decree implementing some provisions of the law on insurance business is focused, among other things, on the control and managerial system of insurance companies which plays an important role in corporate governance. Also important is implementation of the EU guidelines on financial tools market (MiFID) and the guideline on mediation of insurance (IMD) in corresponding Czech laws. An amendment of the new law on insurance business will result from implementation of Solvency II which is planned for October 2012. The main content of this legislation from the point of view of governance is to facilitate in fact smooth operation of private insurance business, its appropriate resistance against bankruptcies and crises.

1.3 Czech Specifics

The Czech insurance business was much less affected by the financial crisis. It probably was not because of the level of the Czech legislation or the quality of supervision. The main reasons for the mentioned positive phenomenon are, most probably, specifics of the Czech insurance market linked with the stressed high earnings of the Czech insurance sector. The Czech insurance sector has been in fact already “for long” fully private (excluding the state insurance of export credits), in contrast to Poland and Slovenia. Its structure is strong oligopoly, as well as in other post-communist countries, thanks to privatization of former state-owned monopoly insurance companies. In this country, as well as in other medium and small post-communist countries, only several global and Central-European players are efficiently involved in the insurance market. Entry of new insurance companies to the market – otherwise than by purchase of an already existing insurance company – is “blocked” by a high barrier in the form of existing intermediary networks and insurance portfolios. It results in the overall high profitability of the Czech insurance business. This is a positive thing for the sector stability, but for consumers it means worse products and higher prices.

We will document the hypothesis about worse products and higher prices with two examples from the unit-linked life insurance which is, from among the sold products, the closest to securing for old age. A well known case is the high commission for sale of the products – in comparison with the western countries and with mutual funds. The amount of the commission for long-term unit-linked life insurance can be seen from the following relations: in Germany, the commission is approx. 100%, in the Czech Republic 200% (and in Russia 300%) of the first-year current insurance premium. This fact will not be probably changed by issuing of the codex of corporate governance for private insurance companies or by obligatory notifying of the client of the amount of the agent’s commission. The second example includes the insurance conditions of one well-known product of the life-insurance market leader according to which the insurance company “can” collect fees from customers. The hidden fees for the product were criticized repeatedly and strongly in the magazine *Finanční poradce* (Financial Advisor) without any (visible) response from public institutions responsible for consumers protection. It is possible to consider that clients do not pay any visible fees for the product – and do not “have” to pay because the premium is invested into a special fund administered by an affiliated investment company only for purposes of the insurance company, resp. for purposes of the financial group as a whole.

Pension insurance is not, on principle, offered by Czech insurance companies. If it is offered, then rather due to completeness of assortment and its prices are usually high. The specific causes of this situation are the same like with other products.

1.4 Failure of Annuity Markets

A general problem of provision of private pensions in all developed and relatively developed economies is failure of pension (annuity) markets which is a standard finding of political economy textbooks. The failure of private annuity markets is derived from several facts, part of which applies only to the conditions of a market in typical private pension

insurance which is voluntary insurance. Only with the possibility to choose so called adverse selection of risks can occur when the tendency to conclude pension insurance cannot be expected from persons with below-average health. From this fact, directly results the necessity of appropriate correction of the used mortality tables with the risk margin in addition to that.

Even bigger, entirely fundamental problem is the fact that even persons with over-average health are not much interested in pension insurance. That is to say that pension insurance is too perfect method of securing for old age, upon "occurrence" of this insurance need, in comparison with usual thinking of people. In this context, "myopia" is mentioned, preferring today's consumption to uncertain future and possibly even stronger argument is the requirement of the "rate of return" of the funds invested into life insurance. This leads to preference of insurance with once-off settlement against insurance with life-long pension. This is documented also by behaviour of clients of Czech pension funds during the first decade of their operation when the law ordered them to use statistical mortality tables incorrect from the professional point of view (for this purpose); if those clients behaved rationally (and took life-long pension) then all pension funds offering life-long pension would fail. At the same time, however, it is true that for sale of life (and pension) insurance the decisive factor is marketing, not the quality and advantages of individual products. Also this fact shows the fundamental role of the state pension policy; it must express clearly which products are favourable for appropriate securing of most of the population. On no account it is possible to rely on the simple "market solution" in the form of classical voluntary pension insurance without strong state regulation.

To conclude with, we can state about corporate governance of life insurance companies that it in fact does not matter that no attention is paid to the "market" pension insurance and its consumers – at least because such clients in fact do not exist and will not exist. This, however, applies only in the case of voluntarily concluded individual insurance. If, however, obligatory private pension insurance or pension insurance sponsored by employers exists or should exist, this means an entirely different situation. The theoretical finding about failure of the annuities market does not lose validity, however a number of "parameters" change with the model impact on the price level. Very intensive regulation of the market in obligatory private insurance is a need, its results depend on how professionally the regulation is performed, as well as on influence of interest groups, in particular providers of the products.

The Bezděk advisory and expert body (PES), in which the interested representatives of those groups directly dominated, recommended implementation of the obligatory purchase of life-long pension for funds from the obligatory private pension savings without any mention of the issue of failure of annuity markets.

2 Governance of Pension Funds

The issue of governance of pension funds is a much frequented topic of discussions and studies. This might seem surprising under our conditions, particularly due to the Czech legislation for pension funds.

2.1 Different Types of Pension Funds

There is a wide range of pension funds in the world; pension funds can generally be classified into two main types:

1. Contractual type: pension funds without legal subjectivity designed as funds for pensions operated by one-purpose providers or other financial institutions (for example investment banks);
2. Institutional type: pension funds with legal subjectivity – in the form of a foundation or association or in the form of a company.

An interim type includes trusts pursuant to the Anglo-Saxon legislation; when a pension fund is in the form of a trust its trustees are entitled to dispose assets of the pension fund – while they must do so exclusively in the interest of the fund participants who benefit from investing of the fund's money. Trustees are not, from the legal point of view, part of the trust. Special legislation applies in the USA where the governing body can be both the trustee, and the "sponsor" (employer), and also a "third party". All this influence also the specific design of governance of pension funds.

Contractual pension funds are governed externally, this by a standard financial institution or by a management company specialized in pension funds the work of which is separated legally from the pension funds assets.

Institutional pension funds have an internal governing body. If this is a joint stock company there is one governing body (Anglo-Saxon version) or there are two pillars consisting of the board of directors and the supervisory board (German version).

It is said that there is no a priori reason to prefer any of the legal forms of pension funds. The choice depends on the nature of the product, resp. on the target group of clients (corporate or private pensions), on the legal tradition of the state and the tax legislation. Different legislations, however, result in different attitudes regarding governance of pension funds. This involves in particular conflict of interest, qualification of members of the governing bodies, etc. (Stewart – Yermo, 2008).

Czech pension funds are joint stock companies; from the global point of view it is a minority type of pension funds. Their product is defined by contributions (pension plans). Czech pension funds are not, on principal (from the point of view of governance) sponsored only by employers. Provision of contributions by employers for additional pension insurance of employees, however, also influences governance of pension funds.

Czech pension funds are joint stock companies, as well as Czech private insurance companies. Legislation of Czech pension funds is very special, even quaint. Legislation of pension funds and of the product provided by them is included in the law on additional pension insurance with the state contribution implemented in 1994, i.e. at the time when we did not have (and could not have) the Czech insurance legislation harmonized with the EU guidelines.

The Czech system of additional pension insurance with the state contribution is presented to the world as a system of pension funds, as a special pension system, although in fact they are only special life insurance companies, specialized in sale of a single product of private pension insurance. The only fundamental economic speciality of that product includes the high state subsidies – in the form of the state contribution, as well as in the form of tax allowance. The same product could be sold – from the legal point of view – also by life insurance companies, however under the applicable legislation without the state contribution. There is, therefore, no economic reason for existence of Czech pension funds.

2.2 Recommendations of the World Bank for the Czech Republic

Governance of the system of Czech pension funds was covered by the World Bank in 2005 (WB, 2007). That mission based formulation of its evaluation and recommendations on the applicable OECD guidelines for pension funds governance. In the document of the World Bank, we can find in page 5 the following thesis: “The primary objective of pension funds governance should be dual: (1) to protect rights and interests of members of the pension funds and (2) to arrange secure sources of the fund for payment of timely and reasonable pension benefits to those who have paid contributions to their pension.” This thesis documents entirely different attitude to pension funds governance and life insurance companies governance: while governance of insurance companies respects the dominant interest of shareholders, the present governance of pension funds emphasizes the basic protection of consumers – participants of the pension funds. The specific methods for pension funds governance strongly depend on the legislation for pension funds, as well as on the provided products. From the governance point of view, there is a fundamental difference between defined benefit and defined contribution products. Another important parameter for governance is whether the pension fund is “sponsored” by the employer.

The above mentioned mission of the World Bank resulted in 30 recommendations focused on creation of standard governance of pension funds under the Czech conditions, i.e. under the precondition of existence of the present (initial) state pension policy in this field. During the process, also already proposed reform measures in the field of additional pension insurance were discussed. It means in particular the proposed separation of the funds of participants from the funds of shareholders, and principal change of the product in the form of foundation of new pension institutions as implemented later on principle in the form of the state draft on pension savings. (The draft was submitted to the Parliament by Topolánek’s cabinet at the end of its rule; the draft was not included at all into the agenda of the Chamber of Deputies. Representatives of pension funds had the crucial influence on the concept and content of the law).

We will discuss in particular those recommendations of the World Bank which relate to the whole pension system. We have already mentioned above the initial credo of OECD, according to which the primary objective of pension funds governance is to protect interests of consumers, i.e. participants of the additional pension insurance. This should be reflected also in legislative provisions about tasks of members of the boards of directors and the supervisory boards. In particular, members of the supervisory board should act

as independent experts, not namely as representatives of the pension fund. It is noticeable that the World Bank (either OECD) does not pay attention to the fact that this undermines the basic goal of a private company operation. Both of that can be explained only by the fact that any private insurance for old age can be meaningful only under the condition that its stability will be sufficiently facilitated in the horizon of many decades. Otherwise, the purpose of the security could not be achieved; a client of a private pension fund must not have permanent or more or less regular fears about his/her long-life savings and the subsequent pension. The purpose of pension products, in fact, does not involve short-term or medium-term savings linked with wide state contributions, which is the present situation in the Czech Republic, while the original status was even worse. The World Bank's mission did not comment on the amount of subsidies for the additional pension insurance, either it compared the rate of subsidies with the so called private life insurance. Perhaps, also because nobody pointed out the mentioned connections. The uneven conditions on the savings market are the fundamental deformation factor of the market influencing also the demand for individual products. The Czech additional pension insurance is, according to comparison performed by OECD, the pension product with the highest subsidies from among all OECD countries (Whitehouse, 2006).

The mission of the World Bank mentioned the low real yield of the Czech additional pension insurance product; it provides the average rate of 0.5% p.a. (before the crisis!). In this context, the World Bank stressed the need of higher transparency in reporting of costs in annual reports including specification of standard cost coefficients allowing comparison of efficiency of pension funds. This includes also the necessity to report relationships with linked companies from the same financial groups including the amount of investment fees provided by investment companies from the financial groups. The World Bank points out also an increase in the achievable costs of pension funds in several recent years while this fact is better expressed in the ratio of the total costs of pension funds to the received contributions, not to the assets.

The mission of the World Bank criticized, among other things, also the purposeless dragging of clients between individual pension funds, not reasoned results achieved by pension funds and the related increase in the achievable costs and increase in DAC (deferred acquisition costs, resp. the sales expenses not reflected into the costs). Amendment of the law on capital market business of 2009 implemented also recommendations of the World Bank's mission that the employer cannot influence an employee's decision on the pension fund choice. The World Bank rejects such practice in the interest of unlimited competition of pension funds and in the interest of struggle against unwanted motivating of selected employees of the employer (earlier) deciding about the choice of the pension fund into which the employer would pay its contributions.

In the Czech model of pension funds therefore occurred – at least in legislation – elimination of the originally key role of the employer in formation of the pension fund as funds of pension insurance of employees above the scope of the social pension insurance. Besides, this was the initial intention of the system of additional pension insurance. To disable the employer to use the additional pension insurance as a tool of HR policy (cancellation of the policy by the employer when the employee leaves the company) he was not given the possibility to “insure” his employees. He only could make contributions to the employee's policy.

Later, implementation of very attractive state support for contributions of the employer to the Czech additional pension insurance helped the strong increase in employers' contributions. Since 2008, there has been a joint limit for contributions of the employer to the additional pension insurance and to the so called private life insurance of CZK 24,000 a year; up to this limit, the contributions can be included into the costs of the company and the social and health insurance premiums are not paid from the contributions (analogous to a subsidy of 45% of the gross salary) and the employee does not pay the income tax (another up to 15%)! The state support of employer's contribution is even higher than the state contribution to the participants' premium itself, it equals 94.5% of the equivalent net salary! Do not, however, see any theory behind, this is exclusively expression of rent-seeking by the involved financial groups.

2.3 Product Changes, Czech Specifics

The initial standard of pension funds systems in the western countries were corporate pensions, defined benefit (DB). This construction of the product generally well suits interests of the consumer, the pension is guaranteed – it is on principle a classical product of life insurance while the only important difference is calculation of the pension analogical to calculation of the pension in the social pension insurance. This product can be operated according to usual principles in private insurance which means creation of appropriate reserves based on insurance mathematics; pension funds with such operation are called “/fully/ funded”. On the other hand, there are also systems of corporate pensions entirely without creation of appropriate reserves based on insurance mathematics. And there are also many “variants in between” where reserves are created but not to the extent corresponding private insurance. The main initial problem of such funds governance is this insufficient creation of reserves within the meaning of principles of private life insurance operation. Most of foreign books about this matter of governance cover in particular this issue. Because we do not have this system in this country and its implementation is not proposed we will not deal with it in detail.

During the recent decades, private (as well as public) pension have changed fundamentally; the “defined contribution” (DC) system, resp. the product is implemented. DC product means in fact pension savings, resp. investing, the client bears the whole investment risk – unless the product includes the guarantee of the pension fund. With DC product it is not important whether the “saved” funds on the personal account of the client are paid in once-off payment, or in instalments, or whether payment of life-long pension will follow.

Governance of corporate pension funds with defined benefit product and with defined contribution product differs strongly. The differences, according to the World Bank, are caused namely by inherent conflicts of interest between members (clients) and financial market players, this even without attention to whether these are employer's (corporate) pension funds or not. The governance solution is very demanding under these conditions, unsuitable attitude can lead to “governance vacuum” and damage of the whole sector of pension funds.

The “governance vacuum” does exist, according to the World Bank mission opinion, also in the Czech sector of additional pension insurance; DC model implemented in this country

is specified by the mission as contractual in the sense that in fact everything is based only on an agreement between the client and a joint stock company. Besides, the company – pension fund often subcontracts the services to organizations linked with the pension fund. According to the author's opinion, money from the pension funds is drawn to other companies of the same financial group and through that, the legal provision on allocation of a pension fund profit between its participants (minimum 85%), the reserve fund and the company is overcome. An indirect evidence of that is the fact that none of the Czech pension funds has ever paid dividend to its shareholders; this is not normal for sure. The fundamental problem is that the real appreciation of money of the clients during the whole period of the pension fund existence is on average zero; now, after the crisis which had little influence on the Czech pension funds, it is a "negative zero".

The World Bank's mission specified the product of the Czech additional pension insurance as a variation of the "classical" defined contribution product (DC), with the reasoning that there is not direct connection between the assets value and liabilities value of a pension fund. This fact has a practical impact on governance, specifically in the area of disclosure of information and risk management.

A "classical" defined contribution pension fund not including any guarantees as to the amount of the "saved" money is for its provider very riskless, very comfortable – any investment risk is borne by the client. An advantage in sale of such a product, particularly under the existing Czech conditions, includes also the possibility to promise a higher appreciation in the case of provision of a fund with a higher risk exposure. The client is "drawn in" with the use of graphs and words about high yield and if he perhaps rejects the high investment risk, the fund with conservative anticipated yield is sold to him. This simple selling strategy suits best for simultaneous sale of three funds with differentiated risk profile. Insurance companies may create their "internal", separately not tradable funds, and some of them purchase such funds from their affiliated companies under special conditions as to commission and fees. This is exactly what is to be eliminated by governance or directly the state regulation.

The mission of the World Bank emphasizes preservation of long-term guarantees in a product or products provided by pension funds – only in this way it is possible to achieve the "final purpose" of additional pension insurance which is insurance for old age. Short-term guarantees therefore can be broken. Therefore it is not necessary to insist on the present practice when the amount of money on the personal client's account cannot decrease (in nominal sense), this even as a result of charging fees (which are not allowed at all for that reason). Under a long-term guarantee, guarantee of the amount of benefit at the moment of originated entitlement to the pension is understood.

One of the basic principles of Czech pension funds governance according to the findings of the World Bank's mission must be involvement of responsible actuaries to the extent usual (required) in life insurance companies. This applies also to the present pension funds with their existing simple products. This would apply even more in the case of the product change, for example in connection with transition to the mentioned long-term guarantees. And this would apply also in the situation when pension funds would pass the agenda of pensions provision to insurance companies which is in fact recommended by the mission, without specification of a clear reason.

An entirely decisive majority of the World Bank recommendations how to implement governance of Czech pension funds has not been implemented and nobody probably has worked on their implementation. The association of pension funds, on the contrary, carried through the governmental draft of the pension savings law the adoption of which would mean transition to products without guarantees, further increase in direct and indirect state subsidies and even implementation of simultaneous state contribution and the tax deduction of the client within the range CZK 500 – 700 monthly.

The existing Czech pension funds must be reformed already with the view of the EU legislation and the simplest solution is their obligatory transformation into life insurance companies. A radical reform of regulation of the market in additional pension insurance and competitive products is the precondition for implementation of a unified concept of corporate governance in the sector of provision of private pensions.

2.4 Pan European Pensions

Pension funds were originally established with the purpose to administer corporate pensions. The original main purpose of corporate pensions was motivation of employees to loyalty to the company. This included also the loss of the corporate pension when an employee left company.

Another development stage of corporate pensions in a number of countries was their larger expansion thanks to trade unions pressure which in several countries resulted even in the obligatory corporate pensions – trade unions helped to domination of private insurance.

The purpose of today's corporate pensions is, on principle, no more motivation of employees but utilization of the state support for corporate pensions which developed after the Second World War. All international institutions require transferability of pension entitlements upon a change of the employer which is the opposite to the former loyalty principle.

Through the change of the original purpose of corporate pensions this pillar of pension insurance loses its justification resulting from the interest of the company, resp. its owners. The primary interest in the corporate pensions moves to employees and trade unions. The key question is the state support of corporate pensions – if any; therefore corporate pensions become primarily a tool for utilization of the state support, not a tool of pension insurance. The basic issue is whether the state should provide the state support to corporate pensions at all. The theory does not in fact cover these issues which can be explained by the fact that in many countries those pensions are so widened that not anybody gets the idea that the classical second pillar of pension insurance could be cancelled. While the Czech practice documents that contributions of companies to individual pensions are an alternative solution. The modern reason of corporate pensions can be seen in the field of the costs of provision of pension in comparison with individual pensions and possibly also public pensions. Possibly also a pragmatic argument can be considered that with the use of corporate pensions higher clients' insurance coverage is achieved.

In some way or other, various pension funds are the reality in almost all developed countries and it is necessary to “grip” with this issue also within the EU. The EU has achieved the conclusion that where possible, it is desirable to create a unified internal pension market. For that reason, the directive on regulation of institutions providing corporate pensions was adopted in 2003 which endeavours to implement the regulated pan European market in corporate pensions intended to reduce the costs of the pensions provision. The directive expresses preference of the pension institutions providing products not undercapitalized. The directive does not apply to quasi insurance systems which do not create reserves like insurance companies. The directive does not interfere with national regulation, for example of private insurance companies.

European pension institutions using the EU pension directive establish separate divisions for individual EU countries which must comply with legislation of the specific country. The Czech Republic does not have created legislation for institutions providing corporate pensions and rejects to create it – today perhaps not due to ideological reasons like at the time of the additional pension insurance origin. From purely technical point of view, however, the problem is artificially generated: a number of Czech companies had their pension funds after 1994, and also today it is possible to have not only the existing pension funds (not compliant with the EU legislation) but also own life insurance companies which can provide corporate pensions.

If the European pension institutions obtain the licence for life insurance in any EU member country they can provide corporate pensions in the Czech Republic – if the project has the characteristics of life insurance. Insurance companies can provide, pursuant to the European legislation, among other things also a product in the field of life insurance called management of group pension funds. The Czech Republic has sufficient legislation for provision of corporate pensions in compliance with the EU pension directive and does not need to create special legislation for institutions providing corporate pensions; it is however necessary to convince the EC about this fact and incorporate this all into the insurance law. Increased competition on the Czech market in corporate pensions is, however, desirable. It is in the interest of this objective to remove the ban on influencing the decision of employees in choice of a pension fund which is absurd within the system of corporate pensions and also generally at least questionable. Upon implementation of a reasonable system of the state support of certified products it would be possible to remove the existing Czech condition for the state contribution to the additional pension insurance – to have only one policy on pension insurance. Transfers of funds of clients from the existing pension funds should be possible also to foreign pension funds with the EU insurance licence and with the Czech certificate of the state support.

We cannot lose anything if the law allows operation of foreign (European) pension funds (sale of their products) on the Czech pension market pursuant to the legislation of life insurance and life insurance companies. And with this policy, we need not invent or take from abroad specific solutions for governance of pension funds providing corporate pensions. Very important for efficiency of this solution is implementation of the above suggested concept of the state support of pension savings including certifying of products supported by the state.

The concept of pensions provided pursuant to the EU pension directive of 2003 is shortly marked as “pan European pension”. From publications it is clear that before the financial crisis there had been only low development of pan European pensions, resp. more strictly speaking, only considering of their implementation on the part of supranational companies. The crisis stopped everything. Now, fast progress is expected; providers are ready, supranational companies start acting. (Burnet, 2010).

Corporate (as well as other) pension funds have suffered deep financial losses during the crisis. The even more is stressed, in present discussion of corporate pension funds governance, the importance of risk management; in this context, the framework of infrastructure of governance is mentioned. C. R. Burnet (2010) formulates the following five principles derived from governance best practice, on the basis of principles of corporate risk management, all of that under prevailing legislation conditions:

- Effective committees (in the board);
- Written guidelines or policies;
- Appropriate accountability;
- Rigorous supervision and monitoring;
- Effective information flow.

Each of the five mentioned principles is, according to C. R. Burnet “independent and mutually dependent”. This is, of course, a high degree of generalization; nevertheless there are enough specific guides in studies about governance of corporate pensions and pension funds to all of these structured items.

3 Governance of Public Pension Institutions

Governance of public pension systems includes a relatively wide spectrum of issues while most of this topic is not characterized in publications as part of governance of those systems. Politicians are strong players in those systems as representatives of citizens, tax payers and after all also of pensioners – the present and the future, potential. The role of politicians is crucial and the fact that politicians change (are replaced and alternated) has been characterized in recent decades as a political risk related with every pension system. In practice, politicians can be in fact lobbyists. In the preceding text, we have noticed this fact only indirectly.

3.1 Political Risk and Rent-Seeking

The political risk exists also in relation to the private insurance business as a whole, to the life insurance or only pension (private) insurance and of course also in relation to corporate and individual pensions. Generally, also the risk of nationalization is included here which was “in the wind” after the First World War, was implemented namely in countries controlled by communists after the Second World War and to a lower extent it must be considered also in the future, in particular in countries which came under the attraction of privatization of public pension systems. Nationalization of private pension funds was a matter of fact in Argentina in 2008. The same risk existed also under the previous Slovak government and efforts in the same direction exist in a number of other countries.

The political risk of a change in the pension system is in practice considerably higher in countries where dictators or governments with fragile parliament support decide to carry through a radical pension reform regardless its opposition. It is (or should be) obvious to everybody and therefore it is a general finding that a paradigmatic pension reform should be made in the form of consensus of all main political powers. The main economic problem of performed (full, as well as partial) privatizations of public pension systems is that their protagonists promised high effects of the privatization for the national economy which, however, did not appear – and could appear only under entirely extraordinary conditions and only for a limited time. In fact, the main economic effect of privatization of the public pension system is a strong increase in the state indebtedness and increase in the tax rates. Namely for that reason, there are tendencies to de-privatize, resp. to nationalize what has been privatized in the mentioned especial manner. The Czech Republic and Slovenia are the only EU member countries from among the former communist countries to escape the privatization efforts in this context.

The Czech public pension system today is really endangered as a result of strong positions of lobbyists, while the fundamental difference against privatizations in Eastern Europe and South America in the past period is that our lobbyists do not promise any (positive) effects of privatization for the national economy – on the contrary, they (only) try to camouflage that “taking out” of for example 3% of salaries from the income of public budgets will lead to permanent additional shortage in the public budgets, resp. the increased taxation. The proposed partial privatization of the Czech pension system does not have any theoretical basis and it is based only on the reputation achieved by the lobbyists during their previous work in the public administration.

From the theoretical point of view it is in fact a standard situation in this context that privatization is strongly supported by directly interested and involved financial groups. From the point of view of public governance, pension and similar reforms must be prepared by commissions consisting of independent experts; any single member of such committee must not be even a bare employee of a pension fund.

Existence of various interests and interest groups is an obvious matter of fact when public pension systems are involved. Decision making about existence, construction and quality of the public pension system is subject to public choice in democratic conditions. Regarding governance the decisive factor should be the interest of clients; the specific implementation of this general thesis is, however, the matter of consideration of a number of economic, social and other circumstances. A number of public pension models have been developed on this basis.

3.2 Governance in Social Insurance

From the point of view of governance, any legitimate concept of the basic pension pillar is generally acceptable. Nevertheless it is true that the population usually prefer the system of social insurance as the basic pension pillar. While they expect from it also a decent benefit rate if the insured person was economically active for the whole life with a salary, let us say, within the range 125-150% of the nationwide average salary. For that reason, we will focus on governance of social pension insurance.

Legislation of the social pension insurance is, as a model, part of the integrated legislation of the whole social insurance, resp. part of the social code (Germany). Already since the Chancellor Bismarck, administration of the social insurance has been devoted to three interested entities, resp. their representatives: employees (insured persons), employers and the state. This concept has in particular political, resp. ideological basis linked with corporatism. Nevertheless, the tripartite administration of social insurance institutions has its practical purpose, this from the point of view of governance. Anyway, the tripartite administration should be considered only from the point of view of governance; it should not be considered as a certain generator of corporatism and for that reason it should not be rejected a priori.

An institution of social (pension) insurance is managed by its management; supervision over the management work is performed by, let us say, managing board. Although members of the managing board are nominated or elected by the corresponding interested entity they are personally liable for their work as a member of the boards. Their tasks include also acting in favour of stability of the whole system of social insurance devoted to the specific institution. Frequent changes with little concept in the social insurance system result in lack of confidence of clients and have negative impact on the system. The rules for good governance of the institution with tasks for individual members of the managing board and other managerial and other entities are included in the basic documentation which members of the managerial board work with. Responsibility of the managerial board can include also discussion of placement of disposable funds of the institution, resp. the reserve fund of the institution. (ILO, 2005)

Generally, it is also possible to imagine a model of social insurance without tripartite administration of social insurance institutions, namely if the social insurance institutions are nationwide. Also internal structuring of the nationwide institutions of social insurance can be an important issue. Much will for sure depend also on advanced level and culture of the specific country.

Federal programmes of social insurance in the USA are administered by the U. S. Social Security Administration (SSA), considered since 1994 as an agency of the federal government. Executive of the agency is lead by the Commissioner elected for a period of 6 years. The board of trustees has six members, one of them is the Commissioner, other three are ministers of the federal government and the remaining two members are external persons (representative of the public – public trustees), appointed by the President upon previous approval by the Congress. The American system of “social insurance” operates funds with large amounts. The board of trustees submits every year to the Congress a report on financial condition of the trust funds of social insurance. According to the report of 2010, the funds’ assets will be exhausted in 2037. Fundamental role in operation of the social insurance administration is played by actuaries; projection of income and expenses of the whole system for a period of 75 years is submitted every year. The American programme of social insurance is the largest institution of that type in the world, with big stability of financial parameters. Administration costs in 2009 represented 0.9% of the whole expenses.

3.3 Governance of Public Pension Funds

In the USA, publications pay attention to governance of public pension funds the purpose of which is to secure public employees above the scope of the federal programme for social insurance. In fact, these are systems of “corporate pensions” for public employees; it is considered implied that these are public pension funds. Their financial importance is large – according to the data of 1999, the pension funds owned 23% shares hold by institutional investors. (Schneider – Damanpour, 2002). These public pension funds (resp. “plans”) are sponsored by corresponding public institutions under the supervision of the board of trustees and are under administration of either the sponsor, or an independent institution. In comparison with operation of the private sector, a wide spectrum of interests is seen in the public administration. Public pension funds are, to a large extent, funded from taxes like other “usual” public expenses, competing with them. Most products have the characteristics of a defined contribution plan and often the amount of reserves is lower than would be accordant to the private insurance. Legislation for these pension funds is at a lower level – in comparison with federal regulation of corporate pensions in the private sector. Subsequently, there is a larger space for discussion in the style of the theory of public choice. The study Schneider – Damanpour (2002) confirmed some of the hypotheses. Other sources state that operation of public pension funds contributed strongly to improvement of corporate governance in societies where the funds operate as institutional investors. (Schneider – Damanpour, 2002).

Governance of public pension institutions is now considered as relatively very important. Codes of governance are not generally issued; separate importance of such codex cannot be expected especially in centralised institutions. Nevertheless, basic elements of the governance system are given already by legislation of public pension funds. Governance is given special strong importance in pension systems operating with reserve funds. Objectively, governance is focused namely on risk management and on internal and external audits. It is recommended to produce and publish actuarial reports about the status and prognosis of the institutions. (Daykin, 2004). It is mentioned that for wider investing activity of an institution, corporate governance is extensively used. (Bingwen, 2008).

An important objective of governance is also to eliminate undesired political influence on allocation of money from the reserve funds of public pension institutions. Similar governance standards should apply to public pension funds and management of investments like those included in OECD guideline for pension funds. (Yermo, 2008).

4 Governance in the System of Obligatory Private Pensions

Privatization of the public pension system was “invented” as part of the shock therapy for Chile during Pinochet rule. The theory of Chilean “Chicago Boys” was taken over and developed by the World Bank, in an integrated form in the research report. (WB, 1994). The very subtitle of the report promises support of economic growth if privatization is implemented. More or less privatized systems of obligatory pension savings or insurance have not developed only under the influence of Chile and the World Bank. In several countries, penetration of privatization was implemented as a result of pressure of trade unions and the appropriate private pension institutions were glad to implement it. Trade unions have in

fact always supported development of corporate pensions – and if corporate pensions are applied to vast majority of employees, there is just one other “small step” – to make the system of corporate pensions obligatory like for example in Switzerland.

In addition to distinct model examples like Chile or Switzerland, in a number of countries the obligatory private pillar plays an accessory role (in relation to the public pillar). It has developed according to the diversification theory and policy, resp. as a result of efforts of the involved interested entities – to carry through the obligatory private pillar in any extent, at least to “catch up”, and when it is impossible to achieve more. The same effort is now developed by lobbyists in this country. Situation has therefore developed when although private pension savings or insurance does not have much importance globally but in individual countries the situation is different and the specific design of the obligatory private pillar is in fact individual. This has fundamental importance also for governance of those systems.

The original idea of governance of Chilean private pensions was very simple: For private pension funds of insurance companies type, only corporate governance is possible because the basic efficiency of the system operation in relation to the clients will be facilitated namely by the pension market (according to neoliberals’ ideas), accompanied with the state regulation. Therefore, regulation will be implemented typical for pension funds, resp. in the specific case rather typical supervision over private insurance companies. This of course includes also the legislation itself for the obligatory private insurance as a product, in this case for a product with characteristics of the unit-linked insurance. Once it is initiated in this way, the state does not have to do anything more, the system will principally help itself. (Hyde – Dixon, 2008). Regulation of fees is not necessary, market forces are enough. “Good practices of corporate governance maximize the value of the society and therefore support economic growth. Pension funds in Chile contributed to improvement of corporate governance standards in particular in two ways: i) support of development and improvement of capital markets which allows development of more comprehensive financial industry, improvement of information flow and limitation of supervision costs; and ii) directly by protection of interests of minority shareholders”. (Hormazábal, 2009). Only during the pension reform in 2008, possible conflicts of interest between a pension fund shareholders and its insured persons started to be taken into account.

Today, it is possible to claim that governance is in fact considered to be the fifth of the five areas of design of the pension system with obligatory private insurance or savings: after specification of the type of insured persons, the title to benefits, the form of benefits and of the contribution payers (and the use of the contribution). (Hyde – Dixon, 2008). More detailed analyses of governance in this system have practical importance only under the specific conditions of a particular country – considering the big differences in the overall design of the pension system, regardless special conditions of individual countries.

In 2003, the World Bank developed an entirely new theory and policy which results in so called pan-European pension system, designed with priority for the EU countries. In that system, there is no obligatory private pillar at all. The central pillar of the system is a mod-

ernized social old-age insurance which is based on the principle of credits (deserved). The system also includes two “wings”: social pensions and private pensions. For both wings it is anticipated that they will be important pillars of the system. Social insurance is again the basic pension pillar, as well as it is in most countries and earlier theories. Private insurance summarizes the former pillars of corporate pensions and individual pensions which suggests also an equal access to those two former pillars. Social pensions used to be, in concept of the World Bank, the only public pension system, now they are a wing in the social insurance as the basic pension pillar.

Conclusions

The role of governance in individual pension systems is very different, in spite of tendencies to mutual influencing. Nevertheless, it is also possible to see growing importance of some elements of governance in all existing pension systems; this includes emphasis on qualified decision making of members of managing boards, on utilization of internal, as well as external audits, on increasing importance of actuaries and on long-term prognoses of development of pension systems and institutions. In systems based on competition of pension providers, the importance of governance, as well as general regulation of pension business increases, reliance on the self-regulating ability of the market is lower and lower. The role of the state and the state supervision is crucial in those systems and subsystems which on the other hand increases also the political risk including the risk of the state acting mostly in the interest of several financial groups interested also in self-purposeful origin and development of the specific system. This is especially strongly obvious in this country. Effective governance is the precondition for optimal operation of pension funds, it is not, however, a sufficient condition for good operation of any pension system.

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Remarks to the Development of Public Administration from the Concept of "Government" to the Concept of "Governance"

K vývoji veřejné správy od pojetí „government“ k pojetí „governance“

KAREL LACINA

Abstract

Public administration in the European continent is characterized by relatively significant changes implemented predominantly since the 1970s. They are represented predominantly by reforms based on the decentralisation, deconcentration, subsidiarity and global democratisation of public administration execution principles. The another their important aspect is the implementation of several management approaches time-tested in the private sector, mainly on the basis of the so called New Public Management (NPM). It is the conception having the decisive position in the European public administration mainly in the 1980s and the first half of the 1990s. This approach criticized nowadays is more and more replaced by the conception of "public governance" or "good governance" since the end of the last century.

Keywords

public administration, reforms, decentralisation, deconcentration, democratisation, subsidiarity, New Public Management, "public governance", "good governance"

Abstrakt

Veřejná správa na evropském kontinentu prochází zvláště od sedmdesátých let minulého století poměrně značnými změnami. Patří k nim zejména samotné reformy veřejné správy založené především na uskutečňování principů decentralizace, dekoncentrace, subsidiarity a celkové demokratizace výkonu správní činnosti. Další důležitou rovinu představuje uplatňování některých manažerských přístupů osvědčených dříve v podnikatelském sektoru – zejména na bázi tzv. New Public Managementu (NPM). Jedná se o koncepci zaujímající v evropské veřejné správě dominantní postavení hlavně v osmdesátých a v první polovině devadesátých let minulého století. Uvedené dnes značně diskutované pojetí je od přelomu tisíciletí stále více nahrazováno koncepcí „public governance“, resp. „good governance“.

Klíčová slova

veřejná správa, reformy, decentralizace, dekoncentrace, demokratizace, subsidiarita, New Public Management, „veřejné vládnutí“, „dobré vládnutí“

Objective of this Paper

The author's main objective is, in part, to emphasize the changes that have taken place in the performance of public administration on the European continent as a result of public administration reforms and, in part, to bring into greater focus some of the discussions conducted by theoreticians aimed at clarifying the direction of administrative activities at the end of the first decade of the 21st century.

Public administration on the European continent, particularly in the last two decades, is going through important changes, characterised amongst other things, in no small degree, by the application of managerial – and in part also marketing – principles. In principle, it can be said that the outlined changes laid the groundwork for the implementation of the concept, which is ever more frequently characterised as “governance”, and very often also as “public governance”, or also as “good governance”, as may be the case. Even though theoreticians are not always in complete agreement as far as the component aspects of the definition of the term “governance”, they are fundamentally in consensus on the standpoint that its key components should include the points contained in the Charter of the United Nations and in the Millennium Declaration adopted by the United Nations, such as:

- *“Respecting human rights, civil liberties and the rule of law;*
- *Freedom of the press, autonomy of mass media;*
- *Open and democratic political processes;*
- *Independence of civil society from excessive state interference;*
- *Transparency of and confidence in all social transactions.”¹*

Michael Duggett, the International Institute of Administration Sciences general director adds the following to the above list:

- *democratic accountability;*
- *rule of law;*
- *professional integrity and the effectiveness of public services;*
- *receptiveness towards civil society.*²

The gradual formation of the said concept represents a rather pronounced change from the aspect of the long-term developmental tendencies of the European public administration. This is because in countries belonging to the so-called continental concept of the performance of public administration – i.e. in the predominant part of the European states – the concept, often designated using the English term “government”, held a dominant position as recently as the 1960s and, in many places, even at the start of the 1970s. The concept of “government” was not infrequently characterised more as a concept influenced by the so-called command model of administration. Under the said traditional approach, some general elements of which reach as far back as to the methods of administration

1 MAKRYDEMETRES, A., *The Morality of Governance*, 2007, p. 130.

2 DUGGETT, M., *Defining Terms and Delineating the Debate in Global Governance*, 2007, p.15.

performance employed in the 19th and at the start of the 20th century, the main emphasis as far as the activities performed by elected representatives and civil servants was placed almost exclusively on knowledge of the law and on the application of legal regulations. In comparison, relatively small significance was placed on the possible employment of managerial approaches and skills. The approaches, inter alia, to the concept of professional education in public administration applied at that time corresponded to this.

It was not until more or less the 1960s that more detailed discussions began to be held in continental Europe about the necessary modernisation of the performance of administrative activities, which was hindered mainly by the following facts:

- *Extensive division of labour at public administration authorities, which led, inter alia, to the excessive selective acquisition, processing, and evaluation of information.*
- *This resulted primarily in:
+ a tendency to establish often needlessly small organisational units linked with attempts at defending the purpose of their existence together with the complicated ability to resolve the said problem in a comprehensive manner;*
- *The fact that the hierarchically arranged spheres of authority and the extensive formal powers of the line managers of the units of authorities had, on more than one occasion, complicated the conditions for utilizing the knowledge and skills of specialists;*
- *Vertically arranged management and communication relationships based on the hierarchical structure of the functions hindering inter-disciplinary (i.e. horizontal) co-operation;*
- *The making of far too many decisions by central authorities of state administrative.*

1 Contemporary Discussions Concerning Conception of Governance

Discussions around the question of the necessary streamlining of the methods of managing authorities were connected, in no small degree, with the prepared and subsequently implemented reforms in public administration. Some approaches and procedures, that had been previously proven successfully in the business sector, began to be gradually introduced as part of these reforms. The application of selected managerial, and later also some marketing principles, proceeded predominantly under conditions of the implementation of the principles of decentralisation of decentralisation, deconcentration, subsidiarity and the overall democratisation of the administrative function. One of the reflections of changing situation became, inter alia, the gradual use of the term "governance" (or "good governance", as the case may be).

On a European level, discussions around the possible approach to the concept of "governance" have intensified, especially in 2001 with the publication by the European Commission of the English-language text titled "European Governance. A White Paper"³. In this document, "governance" was characterised as "rules, processes and behaviour that affect the way in which powers are exercised at European level, particularly as regards openness, participation, accountability, effectiveness and coherence"⁴.

3 COM, *European Governance. A White Paper, 2001, p. 1.*

4 MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context, 2007, p. 27.*

In the White Paper, it is directly noted that: "Today, political leaders throughout Europe are facing a real paradox. On the one hand, Europeans want them to find solutions to the major problems confronting our societies. On the other hand, people increasingly distrust institutions and politics or are simply not interested in them. The problem is acknowledged by national parliaments and governments alike. It is particularly acute at the level of the European Union. Many people are losing confidence in a poorly understood and complex system to deliver the policies that they want... Yet people also expect the Union to take the lead in seizing the opportunities of globalisation for economic and human development, and in responding to environmental challenges, unemployment, concerns over food safety, crime and regional conflicts."⁵

The British author Andrew Massey adds that the "European Governance. A White Paper of the European Commission" claims that "good governance consists of:

1. **Openness** – whereby EU institutions work in an open manner and communicate widely about their activities throughout the European Union as well as outside of it, they use language that is accessible and understandable for the general public, in order to improve the confidence in complex institutions.
2. **Participation** – because direct democracy is of limited use. The Commission seeks wide participation using what it calls the political chain – from conception to implementation. This participation depends on central governments following the participation method when developing and implementing EU policies.
3. **Accountability** – in the form of better-defined roles in the legislative and executive processes, with each of the EU institutions explaining what it does and what it takes responsibility for. All institutions need to deliver greater clarity and responsibility.
4. **Effectiveness** – which is another component identifying, which policies are effective and timely, delivering what is needed on the basis of clear objectives, an evaluation of future impact and, where available, of past experience. Effectiveness also depends on implementing EU policies in a proportionate manner and on taking decisions at the most appropriate level.
5. Finally, "**coherence**" is identified in the White Paper as the fundamental component of good governance."⁶

The actual term of "coherence" is specified by the European Commission as follows: "Policies and action must be coherent and easily understood. The need for coherence in the Union is increasing: the range of tasks has grown; enlargement will increase diversity; challenges such as climate and demographic change cross the boundaries of the sectoral policies on which the Union has been built; regional and local authorities are increasingly involved in EU policies. Coherence requires political leadership and a strong responsibility on the part of the Institutions to ensure a consistent approach within a complex system."⁷

5 COM, *European Governance. A White Paper, 2001*, p. 4.

6 MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context, 2007*, p. 30.

7 COM, *European Governance. A White Paper, 2001*, p. 11.

It is also stipulated in the document quoted above that "the application of these five principles reinforces these principles: **proportionality** and **subsidiarity**. From the conception of policy to its implementation, the choice of the level at which action is taken (from European to local one) as well as the selection of the tools used must be in proportion to the objectives pursued. This means that before launching a certain initiative, it is essential to check systematically (a) whether public action is really necessary, (b) whether the European level is the most appropriate one, and (c) whether the measures chosen are proportionate to those objectives."⁸

As stated by A. Massey: "governance is a term that pertains to the activities and processes of government and governing, including the relationship between the state and civil society. The sense in which this term is now used is a reflection of the fragmentation and complexity of the modern state... This term represents the activities concurrently located at several distinct levels of government: local, national, regional and global."⁹

The following are considered to be the decisive attributes of "governance":

- *"access to justice;*
- *compliance with the due process and the rule of law;*
- *respect for human rights;*
- *respect for democratic values and support thereof;*
- *promoting the issue of rights and freedoms deprivation in the case of disabled people;*
- *care for the needs of the poorest and the most vulnerable groups;*
- *tolerance to diversity, protection of the environment;*
- *sustainability of the results;*
- *professionalism of public administration.*"¹⁰

In this context, A. Massey emphasised that "changes in public administration throughout the world, often referred to as new public management (NPM), have had an impact on governing and governance. Essentially, however, governing can be viewed as the totality of the interactions involving public and private actors alike, aimed at the resolution of social problems or the creation of social opportunities; servicing of institutions as the contexts for these government interactions; and the establishment of a normative base for all of these activities."¹¹

One of the very important phenomena of the concept of "governance" is considered to be non-profit organisations' share in the provision of public services (first and foremost in the social field) as well as welfare services, which were previously provided solely by public administration. The afore mentioned A. Massey characterises the given fact by stating that "governance represents the inclusion of the civil society and professional economic and

8 COM, *European Governance. A White Paper, 2001, p. 11.*

9 MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context, 2007, p. 25.*

10 ARGYRIADES, D., *Administering Global Governance, 2007, p. 22.*

11 MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context, 2007, p. 26.*

social interest groups into the network of the formulation and implementation of policies. This inclusion is not, however, all-encompassing nor is it on an equal basis. Some groups and networks are exclusive and dominant, and this ... raises questions about the democratic deficit and the resources available to national governments and to civil society as a whole to compel those participating in governance to be accountable for it. Growth in the number and activities of NGOs is a specific issue, evoked by those who have an interest in keeping governments accountable in a global age, particularly in a situation where sovereignty and thus effective and enforceable law is located at the nation-state level."¹²

The meaning of the above-mentioned long-standing focus is underlined in the Communication from the European Commission of 25 July 2001 with the statement that "civil society plays an important role in giving voice to the concerns of citizens and it helps delivering services that meet peoples' needs. An important part in this activity is played namely by churches and religious communities. Organisations that establish civil society, mobilise people and support those who, for example, suffer exclusion or discrimination... Civil society increasingly sees Europe as offering a good platform to change policy orientations and society. This offers a real potential to broaden the debate on Europe's role. This is a chance both to more actively involve citizens in order to attain the objectives of the Union and to offer them the possibility of feedback, criticism protest."¹³

In the theoretical area, there exists, to a considerable extent, concord in the statement that "multigovernance is a reality which exist in several forms and in different contexts. ... The concept of differentiated forms of government also recognises the role of regional political organisations, decentralisation, federalism, professional groups, international corporations and other transnational organisations in governance. As a neutral model, it does not express consent or opposition thereto, but merely draws attention to the reality of this situation. ... Multilevel governance is thus exercised at a supranational, both on a global as well as a regional level; national level, where the legal origin of sovereignty remains, but from which a great deal of devolution occurred, and at the sub-national level."¹⁴

From the viewpoint of the principle of "good governance" application, A. Massey underlines the fact, already mentioned by M. Omelichová, that "at the local level, with regard to the small form of government or local authority, good governance begins with democratic accountability, but at the global level, this kind of direct democratic accountability is a problem. Global civil society organisations, non-government organizations and others, could (or maybe "should"), according to some observers, endeavour to:

1. be transparent;
2. be responsible for their conduct;

12 MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context*, 2007, p. 26.

13 COM European Governance. *A White Paper*, 2001, p. 15.

14 MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context*, 2007, p. 27.

3. be responsible not only for their conduct, but also for their management, the implementation of projects, financial management and reporting of information and policies;
4. operate in an ethical manner;
5. operate regardless of, or rather beyond, the borders of race, nationality, religion, culture and politics;
6. respect and promote individual human rights.¹⁵

If we try to summarise the approaches taken by the European Union to the issue of "governance", it is once again possible to make reference to the Communication from the European Commission of 25 July 2001, which states that:

"Building on these principles, the proposals in this White Paper will:

Structure the European Union's relationship with civil society. A code of conduct for consultation will identify responsibilities and improve accountability of all partners. It will enhance dialogue, and contribute to the openness of organised civil society.

Make greater use of the skills and practical experience of regional and local actors. In the first place, this is an issue for national authorities according to their national constitutional and administrative arrangements. At the same time the Union should make fuller use of the existing potential for flexibility to improve the ways European policies are applied on the ground.

Build public confidence in the way policy makers use expert advice. The European Union multi-disciplinary expert system will be opened up to greater public scrutiny and debate. This is needed to manage the challenges, risks and ethical questions thrown up by science and technology.

Support the clearer definition of EU policy objectives and improve the effectiveness of EU policies by combining formal legislation with non-legislative and self-regulatory solutions to better achieve those objectives.

Set out the conditions for establishing EU regulatory agencies. These agencies can reinforce the effectiveness and visibility of EU law in the eyes of both entrepreneurs and the public by bringing decisions in some of the most complex and technical areas closer to the sectors affected.

Refocus the roles and responsibilities of each Institution. This should help citizens to hold their political leaders and the institutions responsible for the decisions that the Union takes ... By adapting governance at home environment, the Union will be able to contribute better to new forms of global governance.¹⁶

¹⁵ MASSEY, A., *Multilevel Governance: Administering Global Governance in a Differentiated Political Context*, 2007, p. 29.

¹⁶ COM, *European Governance. A White Paper, 2001*, p. 33.

2 European Public Administration Reforms and Conception of Governance

One of the characteristic traits of the contemporary performance of public administration on the European continent is the growing role played by managerial approaches contained in the actual concept of the public administration modern performance. The tasks and approaches, which had a decisive role in the success of the public administration reforms, are contained in the key reform concepts. As regards their nature, contemporary theoreticians (in particular, Wright, Flynn, Strehl and Ference), are unified in underlining the seriousness of the following facts:

- *The role of reforms as processes accentuating the positive results of the activities of the public sector and enabling the creation of systems of stimulation connected with a focus on performance.*
- *The fact that the objective of the reforms is to change how the public sector operates, i.e. perceiving the recipients of the services – citizens – also as, inter alia, the consumers of these services.*

In spite of the fact that the reforms implemented gradually varied in their particulars (depending on the specific conditions of individual Member States of the EU), its common components can be characterised by the following facts:

- *Overall improvement of the management of public administration;*
- *Increasing accountability for the financial resources earmarked for administrative activities;*
- *Improvement of the policy for the management of human resources with an emphasis on the growth of their adaptability;*
- *Flexibility and mobility;*
- *Substantially greater emphasis on ethics in public administration;*
- *Use of information technologies, first and foremost in the shape of e-government.*

Realistic consideration began to be given in continental Europe to the possibility of applying selected management principles in the management of public administration only from the 1970s onward, even though certain groundwork for such a procedure was being laid back in the 1960s in part of the Member States of the European Communities. At that time, the members of the then "European nine" lagged behind in the application of managerial approaches, particularly behind the concept of the management of public administration, employed namely in the United States of America and Canada, where the principles of "city management" were gradually being developed since the 1930s and 1940s.

More favourable prerequisites for the use of selected management approaches in the public administration on our continent were only created by the said reforms in European public administration. If we are searching for the causes of the administrative reforms implemented in the Member States of the European Union since the 1970s and in Central Europe since the 1990s, mainly the following facts may be identified:

- *Limitation of the volume of financial resources earmarked from state budgets;*

- *Need to establish and deepen international, border and cross-border co-operation between public administration authorities;*
- *So-called challenges aimed at public administration as a whole, which became namely:*
 - + *Greater emphasis placed on the role of public administration in environmental protection;*
 - + *Need to resolve, in an integrated manner, the issue of the spread of drugs and the growth in drug addiction, first and foremost among young people,*
 - + *The so-called feminism issue (with an emphasis on the attainment of equal opportunities for men and women in the work process and in public life).*

It was namely the more demanding conditions, peculiar to the development of the economies of the Member States of the European Communities in the 1970s, which exacted the gradual transition to a decentralised approach to management. In comparison to the 1950s and 1960s, public administration as a whole had to first and foremost come to grips with the limited volume of financial resources earmarked from state budgets for the performance of administrative activities. Representatives of public administration were thus forced to think about the possibilities of applying some more effective tools, approaches and means, which would, in particular, enable the more effective financing of compulsory and part of the optional services mainly provided by the territorial self-government at the municipal level. The new economic reality thus forced the central state administration, and particularly representatives of municipalities and regions, to find inspiration for the provision for administrative activities in certain approaches proven in the long-term in corporate management. In the end, diverting from the traditional concept showed itself to be more radical than originally envisaged by certain administrative science theoreticians. In the said context, the so-called *top-down model of administration* began to be gradually presented as not corresponding a great deal to the requirements of the performance of administrative activities at the turn of the 20th and 21st centuries.

A significant base for the gradual formation of the concept of "governance" was the implementation of the *acquis communautaire* principles, enabling – inter alia – the gradual formation of the so-called European Administrative Space. This space, constituted of the public administration of 27 Member States of the European Union, is represented by a "set of general standards for public administration activities, which are contained in the law and implemented in practice by prescribed procedures and mechanisms based on accountability ... It is anticipated that the individual actors in this space accept these principles, which are only rarely formalised in written legal form or subject to codification, but are nevertheless ethically and legally binding ... This non-formalised European administrative law thus contributes to the Europeanisation of national public administrations and the administrative law of Member States of the EU."¹⁷

In the last third of the 20th century, the performance of European public administration resulted in a gradual change in the methods of managing administrative activities as a whole. As has been stated, room for the application of managerial approaches and skills had already been created by the actual reforms in public administration. The reforms,

¹⁷ HALÁSKOVÁ, M., *Veřejná správa v Evropské unii*, 2009, p. 10.

implemented in the specific conditions of individual European states, mainly introduced topics such as:

- *The role of the state at the turn of the 20th and 21st centuries;*
- *Methods of weakening centralism in the continental model of the performance of public administration;*
- *Increasing public administration efficiency as a whole;*
- *Improving co-operation between all the partners involved in the public administration;*
- *Gradual review of the career systems pertaining to the work of civil servants, with an emphasis on growth in their qualifications, competence and performance;*
- *Efforts to improve the overall image of the public administration in citizens' eyes.*

One of the outcomes of the reforms was the gradual devolution of powers from state administration to territorial self-government, representing the essence of the principle of *decentralisation* of administrative activities. The application of the *deconcentration* principle, consisting of the devolution of powers from higher levels of state administration performance to lower state administration authorities became no less topical. The said processes were the primary factors thanks to which the powers of municipalities were strengthened and the process of forming regional self-government as well as state administration was completed. At the same time, groundwork was laid for the involvement of private commercial entities and as well as organisations from the so-called third sector – i. e. voluntary non-profit and charity organisations – into the performance of administrative activities.

The fact that public administration reforms were predominantly dictated by administrative, economic as well as managerial reasons was confirmed. It is understandable that neither territorial self-government at the municipal level nor regional public administration could have played their expected role in the countries of the European continent in the absence of the implementation of the key democratic principles of the performance of the administrative activities, the failure to define and make more effective use of material resources essential in providing for administrative activities and had the demands placed by authorities on the qualifications of their employees not been raised at the same time.

In evaluating the results of the reforms, it can be concurred that:

1. *The fundamental prerequisite for the modern performance of administrative activities became the thorough implementation of the principles of decentralisation and deconcentration.* One of the important results of the said processes was the completion of regional state administration and the formation of the regional territorial self-government.
2. It was also confirmed that the *implementation of the subsidiarity principle in the performance of local and regional public administration leads to a strengthening of the powers and responsibilities, both of territorial self-government as a whole, as well as local and regional state administration.* This fact can, inter alia, be demonstrated on the example of the development of public administration in the Czech Republic and in other Central European countries.

3. In this context, findings from Western European countries document the fact that the implementation of the principles of decentralisation and deconcentration in administrative activities is a complicated process, the success of which is conditional on the support of the wider layers of the public.
4. Another essential condition of the successful realisation of the outlined reforms proved to be the need to reach consensus in the opinions and standpoints of the representatives of ruling political parties, democratic parliamentary opposition parties and a majority of NGOs on the solution of key problems in the life of municipalities and regions.
5. A valuable finding is that it is essential to perceive the development of territorial self-governance at the municipal and regional level as a focus on the realisation of objectives and assignment which have a priority importance to the whole society. The effectiveness and efficiency demonstrated in the attainment of the specific objectives, as well as efforts to use the experience and methods developed and proven in the business sector and the creation of effective control mechanisms, represent further typical characteristics of the modern performance of administrative activities in the Member States of the European Union.

Discussions about the need to address the disparity in the economic and social areas of the Member States of the European Communities and their regions intensified around the time of the first reforms being implemented. In this context, for example, Czech authors Jan Stejskal and Jaroslav Kovárník, point out that the objective of the regional policy "has become to reduce regional difference"¹⁸. As pointed out by the British author A. Daltrop: "In the post-World War Two period, all of the Western European governments attempted to resolve the issue of regional economic disparities. A special minister was appointed in some countries, responsible for regional development ... and for measures giving regions a certain degree of autonomy, or for the creation of specific regional planning bodies within the framework of authorities of territorial self-government."¹⁹ Resolution of the issue of disparities thus became one of the factors speeding up the formation of the regional administration.

The way to growth in efficiency also started to be seen in the gradual privatisation of part of the services provided to citizens by municipal self-government and their subsequent contracting-out on the basis of the signing of contracts with the winners of public tenders. The given approach, often characterised as "contracting-out", tends to be designated as a guarantee of legal certainty and equality for all the entities that wish to participate in the provision of part of the public and welfare services on the basis of public tenders.

To date, the said system has been elaborated upon to the greatest degree and implemented in Great Britain, where at the start of the 1990s it was enshrined predominantly by the adoption of the document titled "Citizen's Charter", ratified by the Parliament of the United Kingdom in 1991. Its key objectives were formulated as follows:

- Establishment of service standards.
- Achievement of citizens' maximum awareness as service users.
- Maximum openness, if possible, of authorities in their dealings with citizens.

18 STEJSKAL, J.; KOVÁRNÍK, J., *Regionální politika a její nástroje*, 2009, p. 11.

19 DALTROP, A., *Political Realities: Politics and the European Community*, 1982, p. 113.

- *Readiness of authorities to render various types of consultations to citizens.*
- *Maximum possible courteous dealings by civil servants with citizens.*
- *Readiness of authorities to also provide citizens other forms of assistance.*

The principles contained in the Charter are accompanied in Great Britain by the application of another document, bearing the title "*Competing for Quality*", which is mainly aimed at the conducting of *market research*. Implementation of the principles of the said document is illustrated, inter alia, by the growing significance of the application of marketing approaches in today's public administration.

3 Causes of New Public Management Transition into Conception of Governance

The causes of the transition to the concept of "public governance", or "good governance", as the case may be, can be demonstrated on the overall post-war development of the public administration of democratic states on the European continent roughly since the 1950s. Werner Jann notes that "the first phase, which begins at the start of the 1950s, comes after the worst problems of the war have been overcome. It was not so much about the effectiveness or efficiency of public administration or the public sector, but particularly about democracy and the rule of law ... It is not surprising that the main concept of the reforms of this period were inspired by traditional ideas of the democratic state, such as parliamentarism and pluralism, together with the re-discovery of the Weberian model and corresponding public sector reform theories, i.e. a model of the legally and hierarchically organised public administration.

New difficulties only came to the fore after these critical components were taken into consideration and provided for. They were designated as an "active state". "Planning" became a slogan, starting in the mid-1960s. This was a period of the consolidation and expansion of the modern welfare state, at the very least in Western Europe. It was perceived that the main problem was market failure rather than democratic failure. The importance and scope of government, the public sector and public administration increased. They acquired more wide-ranging functions and more complicated duties in all forms of public administration.

There was increased optimism over what a strong, well-organised government and public sector was capable of achieving. For this reason, the main debate on the public sector concentrated on the problems of planning, implementing and evaluating of public sector programmes. The main concern was what to do to increase the capacity of public sector agencies to solve problems ... This period coincided with the first wave of the ambitious and far-reaching public sector reforms and corresponding contracts in many countries of Western Europe."²⁰

Christoph Reichard points to the fact that "roughly from the beginning of the 1980s, a common view of administrative management appeared on a worldwide scale, which was known internationally as "New Public Management" (NPM). The concept of NPM is universally characterised by the following key attributes:

- *increased market orientation and focus on competitiveness;*

²⁰ JANN, W., *Modern Governance: A European Perspective*, 2007, p. 122.

- *corporate management concept adopted from the private sector;*
- *separation of strategic (political) and operational (administrative) responsibility;*
- *ideas derived from management by objectives and by outcomes, and*
- *decentralised, semi-autonomous structures.*²¹

Some clarified principles of measuring the efficiency of performance thus began to be gradually elaborated to the conditions of the non-profit sector of public administration. Applied are principles, designated as "3Es" (Economy, Effectiveness, Efficiency), forming the core of the so-called *New Public Management*. Their gradual implementation was undeniably influenced, to a significant extent, by the already mentioned restriction in the amount of financial and other material resources, which public administration received from state budgets (the term "*cutback policy*" started to be used in some Member States of the European Union for the said process).

Followers of the concept of New Public Management²² usually characterised it as key from the viewpoint of long-term prospects. As W. Jann points out, "New Public Management arose as a new, widely used reform idea. It should however be noted that NPM was not only attractive to conservatives and neoliberals, who were suspicious of an active state from the start, but also to some followers of a welfare state, as it promised a "government that works better and costs less". NPM thereby offered hope for critics as well as followers of a strong government and public administration."²³

However, in connection with discussions on the application of the principles of New Public Management, Demetrios Argyriades for example notes that "economy, performance and efficiency are undoubtedly extremely important, but only on the condition that the decisions made and the objectives pursued are ethical and fair, and furthermore that the results obtained in administering global governance shall support general interest and promote public wellbeing of mankind as a whole, not just the goodwill of several people".²⁴ F. Heady talks of a clear deviation from the traditional performance of public administration and the creation of a new role responding to global changes in modern society.²⁵

If we evaluate the role of the New Public Management concept, it is necessary to take into consideration the fact that N.P.M. almost controlled the scene of the 1980s and 1990s. "There is no doubt that New Public Management never appeared as a unified and coherent school of thought, but rather as a comprehensive collection of ideas and theories which were sometimes in conflict with each other, even though they were always mostly inspired by private sector practice. Their diverse tools and concepts were not applied in Europe, whether as a group or individually. Quite the contrary, in fact. It remains, however, a common topic, which produces a unique and extraordinary impact on public administration reform in Europe."²⁶

21 REICHARD, CH., *New Approaches of Public management*, 2003, p. 12.

22 HUGHES, O., *Public Management and Administration*, 2003, p. 34.

23 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 122.

24 ARGYRIADES, D., *Administering Global Governance – An Introduction*, 2007, p. 22.

25 HEADY, F., *Public Administration: A Comparative Perspective*, 2001, p. 102.

26 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 123.

As noted by W. Jann, "management has become the new slogan and "bureaucracy" the root of evil ... Well-known public management terms such as "cost accounting", "benchmarking" (models of best practice from another country), "outsourcing" (transfer of a certain activity from a state authority to the private sector), "privatising", are still ever-present with us and remain prominent".²⁷ Nevertheless, the use of principles of New Public Management in a growing number of subjects of public administration in European countries is wedded many a times with the notion of the so-called "*hollowing out the state*". This is a concept which counts on part of the activities and responsibilities being transferred to private enterprise entities who shall – on the basis of contracts – providing for part of the services to citizens within territorial self-government entities.

W. Jann, who takes a fairly critical position as regards the concept of NPM, also states that "the main problem that New Public Management tried to solve was the public sector's presumed ineffectiveness ... Traditional bureaucratic organisations are criticised, condemned and sometimes ridiculed as "reliant on regulations", "bureaucratic" and a model of "organised irresponsibility". Instead of the traditional Weberian values of process, reliability, fairness and responsibility, emphasis was placed on new values such as quality, service delivery, ... timeliness and focus on clients ... According to the predominant premise, the public sector should have been seen as a business activity, public administration as a firm and local government as a service (in German: Dienstleistungskommune). As "lean" management in the public sector, the "the lean State" became the new paradigm."²⁸

In general, it can be concluded that, on account of the gradual application of the principles of New Public Management, substantially more consideration than before started to be paid in public administration as a whole to, among other things, the opinions, ideas and requirements of service users, as well as to their standpoints pertaining to the manner in which municipalities and regions are managed. At the same time, however, approaches known as "citizen participation" started to be developed. These approaches are based on an awareness of the fact that citizens should be given a substantially greater chance than in the past to influence the performance of public administration in their municipality, region and in the nation-state. At the same time, the principle of "citizen participation" requires citizens to actively participate – by taking advantage of, inter alia, the institute of the referendum, in the process of the taking of decisions by the elected representatives of municipalities, regions and by members of parliaments.

During the 1990s, the concept of New Public Management started to gradually lose its dominant status. "It was not merely bureaucracy, which appeared as the main obstacle of the effective solution of the problem, but rather the organisational characteristics of society itself. As desired by this new approach, it is civil society that needs to be strengthened and to be given the opportunity to participate; it should have learned to work with public and private actors in resolving collective problems. New eminent values appeared: social, political and co-operation, coherence and interdependence, public participation and citizen participation. The organisation of citizen participation and problem solving (in German: "Bürgerkom-

27 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 122.

28 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 123.

mune") was seen as the main and only purpose of local government, rather than the provision of services."²⁹

W. Jann characterises the differences between the New Public Management concept and the governance concept as follows: "Whereas discourse on New Public Management was concentrated on public organisations, their internal control and management mechanisms, as well as on a lack of incentives, the approach of new governance was to shift its attention towards co-ordination of and co-operation between public and private actors; towards the management network and towards the combination of various management and control methods over the framework of markets and hierarchy. The interdependence of various public and private actors and the coherence in collective action gradually became the main concern. Whereas the priority solution for New Public Management was very often derived from private sector practice – with an emphasis on decentralisation, contract management, and modern financial management and human resources management tools – the approach of new governance focuses on a new division of labour between the state, the market and civil society. The new solutions were differentiated in the creation and the strengthening of autonomous, automatically regulated networks, which produce "public value" without the state. Accordingly, emphasis was placed on the so-called third sector lying between the state and the market. This sector includes associations, non-profit organisations, cooperatives, charity groups and religious brotherhoods. This sector has been re-discovered together with civil society, and has been given a new level of importance."³⁰

The contemporary, rather critical, approach to New Public Management is based on the finding that the *implementation of the principles of New Public Management actually results in a certain fragmentation in the decision-making methods and, at the same time, a certain degree of separation of the process of making decisions from the exercising of these decisions*. The essence of this approach is the fact that the sphere of civil servants participating in the setting and implementation of strategies for the performance of administrative activities has even expanded in the authorities of state administration of the Member States of the European Union in the current period, compared to the situation prevailing at the turn of the 1970s and 1980s. This situation is namely characteristic for Great Britain's system of public administration (an exponent of the so-called Anglo-Saxon system of administration), as part of which the principles of NPM – as has already been stated – are implemented even in state administration to a relatively significant extent.

There is talk today that at the territorial self-government level in a growing number of Member States of the European Union is a continuation in the so-called "*purchaser-provider divide*". This focus can be designated as an *important characteristic component of the application of managerial approaches and skills in contemporary European public administration. It is a focus on the creation of standards of public and welfare services, aimed at effectively responding to the wishes and requirements of citizens = clients*. A feature peculiar to the contemporary concept of the management of public administration has become, last but not least, by way of the assessment of individual civil servants – namely in the form of audits and assessments, the fact that there has been an overall *improvement in the quality of the systems for the monitoring and*

29 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 123.

30 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 124.

assessment of the activities performed by authorities (i.e. procedures employed in the business sector, especially when drafting budgets, and planning and evaluation of activities).

Certain proven managerial approaches are also used in the management of state administration. The British "*New Steps Initiative*" concept can serve as an example. Well-measurable activities were appropriated in Great Britain from authorities of state administration into so-called agencies, of which there are around 130. These agencies currently employ approximately 67% of the original British state administration staff. This is a definite cost-saving measure, consisting of the fact that the agency staff are not subject to the provisions of the Civil Service Code.

A no less important aspect of efforts to utilise the principles of New Public Management has become the application of the principles of *Total Quality Management*. Furthermore, reform steps were outlined in Great Britain in 1999, supplemented by a "*White Paper on Modernising Government*", which accentuates:

- *Even more substantial focus on clients (citizens) of the services provided.*
- *Efforts to attain the highest possible standard of quality of all services provided.*
- *Maximum possible use of information technology in public administration.*

The development towards "good governance" was somewhat different in the Federal Republic of Germany. In this country, the "active state and the modern welfare state were never refused. But in Germany this was the case only until the end of the 1970s, when, after frequent disappointments over large government programmes and the coming economic crisis (after the oil crises), the new visions of the public sector began to be implemented. Use was made of the label lean state. Government and the public sector were more and more frequently not seen as the solution, but rather as the source of many social problems. By contrast, the private sector suddenly emerged as a model and served as inspiration for the public sector reform."³¹

The project, titled "*Schlanker Staat*" ("Leaner State"), which was developed and started to be implemented in the Federal Republic of Germany at the turn of the 1980s and 1990s, and which, in comparison to the British concept, is a less radical reform programme, containing managerial components, became one of the results of the outlined development. Its main pillars became:

- *Limitation in the amount of regulations and other by-laws governing the performance of public administration.*
- *Limitation in the number of staff employed at the authorities of central state administration.*
- *Privatisation of state enterprises (in particular railways, postal services, air traffic control authorities and space research).*
- *Rationalisation of statistical services.*
- *Improving the system of human resources management.*
- *More efficient use of information systems in public administration.*

31 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 122.

Based on findings about the development of the public administration reforms on the European continent, we can reach the conclusion that the formation of the principles "good governance" was and remains influenced by the following facts:

- *By the operation of important economic and financial factors.*
- *By the formation of visions pertaining to the objectives of the reforms and the manner of their realisation.*
- *In part also by the pressure of the efforts to form a so-called European Administrative Space.*

The *technological* changes contributing to the transformation of the organisational structures and procedures applied in the performance of administrative activities (including the development of the so-called e-government) act to a significant degree on the performance of public administration at the start of the 21st century. The utilization of modern information technologies have become important challenge, which is of course also projected into the personnel management area and into the concrete service provision systems.

At present, the outlined concept of governance places an extraordinary emphasis on the abilities of elected representatives and civil servants:

- *To harmonise the interests of various groups of citizens with the strategic development plans of the state, municipalities and regions.*
- *To match citizens' requirements for the arrangement and provision of the widest possible range of services (i.e. not only optional, but also compulsory services) with the material resources of the state, municipalities and regions – especially in conditions where the costs of the said services are raising in the long-term.*
- *To bring the requirements for the quality of services into compliance with the technical resources available to the state, municipalities and regions.*

A certain shift in the performance of public administration is documented, for example, by the *Urban Management Programme*, the compilation of which was the outcome of the efforts of the United Nations, including the activities of the World Bank and Habitat, the United Nations Centre for Human Settlements. In accordance with this programme, the authorities of cities and municipalities should make efforts, in a suitable manner and in accordance with local conditions, to:

- *create jobs, particularly for socially disadvantaged citizens;*
- *improve urban infrastructure and services for citizens;*
- *support economic activities in the so-called informal sector; in the environmental area this concerns, for example, the building of small plants aimed at the processing and recycling of waste and assorted repair services, which is mainly aimed at achieving savings in the use of natural resources;*
- *provide housing for poorer layers of the population and put in place conditions that would prevent the creation of homeless groups;*
- *provide incentive for the creation of voluntary non-governmental non-profit organisations, the activities of which would contribute to improving the quality of life of most of the citizens of a particular city or region.*

If we endeavour to provide a certain summary of the application of the New Public Management principles and the subsequent concept of "governance", it can be stated that, since the last third of the 20th century, public administration of the Member States of the European Union is influenced, in no small degree, by the development of the so-called post-modernist managerial revolution, which puts in question, inter alia, traditional procedures and organisational structures and the work styles in public administration authorities as well as in firms. Gradually, the standpoint which began to prevail in theory as well as in practice was that an effectively regulated post-modernist managerial revolution should result in the formation in the public sector, first and foremost in public administration, in simpler hierarchical organisational structures and in the creation of more favourable conditions for the more intensive involvement of representatives and civil servants of public administration in the fulfilment of duties of their particular workplace. The traditional management approaches and organisational structures were progressively and partially loosened up on this more or less theoretical basis as well as in the non-profit sector. At the same time, emphasis began to be placed on the need for the transition to the formation of more flexible, smaller and more specialised units entrusted with more extensive decision-making powers. One of the outcomes of the said processes was the preference for smaller, more flexible, more specialised and more autonomous units administered by managers with management experience (i.e. not by typical public servants).

One of the main objectives of the contemporary modernisation of European public administration is the completion of the concept of "governance" (or "public governance" and "good governance" as the case may be). Their significant aspects were illuminated back in 1999 in the Federal Republic of Germany by the adoption of an important programme bearing the title "*Modern State – Modern Administration*". In it is stated, inter alia, the following:

"The state and the administrative system must redefine their duties and powers, taking into account the altered conditions within society. The delegating state shall encourage the devolution of responsibility where it is possible. This means that there will be a new division and categorisation of responsibility between the state and society ... The reform of the state and its administrative system, which is based on such a model, must establish a new balance between the obligations of the state, individual initiatives and social participation. This will shift the focus in such a manner that the state will be less a decision maker and producer and more a mediator and catalyst of social development that it cannot and need not control itself. The delegating state means the strengthening of social potential for self-regulation and the guaranteeing of the necessary freedom of action. This requires, in particular, the joint activity of public, semi-public and private actors to attain the common objectives."³²

Compared to the concept of New Public Management, the concept of "governance" has some significant advances. In particular, NPM accentuated the need to "obtain the correct incentives", partly within the public sector, and in relationships between the public and private sector. "In contrast to this approach, the emerging debate focused far more attention on the appropriate behaviour, both within the public sector, and between the public and the private sector. The main problem has been defined as follows: How can we ensure that not only public organisations and administrations, but also private bodies, namely

32 Quoted according to: JANN, W., *Modern Governance: A European Perspective*, 2007, p. 124.

from civil society, work together on solving social problems. Clearly, public services and monetary incentives are important, but they are not sufficient.”³³

W. Jann concluded, on the basis of the above findings, that “the latest perspective of European governance can, in the first place, be explained as a reaction to the NPM movement, which, at least for some observers and practitioners, proved to be overly limited, concentrating almost exclusively on internal mechanisms, control tools and the suggestions of discrete organisations, but overlooking all of the complicated interactions between organisational and institutional facilities, as well as the normative foundations of the organisations within the public sector and beyond. However, in the broader, somewhat more theoretical perspective, modern governance is not seen merely as an extension and opposite notion to the discourse on NPM, but also as a perspective on all forms of perceiving traditional government: governance rather than government. Modern governance is thus planned not only as standing above public management and replacing it, but also as increasing the traditional democratic, representative and bureaucratic Weberian paradigm of public administration and the state.”³⁴

Werner Jann expands on this thought by stating that “the new concepts of modern governance go far beyond re-defining or “re-inventing” traditional values. Likewise, they contain new ideas about the appropriate tasks and functions of citizens, companies and states ... The concepts of governance recognise that citizens perform an extensive range of tasks. But their main claim is that they should be seen and treated primarily as activists and co-producers of social services and values. According to this, citizens are neither sovereign voters scrutinizing the provision of public services, nor clients dependent on services, but rather the main partners in social co-operation and negotiation. Empowerment is thus becoming a new slogan ... An ideal image is an active civil society and social self-regulation as the preferred solution ... In this light democratic governance can no longer be defined merely as a function of parties, interest groups, parliamentary institutions and a quasi-state monopoly with the subsequent resolution of disputes and organisation of the welfare state. Instead, the articulation and co-ordination of collective interests is characterised by direct participation and the extensive diversity in the models of public-private relationships considered, co-ordination and co-operation.”³⁵

By comparing the concept of New Public Management with that of governance, W. Jann reaches the conclusion that “the previously dominant minimalistic and market-oriented N.P.M. (New Public Management) doctrine was merely a temporary phase (1980-2000). Its space application was limited predominantly to the Anglo-Saxony world. Nevertheless, this paradigm influenced and changed the traditional Weberian model of public administration almost in all of Europe. Indeed, observers claim that in present-day Europe we are moving towards a neo-Weberian model with the following characteristics:

- the state remains a “legal state” (Etat de droit, Rechtsstaat). Its public servants, however, are not exactly “bureaucrats” and experts in law and procedures; likewise, they

33 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 125.

34 JANN, W., *Modern Governance: A European Perspective*, 2007, p. 125.

35 JANN, W., *Modern Governance: A European Perspective*, 2007, pp. 125-126.

belong to the managerial profession concentrated to the performance and the service to citizens / clients;

- citizens have rights and obligations, but their customer role becomes part of a citizen's eminent role;
- public law, which includes administrative law, remains an important tool for the operation of the rule of law state as well as the relationship between the citizen and the state, but private law is becoming increasingly important as an additional tool in public matters;
- a clear public service remains, with its own ethos and characteristic traits (statute, conditions and culture), but its traditional neutrality and relationship to legality must now be linked to a commitment to political objectives and interest in results, which create a professional culture of performance and service quality;
- an ex-ante interest in the process and procedure designed to guarantee legality and the lawfulness of decisions must now also be accompanied by an ex-post interest in the results. This becomes part of the procedures which guarantee the economy, effectiveness and efficiency;
- lawfulness is thus not based merely on legality, but also on economy, effectiveness and efficiency in the functions of the state and the implementation of its policies.³⁶

The conclusions pertaining to the concept of "governance", which was elaborated on by Werner Jann and Demetrios Argyriades, inter alia, were also gradually clarified in the subsequent period by other theoreticians. If I attempt to summarise the essence of the debate, it paid most attention to the following questions and to the answers thereto:

Is the hierarchical governance in decline?

What is the position of the existing bureaucracy within the public governance system?

Can private sector management systems look to public governance for guidance?

What is the good governance model connection with the development of the society?

What place in the concept of New Public Governance is held by contracts?

For example, in response to the first of the questions outlined above, *Carolyn J. Hill* states:

"The growing acceptance of "governance" as an organizing concept for public management reform reflects a widespread, though not universal, belief that the focus of administrative practice is shifting from hierarchical government toward greater reliance on horizontal, hybridized, and associational forms of governance ... We infer that the shifts away from hierarchical government toward horizontal governing reflect instead a gradual addition of new administrative forms that facilitate governance within a system of constitutional authority that is necessarily hierarchical."³⁷

From the perspective of the existing administrative staff in the system of public governance, *Leslie Budd* notes that as a consequence of these changes "bureaucracy has been replaced by post-bureaucracy as a result of these changes. ... There has been a process of

³⁶ JANN, W., *Modern Governance: A European Perspective*, 2007, p. 127.

³⁷ HILL, C. J., *Is Hierarchical Governance in Decline?*, 2005.

extending bureaucracy that cuts across public and non-public boundaries rather than the development of post-bureaucracy per se. ... The need for economies of scale and scope, standardisation and the existence of indivisibilities in public services suggest that public sector reforms and proposals for new governance models establish extended or flexible forms of bureaucracy rather than post-bureaucratic organisational forms ... Attempts to introduce ICT-based services and the need for regulatory agencies to oversee the contracts with private and non-profit service providers reinforce these findings.³⁸

In response to the third question, Matthias Benz and Bruno S. Frey point out that "in view of recent corporate scandals, we argue that corporate governance can learn from public governance. Institutions devised to control and discipline the behavior of executives in the political sphere can give new insights into how to improve the governance of firms."³⁹

As regards the good governance model connection with the social development of the society Jacek Czaputowicz states that "the New Public Management model draws its inspiration from the private sector; Good Governance model is connected with the social context and the reform of public administration."⁴⁰

Conclusions

On the issue of networks between those who occupy key positions in the management of the state, their standpoint is given, for example, by Eva Sorensen and Jacob Torfing, who state that "governance networks are here to stay. They have become a necessary ingredient in the production of efficient public governance in our complex, fragmented and multi-layered societies... Governance networks that take active part in determining the content of public policy making have traditionally been regarded as a threat to democracy on the grounds that they undermine the sovereign position of elected politicians and the autonomy of civil society."⁴¹

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Corporate Governance in Germany

Corporate Governance v Německu

MICHAEL DIEDERICH

Abstract

This will give an overview of the German corporate governance framework which is an important factor in the relationship with institutional investors. The corporate governance codex gives guidelines how the different stakeholder can interact together. In respect to German corporate governance it can be concluded that most of the demands by institutional investors are met, but a few issues of great concern remain. This is of utmost importance because of the dominance of capital markets.

Keywords

institutional shareholder, corporate governance, mutual funds, shareholder value, Companies Act, board composition

JEL classification

M10, D002

Abstrakt

Tento článek přináší přehled o corporate governance v Německu, která je důležitým faktorem ve vztahu s institucionálními investory. Kodex corporate governance dává pokyny, jak se různé zúčastněné strany mohou navzájem ovlivňovat. Ve vztahu k německé corporate governance lze dospět k závěru, že většina požadavků institucionálních investorů je splněna, ale několik otázek velkých podniků zůstává. To má mimořádný význam pro dominanci kapitálových trhů.

Klíčová slova

institucionální akcionář, corporate governance, podílové fondy, hodnoty pro akcionáře, firemní zákon, složení rady

1 Introduction - The Corporate Governance System in Germany

Recent stock exchange scandals as well as spectacular collapses of enterprises¹ resulted in a greater distrust into management of listed corporations by shareholders. The massive abuse of power to make decisions and the disregard of controlling duties by the management and the supervisory boards led to the development of the Corporate Governance

¹ *The most famous scandals are ENRON and Worldcom. For more details see Utzig (2002), pp. 594 et seq.*

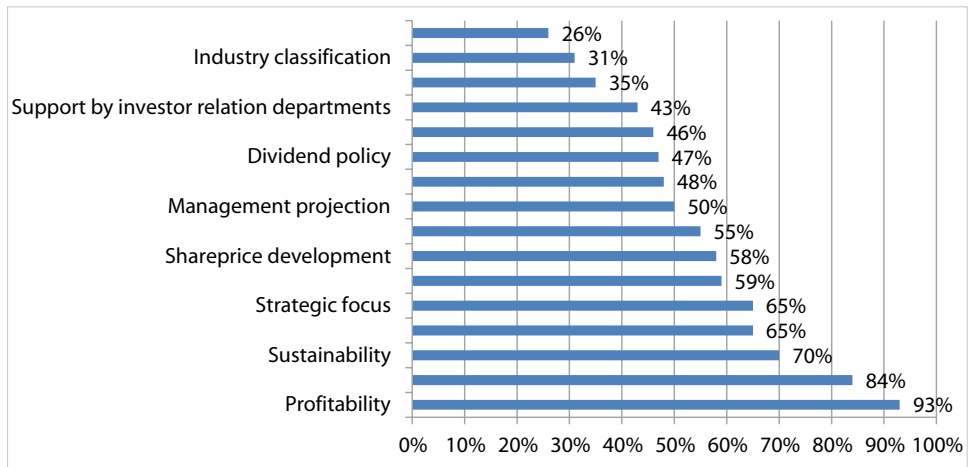
Code in Germany. Meanwhile, corporate governance is seen as a positive attribute which might lead to higher credit of corporations in international capital markets.²

This document addresses the German Corporate Governance approach and its impact on institutional investors. After illustrating the two perspectives on informational needs of shareholders and protection of information by the corporation, the chapter will focus on direct monitoring and indirect firm level monitoring.

1.1 The Need for Information versus the Protection of Information

Initially and before analyzing details of the German Corporate Governance Code³ and the legal framework, which provides informational rights to shareholders, it is important to illustrate the informational needs of institutional investors. Clearly, there is no consistency regarding institutional investors or shareholders. Hence, there is no consistent requirement for information, i.e. investors prefer different information.⁴ First of all, it is important to know on which basis institutional investors select their holdings. Empirically, Ernst et al. found that there are several criteria which influence the portfolio selection of institutional investors. These criteria are illustrated in figure 1.

Figure 1: Factors on which institutional investors select their holdings



Source: In accordance with Ernst et al. (2005), p. 33.

Notably, the majority of institutional investors select their holdings according to the profitability of the firm as well as the quality of the management. This is not really surprising

2 MUELLER, H.; SACH, V., *Corporate Governance: Die deutsche Wirtschaft im Spannungsfeld der neuen regulatorischen Anforderungen*, 2005, p. 5.

3 Commission of the German Corporate Governance Code, 2007, p. 12.

The most famous scandals are ENRON and Worldcom. For more details see UTZIG, 2002, pp. 594 et seq.

4 ERNST, E., et al., *Verhalten und Präferenzen deutscher Aktionäre*, 2005, pp. 10 et seq.

when considering that institutional investors focus on risk-benefit ratios.⁵ Having said that, German institutional investors give more emphasis to personal talks and direct contacts than to annual reports, whereas Anglo-American institutional investors weight these two information channels as equal.⁶ The arrangements or/and advocacies of the German Corporate Governance Code were not covered yet. Informational rights and duties can be subsumed under the term transparency. When having a look at the German Corporate Governance Code and to the EU directive transparency is ensured under following circumstances:

The board of directors publishes insider information regarding the corporation immediately, unless the board is, in a particular case, exempted.

As soon as a corporation gets to generally know that someone achieved or fell short of 3, 5, 10, 15, 20, 25, 30, 50 or 75 percent of the voting rights, the board of directors immediately publishes this issue.

The corporation treats all shareholders equal with regard to informational issues. The corporation should immediately publish all new facts which were provided to financial analysts or comparable receivers.

The corporation uses appropriate communication channels for a contemporary and consistent information flow to shareholders, as for example the internet.⁷

Information regarding the different possibilities for exercising voting rights that are currently published separately will now have to be included in the call for the general meeting.⁸

Legal certainty with regard to takeover bids, while protecting the interests of shareholders, employees and any other interested parties.⁹

1.2 Measures and Forms of Corporate Governance

Generally speaking, monitoring is a quintessential activity of professional ownership of corporate equity. It can either be formal, e.g. by submitting proxies, or informal, e.g. when institutional investors develop an idea and communicate it to the management.¹⁰ Both cases comprise an activity which aims at fostering the organizational accountability between corporate management and owners or between the chains of owners.

5 KENNELLY, J. J., *Institutional Ownership and Multinational Firms: Relationship to Social and Environmental Performance*, 2000, p. 31.

6 ERNST, E., et al., *Verhalten und Präferenzen deutscher Aktionäre*, 2005, p. 34.

7 Commission of the German Corporate Governance Code, 2007, p. 12.

8 EU Directive no 2004/25/CE

9 EU Directive no 2007/36/CE

10 HAWLEY, J. P.; WILLIAMS, A. T., *The Rise of Fiduciary Capitalism*, 2000, p. 124.

Following Black, monitoring by institutional investors can be differentiated into institutional “voice” or institutional “control.”¹¹ Institutional voice requires agents to watch other agents. Brought forward to the topic of this paper, it means that institutional owners watch corporate management, because both parties might have different interests. For that reason voice may shed light into the board room in a sort of check and balances approach to corporate governance.¹² Additionally, Black suggests that in order to enhance institutional voice and to overcome, or at least minimize the free-rider problem, institutional investors should hold between 5 and 10 percent of the stock in a particular corporation.

Through slimming their portfolios it is easier for institutional investors to communicate and, hence, it permits stronger influence on the selection of board members. However, at these levels of ownership it is not possible for a single investor to dominate the selection process of the board. As a result, a few owners could collectively influence major corporate issues, but no single owner alone could dominate or act effectively alone.¹³ On the other hand, institutional control proposes the dominance by one or a small group of institutional investors as it was the case in Germany.

1.2.1 Institutional Investors and the German Annual Meeting

For a better understanding of the role of institutional investors at German AGMs it is necessary to illustrate the functions and the status of the general meetings in the organizational structure of the company. From a legal perspective, there is no statutory definition of the AGM, but § 118 (1) AktG defines that shareholders can regularly exercise their rights regarding issues of the company. Consequently, the AGM can be understood as a meeting where shareholders make their decisions as well as an essential institution of the German stock corporation besides the supervisory board¹⁴ and the managing board.¹⁵

In principle, the AGM has the right to organize itself and to arrange the event within the legal framework. For that reason, the AGM can establish its own bylaw.¹⁶ Furthermore, it is important to outline that the AGM has to choose a chairman who leads the AGM, assign the time of speeches, control the ballots and execute, if necessary, the right to call for order.¹⁷

The prearrangement of the German AGM is, to some extent, different and incumbent to the administration of the corporation. Besides the convening and transmission of the relevant documents to shareholders, most of the time-consuming effort is spend on preparing the discussion with shareholders because the executive board has to response to all

11 BLACK, B. S., *Institutional Investors and Corporate Governance: The Case for Institutional Voice*, 1992b, pp. 19 et seq.

12 BLACK, B. S., *Agents watching agents: The promise of Institutional Investor Voice*, 1992a, p. 832.

13 BLACK, B. S., *Institutional Investors and Corporate Governance: The Case for Institutional Voice*, 1992b, p. 21.

14 §§ 95 AktG.

15 §§ 76 AktG.

16 § 129 (1) 1 AktG.

17 This is determined by §§ 130 (2), 122 (3) 2 AktG.

questions from shareholders which refer to issues of the corporation and to issues which are needed to simplify the process of decision making.¹⁸

On the one hand, the principle task of the AGM is to inform shareholders. On the other hand, its task is also to exercise internal processes of decision making. As already mentioned in chapter 5.1.2, during the AGM shareholders can opt out their rights, in particular, their voting rights. To be more specific and to incorporate special regulation for different institutional investors, the next sub-section will illustrate different legal regulations for insurance companies, commercial banks as well as mutual funds. Additionally, it will outline positive and negative incentives to be active at the AGM.

1.2.1.1 Commercial Banks

Initially, one has to differentiate between legal regulations which regard shareholdings of a commercial bank and regulation which regard shareholdings on a commercial bank.

For the latter, it has to be noted that there are no particular regulations when an individual acquires shares of a bank. The only restriction can be found in the German Banking Act (Kreditwesensgesetz, further KWG). According to this, the acquirer¹⁹ of the stock as well as the bank²⁰ have to inform the Federal Financial Supervisory Authority (further, BAFIN) when acquiring a stake greater than 10 percent.²¹

It can be stated that commercial banks are regulated in regard with their own shareholdings. According to § 12 KWG, a bank is not allowed to acquire a stake on a non-financial company which exceeds 15 percent of the banks liable equity. Additionally, all shareholdings together have to be smaller than 60 percent of the banks liable equity.²² As a matter of fact, shareholdings of banks are also restricted through the regulatory statutes of large credits. This means that stocks, investments in other companies as well as shares in affiliated companies belong to assets by law.²³ As a result, all shareholdings, independent from their purpose, are restricted by §§ 13, 14 KWG. A loan is seen as a large credit and therefore restricted, when reaching 10 percent of the liable equity.²⁴

In summary, it can be noted that commercial banks are, by law, restricted in their investment policy. It is not possible for banks to acquire a large stake in a non-financial company if the price of the outstanding shares of that particular company is greater than 10 percent of the banks own liable equity.

However, commercial banks do not gain their influence through own shareholdings but rather through proxy voting. If an individual shareholder can not be present at the AGM

18 § 131 AktG.

19 § 2c (1) KWG.

20 § 24 (1) no. 10 KWG.

21 § 1 (9) 1 KWG.

22 § 12 (1) 2 KWG.

23 § 19 (1) 1, 2 no. 6 – 8 KWG.

24 § 13 (1) KWG.

of his shareholding, he has the option to assign his depository bank to vote on his behalf. The process of giving proxies to banks is regulated by the German Stock Company Act.²⁵ When a commercial bank preserves the shares of a shareholder and the bank intends to vote on behalf of that shareholder, the bank is required to present own suggestions to particular agenda items.²⁶ In more detail, the bank is required to make its suggestions in the best interest of the shareholder.²⁷ Simultaneously, the bank is required to ask the shareholder for instructions. In case the shareholder gives instructions, the bank is required to follow these directions.²⁸ Nevertheless, in practice only a minority of shareholders instruct their banks. Consequently much leeway is left to banks.²⁹

1.2.1.2 Mutual Funds

Mutual funds (in the sense of public funds) are, according to the Investment Act (further InvG), separate property (Sondervermögen) which is administrated by an investment company (Kapitalanlagegesellschaft).³⁰ There is no legal regulation which limits the acquisition of interests on a mutual fund. Solely, the acquisition of large stakes has to be reported to the BaFin.³¹ The rules and regulations of the German Banking Act (Kreditwesengesetz) have to be applied supplemental because mutual funds are financial institutions in terms of the law.³² The administration of separate property is subject to specific requirements. Particularly, the acquisition of shares is limited. According to the Investment Act, an investment company is only allowed to invest 10 percent of its separate property in shares of one issuer.³³ The background of this regulation can be attributed to the principle of risk diversification.³⁴

Further specifications of mutual funds are special funds (Spezialfonds). The most important feature of special funds is their limited quantity of investors. According to the InvG, only 30 incorporate investors are allowed to hold stakes in the fund.³⁵ In consideration of the limitation of investment decisions, there are no additional regulations for special funds. Only hedge funds have other possibilities concerning investment decisions.³⁶ However, hedge funds are not considered in this thesis. When it comes to voting rights, mutual funds are allowed to act on their own behalf.³⁷ Interestingly and in contrast to banks, mutual funds are not required to get proxies from their stockholders in order to execute voting rights.³⁸

25 For more details see §§ 128, 135 AktG and GADOW, W.; HEINICHEN, E., *AktG - Großkommentar*, 1993, p. 128.

26 § 128 (2) 1 AktG.

27 § 128 (2) 2 AktG.

28 § 128 (3) 3 AktG.

29 FRAUNE, 1996, p. 10.

30 § 2 (1) InvG.

31 §§ 2b (1), 24 (1) KWG.

32 §§ 6 (1) InvG, 1 (1) no. 6 KWG.

33 §§ 47, 52 InvG.

34 § 2 (5) InvG. For more details about portfolio theory and risk diversification, see SPREEMANN, K., *Portfolio Management*, 2006, p. 48.

35 § 91 (1) InvG.

36 §§ 112 InvG.

37 § 32 InvG.

38 § 32 (1) InvG in conjunction with § 129 (3) AktG.

Normally, mutual funds are also required to execute voting rights by themselves.³⁹ Only in individual cases, mutual funds are allowed to assign a third party to execute voting rights. In that case, the third party has to follow the directive of the mutual fund.⁴⁰

1.2.1.3 Insurance Companies

Generally and by the law in force, investments in stocks of an insurance company are not limited. Just as in the case of banks and mutual funds, the acquisition of large stakes⁴¹ on an insurance company has to be reported to the BaFin.⁴²

Conversely, investments by an insurance company in shares of a listed company are restricted. Before going into detail, one has to differentiate between insurance funds (Deckungsstock),⁴³ and unencumbered assets (freies Vermögen). Particularly, investments of insurance funds are restricted by the German Insurance Supervision Act (Versicherungsaufsichtsgesetz, further VAG).⁴⁴ When insurance companies invest their money, they have to mind principle investment rules. They have to consider the basic principles of safety of their investments, profitability, liquidity and diversification.⁴⁵ However, insurance companies are not restricted in their investment decision regarding shares of listed companies.⁴⁶ As already mentioned, they only have to inform the BAFIN when they acquire a stake which is larger than 10 percent of the outstanding shares.⁴⁷

1.2.2 Indirect Firm Level Monitoring

After outlining direct-firm level monitoring, which is basically shaped by the German legal background and provides an internal perspective on corporate governance, it is now important to illustrate external approaches to corporate governance mechanism. This section aims at outlining the market for corporate control, which is a mechanism to discipline management of underperforming corporations. Moreover, this section will focus on the influence of institutional investors on German board structure with regard to reducing board size and enhancing board independence.

39 § 32 (1) 2 InvG.

40 § 32 (1) 3 InvG.

41 Due to the fact that the acquisition of shares is not part of the core business of an insurance company, the Kreditwesengesetz has to be applied. Thus, large stakes refers to 10 percent of the outstanding shares or voting rights of a listed company. See § 1 (3) KWG in conjunction with § 1 (9) KWG and § 54 (4) no. 2 VAG.

42 § 104 (1) 1 VAG.

43 The principle components of insurance funds can be defined as the sum of the book values of actuarial reserves in consideration of the backlog of premiums plus the reserves for not yet transacted insured events plus the provisions for not yet transacted buybacks of several insurance contracts plus the surplus share. For more details see § 66 VAG.

44 §§ 54 - 54d VAG.

45 § 54 (1) VAG.

46 Formerly, insurance companies were restricted in their investment decisions. They were only allowed to invest 30 percent of their investment fund into shares. For more details see § 54a VAG (old version).

47 § 104 (1) 1 VAG.

1.2.2.1 Takeovers or the Market for Corporate Control

Until today, the issue of takeovers as a disciplinary mechanism for corporate management is an unresolved one.⁴⁸ In particular, the question remains whether takeovers are a good substitute for direct shareholder monitoring as illustrated in the recent section. Yet, it is necessary to present the background underlying the market for corporate control. In that context, the terms “merger”, “acquisition”, and “takeovers” are all part of the M&A nomenclature. A typical merger is characterized by an unsolicited incident when firms come together to share their resources in order to realize common objectives. However, in case of a merger the rectifying of corporate management is not of great concern.⁴⁹

A typical takeover is characterized by a tender offer by an investor or a company to dispersed shareholders of the targeted firm. In case shareholders of the targeted company accept the offer, the bidder acquires control of the targeted firm. A more relevant issue regarding corporate control is hostile takeovers. In a hostile takeover the management of the targeted firm opposes the bid and is, thus, likely to be replaced when the bid is successful.⁵⁰

This chapter will solely focus on hostile takeovers as a means of correcting managerial failure. The underlying philosophy of hostile takeovers is conclusively simple. Macey argues that a hostile bidder has an incentive to monitor and search for underperforming firms because he can profit from buying shares of the targeted company and replace the management team through a better one. Nevertheless, the bidder has to consider that the remaining shareholders also profit from a better management team, although they do not bear any costs which is the classical free-rider problem. However, Macey argues that a hostile takeover is still beneficial to the bidder as long as the market pays a risk-adjusted return to the bidder.⁵¹ However, hostile takeovers are not an all-encompassing tool to solve monitoring problems within the corporate governance context.

First, takeovers are very costly. In other words, a bidder has to bear costs to search, find and successfully replace the targeted management of a permanently undervalued company. Additionally, a functioning market for hostile takeovers might be sufficient to affect managerial performance even if there is no announced bid or attempt for a takeover.⁵²

In summary it can be stated that the market for corporate control is a good appliance for improving management performance and, thus, corporate governance. However, there are several reasons why this statement is only partly valid. First, there are too few value-improving hostile takeovers. Second, there may be value-reducing hostile takeovers.⁵³ As already mentioned above, there is the classical free-rider problem which implies that

48 GUGLER, K., *Corporate Governance and Economic Performance*, 2001, p. 32.

49 GUGLER, K., *Corporate Governance and Economic Performance*, 2001, p. 33.

50 MACEY, J. R., *Institutional Investors and Corporate Monitoring*, 1997, p. 606.

51 MACEY, J. R., *Institutional Investors and Corporate Monitoring*, 1997, p. 606.

52 MACEY, J. R., *Institutional Investors and Corporate Monitoring*, 1997, p. 606.

53 GUGLER, K., *Corporate Governance and Economic Performance*, 2001, p. 33.

bidders do not get the full return for their efforts but have to share the gains with the remaining shareholders of the targeted company. These shareholders might have the incentive not to sell their shares to the bidder in order to gain from improvements in post takeover firm value.⁵⁴ Another argument which supports the first caveat is that bidders in a takeover do face competition which possibly drives up the price of the target and reduces the incentive to actually make a bid. Last but not least, targeted firms and targeted management may take defense actions such as poison pills et cetera.⁵⁵ There are also several reasons why takeovers may be value-reducing. At first, the potential acquirer of a corporation might face his own agency problems, which means that the managing board of the acquirer might not act in the best interest of their shareholders.⁵⁶ Additionally, managers might not act under the proposition of profit maximization. As an acquisition is the fastest way to grow, the management of the acquirer might choose takeovers to achieve its own size and growth objectives.⁵⁷ Moreover, hostile takeovers might be value-reducing due to distributional costs. It could mean that the gains from target shareholders are not outweighing the losses of other stakeholders, as for example acquiring shareholders, workers, suppliers et cetera and whether these losses are compensated.⁵⁸

Nevertheless, the question remains whether hostile takeovers are a good process to shape corporate management and corporate governance. From an empirical view, one can adhere that takeovers improve deficient management. Jensen found out that hostile takeovers are a good strategy to reduce excess capacities of corporations, which would not have been possible if the incumbent management resists.⁵⁹ A further argument for hostile takeovers is that takeovers or other forms of acquisitions are socially desirable when they result in other kind of efficiency gains. Other kinds of efficiency gains could be reached through economies of scale or scope and through savings of transaction costs or multi-use assets.⁶⁰ However, several studies indicate that hostile takeovers as well as mergers did not improve firm performance in the post takeover era.⁶¹

One can conclude that hostile takeovers and mergers are able to discipline managements. Nevertheless, one cannot say that hostile takeovers are a superior process or disciplinary device for shaping corporate governance and corporate management.⁶² Although hostile takeovers are not superior, one must admit that this process is able to support corporate governance and that it is a good external process to discipline management.

54 GROSSMANN, S. J.; HART, O. D., *Takeover Bids, the free rider problem and the theory of the corporation*, 1980, p. 43.

55 KOKOT, K. S., *The Art of Takeover Defense*, 2006, p. 18.

56 SHLEIFER, A.; VISHNY, R. W., *Large Shareholders and Corporate Control*, 1986, p. 30.

57 MUELLER, H., 1969, p. 657.

58 GUGLER, K., *Corporate Governance and Economic Performance*, 2001, p. 33.

59 JENSEN, M. C., *The modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 1993, p. 832.

60 GUGLER, K., *Corporate Governance and Economic Performance*, 2001, p. 33.

61 For example, RAVENSCRAFT, D. J.; SCHERER F. M., 1987, p. 216 et seq.; MORCK et al., 1989, p. 852 or MUELLER, H., 1985, p. 259.

62 GUGLER, K., *Corporate Governance and Economic Performance*, 2001, p. 37.

1.2.2.2 Board Composition and Board Structure in Germany

The purpose of this section is to give the reader an overview and an insight to German board structure, its legal back-up as well as to present non-statutory rules from the German Corporate Governance Code. The German Corporate Governance Code was developed by the governmental commission (Regierungskommission Corporate Governance Codex) under the leadership of Mr. Cromme in 2001. In this regard, the German code follows a self-regulatory “comply-or-explain” approach. According to the German company law, companies have to publish a compliance with the code in the annual report.⁶³

In contrast to Anglo-Saxon countries, public companies in Germany are characterized by a two-tiered board model, which is mandatory regardless of the size or listing of the company.⁶⁴ The two-tiered board model consists of the management board and the supervisory board. Basically, the main task of the management board is to run and operate the business.⁶⁵ In comparison to that, the task of the supervisory board is to appoint, supervise and remove the management board.⁶⁶ In more detail, the supervisory board supervises the managing board (not the corporation) and its business strategies. However, the supervisory board cannot directly influence operational business but if the statute of the company demands it or the supervisory board decides so, particular transaction can be subject to its approval.⁶⁷

A membership at the supervisory board and the management board of the same corporation, at the same time, is not possible. Additionally, an individual is limited to 10 seats on supervisory boards at maximum.⁶⁸ One might question that, before the background of “Germany Inc.,” multiple seats on supervisory boards challenge the attributes of independence and objectivity as well as it bears conflicts of interests.⁶⁹ Nevertheless, practice has shown that many companies assigned their former managers, which had a seat on the managing board, to the supervisory board. In that context, it is most common that the former CEO takes the chair of the supervisory board. It is also common procedure that further seats on the supervisory board are offered to other stakeholders like business partners, particularly when the corporations are characterized by cross shareholdings.⁷⁰ As already mentioned, this procedure bears potential conflicts of interests especially in the case of banks. Due to the German universal banking system, banks take a double position. On the one hand, they are depository banks for their clients. In this regard, banks exercise voting rights for clients who gave a proxy. On the other hand, banks are creditors of corporations and, thus, a conflict of interest is present. This conflict of interest could be even more intensified when the bank holds shares on the company by itself. Practitioners realized that problem and, thus, Deutsche Bank AG was one of the first banks in Germany which addressed this issue in its corporate governance principles. According to

63 § 161 AktG.

64 § 30 AktG in conjunction with §§ 96 – 99 AktG.

65 § 76 (1) AktG.

66 § 111 AktG.

67 § 111 (4) AktG.

68 HOPT, K. J.; LEYENS, P. C., *Board Models in Europe*, 2004, p. 5.

69 PRIGGE, S., *A survey of German Corporate Governance*, 1998, p. 957.

70 HOPT, K. J.; LEYENS, P. C., *Board Models in Europe*, 2004, p. 6.

this, Deutsche Bank AG complies the German Corporate Governance Code and stated that no member of the managing board, in principle, is allowed to take a seat on a managing board outside the group.⁷¹

In Germany, the question of independent directors in order to avoid conflicts of interests is also mentioned in the German Corporate Governance Code, which was one of the major demands of institutional investors. However, the German code does not provide a general definition of the term "independence", but it provides a statement. Referring to this, the code basically recommends that the number of former managers from the managing board should be limited to two seats. Additionally, the chair of the audit committee should not be assigned to a former member of the managing board. The code provides a recommendation that parallel seats on the supervisory or managing board of competitors as well as advisory mandates are not compatible with German corporate governance.⁷² Especially the issue of multiple seats was addressed by institutional investors who worried that managers will not act in the best interest of the corporation.⁷³

A special characteristic of the German corporate governance system is the issue of co-determination. According to the Co-determination Act (Mitbestimmungsgesetz, further MitbestG), companies with more than 2,000 employees must compose half of their supervisory board with representatives of workers.⁷⁴ When it comes to votes and there is a stand-off, the vote of the chairman of the supervisory board counts twice, which gives a slight advantage to shareholders.⁷⁵ From a corporate perspective, the model of co-determination has proved its eligibility because it is seen as a warning system for social conflicts as well as it helps to keep down strikes, which is of course, in the best interest of shareholders and in particular institutional investors.⁷⁶

From a more critical perspective, the German system of co-determination is to some extent limiting the efficiency of the boards which is mainly due to size of supervisory boards (up to 21 members).⁷⁷ Moreover, the German legal system does not specify concrete qualification standards for members of the supervisory board. Indeed, the German Corporate Governance Code touches this issue and recommends that members of the board should have the knowledge, ability and professional experience⁷⁸ but this issue is only described superficial and no one has to proof his qualification by, for example, a degree in finance or accounting.

71 DEUTSCHE BANK, *Significant Differences in Corporate Governance Practices for Purposes of Section 303A*, 2008, p. 3. This is consistent with the German Corporate Governance Code, in more detail see Commission of the German Corporate Governance Code, 2007, paragraph 5.4.4.

72 Commission of the German Corporate Governance Code, 2007, paragraph 5.3.2 and 5.4.4.

73 SHLEIFER, A.; VISHNY, R. W., *Large Shareholders and Corporate Control*, 1986, pp. 27 et seq.

74 § 1 MitbestG.

75 § 29 MitbestG in conjunction with § 108 (3) AktG.

76 HOPT, K. J.; LEYENS, P. C., *Board Models in Europe*, 2004, p. 7.

77 § 95 AktG.

78 Commission of the German Corporate Governance Code, 2007, paragraph 5.4.1..

Another point of major interest regarding indirect firm level monitoring, are internal control mechanism and auditing in the German corporate governance system. The composition and the functionality of internal control mechanism, as it exist under current law and under the recommendation of the German Corporate Governance Code, are mainly determined by Germany's two-tiered board model.⁷⁹ In particular, the supervisory board is excluded from operational management of the company. In addition, the supervisory board has limited rights to directly obtain information from executives. In consequence, it is difficult for members of the supervisory board to develop an objective picture of the company and its performance.⁸⁰

When it comes to internal control, the process of auditing and auditing committees is another important aspect. According to the German Corporate Governance Code, the supervisory board should set-up an auditing committee. The main task of the auditing committee is the coordination of control, revision and auditors. In order to be efficient, the chairman of the audit committee should have professional experience and knowledge in financial accounting.⁸¹ Furthermore, the code recommends that the audit committee should demand a statement of independence from the auditor. This statement should comprise a declaration whether the auditor has any relations to institutions of the company which could cause doubts on the independence of the auditor.⁸² The code justifies its request by the argument that auditing companies do a broad spectrum of tasks such as M&A transactions, outsourcing or preparation of initial public offerings, which in consequence could cause conflicts of interests.⁸³

From a legal perspective, the German Commercial Code (Handelsgesetzbuch, further HGB) states, that an auditor who has earned more than 30 percent of his earnings exclusively from one company in the last five years, is ineligible.⁸⁴ Additionally, the same auditor cannot be assigned for auditing more than five times.

This request is particularly important from a control perspective because the auditor checks the annual report of the company which is an important informational source for shareholders. In this context, it is noteworthy that the external auditor is elected by shareholders at the AGM which makes the auditor a control device of shareholders and thus institutional investors.⁸⁵

1.2.3 Institutional Investors and Board Independence

Before giving evidence whether institutional investors do have influence on corporate board structures in respect to independence and board size, it is again necessary to distin-

79 HOPT, K. J.; LEYENS, P. C., *Board Models in Europe*, 2004, p. 9.

80 § 90 (1), (2) AktG.

81 *Commission of the German Corporate Governance Code, 2007, paragraph 5.3.2.*

82 *Commission of the German Corporate Governance Code, 2007, paragraph 7.2.1.*

83 RINGLEB, H. M., et al., *Kommentar zum Deutschen Corporate Governance Kodex, 2005, pp. 288 et seq.*

84 § 319 (3) no. 5 HGB.

85 § 318 (1) HGB as well as GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards, 2007, p. 2.*

guish between the German two-tiered board model and the Anglo-Saxon one-tier board model. In the Anglo-Saxon capital market and especially in the United States, the board of directors has power to control, authority to ratify major corporate policy initiatives and power to hire, fire and set compensation schemes for the top management.⁸⁶

Gallagher et al. scrutinized in their survey in 2007, for the influence of institutional investors on reducing board size and increasing independence of the board.⁸⁷ The outcome of their survey showed that U.S. institutional investor focus on removing inside directors as a mean of reducing board size and, thus, increasing independence.

The underlying philosophy of such a bargaining is that institutional investors take corrective action to improve firm performance and to remove those directors which are seen responsible for poor firm performance.⁸⁸ However, their survey also found that due to institutional investor heterogeneity, some institutional investors are not able to, respectively not willing to, exert their influence. This is mostly due to the fact, that some institutional investors (banks and insurance companies) have existing or potential business ties to companies in which they have a stake and, thus, these institutional investors are less willing to challenge management decisions. Additionally, banks and insurance companies face higher costs of monitoring because an intervention with the management could impair their relationship with the company, which could result in losing actual or future businesses. As a result, these investors stay passive.⁸⁹

In contrast, their survey also showed that investment companies as well as public pension funds and independent investment advisors do not have and do not search for such business ties with companies they invest in. Consequently, these investors face lower monitoring costs and no conflicts of interests. They are active in challenging management decisions.⁹⁰ However, speaking in numbers, Gallagher et al. found out that the average board size in the U.S. consists of 9.7 members with 63.9 percent being independent. Moreover they gave evidence to the fact that inside or grey directors were replaced over time due to activism of institutional investors and the poor performance of the managers.⁹¹

In Germany, institutional investors face a different situation. In general, institutional investors with small shareholdings are not represented on the supervisory board.⁹² The process

86 GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards*, 2007, p. 2.

87 GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards*, 2007, p. 8. Independent directors are defined as: "[...] those which have no family relations with directors on the board, have not worked for the company in the past, are not current employees and also do not have any business relations with the company."

88 GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards*, 2007, p. 4.

89 GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards*, 2007, pp. 11 et seq.

90 GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards*, 2007, p. 11.

91 GALLAGHER, D. R., et al., *Institutional Investor Monitoring and the Structure of Corporate Boards*, 2007, p.17 and p. 27.

92 STEIGER, M. *Institutionelle Investoren im Spannungsfeld zwischen Aktienmarktliquidität und Corporate Governance*, 2000, p. 89.

of selecting members of the supervisory board (from the shareholder side perspective) is usually done by coordination between the supervisory board and the management board. Consequently, the management board has influence on the composition of the supervisory board.⁹³

Support for this view is also given by a study from the association of private investors (Deutsche Schutzvereinigung für Wertpapierbesitz e.V., further DSW). DSW analyzed the structure and interdependence of board members within the German DAX 30 companies in 2006.⁹⁴ It turned out, that seven out of ten managers changed from the position of the chairman of the managing board to the chairman of the supervisory board. Therefore this issue was additionally noted in the German Corporate Governance Code. According to the code, a changeover from the managing board to the supervisory board of the same corporation should only be an exception. An intention to do so should be explained to the shareholders at the AGM.⁹⁵

In Germany, banks and insurance companies are represented on supervisory boards whereas mutual funds.⁹⁶ Moreover, banks and insurance companies have additional business ties with their holdings, e.g. credit links as well as proxy voting. This issue of course raises the question of conflicts of interests and independence of board members. Hence, the German legislator has limited the "power of banks" by the introduction of the Corporate Sector and Transparency Act (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, further KonTraG). For example, § 135 AktG states that a bank with an own stake of 5 percent (or more) is not allowed to exercise proxies for their clients. Additionally, cross-shareholding companies with a share of 25 percent or more are not allowed to exercise their own votes for the election of the supervisory board.⁹⁷

The background of this regulation was the fear of the legislator that public limited companies with low attendance rates at the AGMs will not be controlled by owners but through companies with high stakes. The problem of "the power of the banks" is not of major importance in the Anglo-Saxon capital markets due to the fact that the legislator limited their role through laws and regulations. Additionally and in contrast to Germany, banks provide only short-term loans to companies, whereas long-term debt is usually raised in the bond market.⁹⁸

In conclusion, the German board system cannot be regarded as independent. Empirically, Kim et al. found out that board independence is not found in Germany.⁹⁹ Notably, the survey from Heidrick and Struggels revealed slightly different results which are illustrated in figure 2.

93 STEIGER, M., *Institutionelle Investoren im Spannungsfeld zwischen Aktienmarktliquidität und Corporate Governance*, 2000, p. 87.

94 DSW, *Germany's secret leader*, 2006.

95 Commission of the German Corporate Governance Code, 2007, paragraph 4.3.5 and paragraph 5.4.4.

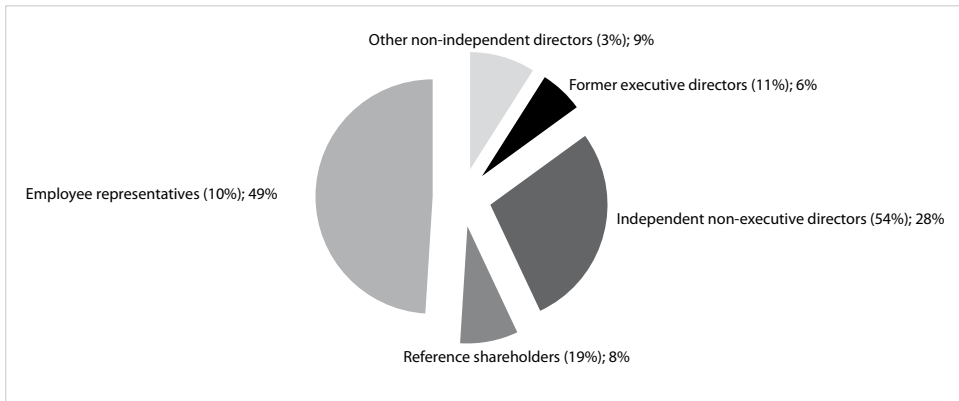
96 DSW, *Germany's secret leader*, 2006.

97 § 328 (1), (3) AktG.

98 STEIGER, M., *Institutionelle Investoren im Spannungsfeld zwischen Aktienmarktliquidität und Corporate Governance*, 2000, p. 83. .

99 KIM, K. A., et al., *Large Shareholders, Board independence, and minority shareholders rights*, 2007, p. 867.

Figure 2: Board composition by category of director



Source: Heidrick & Struggles (2007), p. 23.

Interestingly, 28 percent of the directors are seen as being independent, whereas the European average (in brackets) accounts for 54 percent. Moreover, it can be stated that institutional investors do play a different role in respect to board independence than in the Anglo-Saxon governance system.

For example, mutual funds do not play a significant role in appointing independent directors. Due to their credit links and cross shareholdings banks and insurance companies are traditionally represented on supervisory boards and therefore play a prominent role in appointing independent directors.

1.3 Implementation of the German Corporate Governance Code

Every year, the Berlin Center for Corporate Governance scrutinizes the implementation of the German Corporate Governance Code on the basis of a survey of all listed corporations. Notably, no company within the DAX 30 refuses all recommendations. The Berlin Center found out that five recommendations are of particular interest because less than 90 percent of the DAX 30 corporations do not accept the following points:¹⁰⁰

1. An adequate percentage share for managers on the supervisory board and management board when concluding "D&O" insurances (Directors and Officers insurance, Managerhaftpflicht, acceptance rate: 82.1%).
2. The forwarding of the invitation to the AGM as well as documents for the AGM via Internet. (Acceptance rate: 85.7%)
3. The consultation of the supervisory board about compensation schemes for the management board. (Acceptance rate: 85.2%)
4. The limitation of changeovers from former CEOs' to the position of the chairman of the supervisory board. (Acceptance rate: 71.4%)

¹⁰⁰ V. WERDER, A.; TALAULICAR, T., *Umsetzung der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex, 2008*, p. 2.

5. The performance-related compensation for members of the supervisory board. (Acceptance rate: 82.1%)¹⁰¹

It is striking that the limitation of changeovers from former CEOs to the position of the chairman of the supervisory board evokes such a low acceptance rate. However, the German Corporate Governance Code recommends that the supervisory board should establish a nominating committee, consisting of shareholders, to suggest candidates for the supervisory board, which will then be elected at the AGM. The current acceptance rate for this recommendation is 88.9 percent of the DAX 30 companies. In consequence, this recommendation might limit potential conflicts of interest as well as it opens the door to institutional investors to nominate their own candidates.¹⁰²

Conclusions

This paper picked up the issue of corporate governance in Germany and gave an introduction to legal framework regarding the subject of direct firm level monitoring the paper showed on German AGMs that all institutional investors do have positive incentives to exercise their voting rights. Therefore, "voice" can be confirmed. In respect to indirect firm level monitoring it turned out that activism is not necessarily a superior process to the market of corporate control. Particularly, it can be argued that the threats of takeovers as well as actual takeovers are a possible tool to discipline management. However, takeovers can only be seen as an addition to activism because takeovers do also cause value destruction.

In respect to German corporate governance it can be concluded that most of the demands by institutional investors are met, but a few issues of great concern remain.

First, independence of German supervisory boards is not ensured, although demanded by institutional investors. Second, the limitation of changeovers from former CEOs to the position of the chairman of the supervisory board is only accepted by 71.4 percent of German DAX30 companies.

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101 V. WERDER, A.; TALAULICAR, T., *Umsetzung der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex*, 2008, p. 2.

102 V. WERDER, A.; TALAULICAR, T., *Umsetzung der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex*, 2008, p. 2.

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Public Governance, Social Services and Social Assistance Benefits

Public governance, sociální služby a dávky sociální péče

LADISLAV PRŮŠA

Abstract

This paper aims to characterize the problems that hinder the effective functioning of social services and social assistance benefits in terms of powers of public authorities. By analyzing the current state of selected elements of these systems are design solutions that would lead to the elimination of existing problems.

Keywords

public governance, social services, social assistance benefits

Abstrakt

Cílem příspěvku je charakterizovat problémy, které brání efektivnímu fungování systému sociálních služeb a dávek sociální péče z hlediska kompetencí jednotlivých orgánů veřejné správy. Na základě rozboru současného stavu vybraných prvků těchto systémů jsou navržena řešení, která by vedla k odstranění současných problémů.

Klíčová slova

veřejné vládnutí, sociální služby, dávky sociální péče

Introduction

Suitable architecture setup, that is the optimal fine-tuning of relations between individual entities that are involved in its functioning, is one of the key aspects influencing the effective functioning of each system. In addition to the Ministry of Labour and Social Affairs, regions and municipalities act, both in their self-governing and delegated competence, in the area of social services. The experience with the application of Act 108/2006 Coll., on Social Services, as amended, has shown so far that in many cases there are conflicts regarding the application of the self-governing roles and roles of the state. This results from the implementation of the II. phase of public administration reform when competencies were, in connection with the abolition of district authorities transferred on the delegated competence of regional authorities and newly established municipal authorities with extended powers. The merger of the role of the state with the self-governing one of these entities contradicts the long term concepts of the Ministry of Labour and Social Affairs incorporated in the script for social reform, according to which it is necessary to separate the role of the state and the role of self-governing bodies so

that each citizens should know what is the outcome of his/her activity resulting from the insurance, what he/she receives from the state and what is a result of activities of self-governing bodies of municipalities, towns and regions¹.

1 Current Legal Status, Issues and Impacts

The crucial competencies of municipalities and regions in their self-governing and delegated competence concerning the issues of creating and fulfilling of the mid-term development plan of social services, registration of social services providers and system of financing of social services are laid down in Act 108/2006 Coll., on Social Services, as amended, in many Sections:

- Under Section 7 (4) a municipal authority of a municipality with extended powers shall decide on the allowance; the specific procedure concerning the allowance proceedings is given in Section 25,
- Under Section 78 a regional authority in its delegated competence shall decided on the registration of the social services providers,
- Under Section 94 a municipality in its self-governing competence:
 - Shall research needs in of social services provision to persons in its territory,
 - May prepare a medium-term plan of social services development in cooperation with a region, social services providers and with participation of persons to whom social services are provided,
 - Shall cooperate with a region when preparing and implementing the medium-term of development of social services in the region,
- Under Section 95 a region in its self-governing competence:
 - Shall prepare a medium-term plan of social services development with participation of social services providers and representatives of persons to whom social services are provided,
 - Shall monitor and evaluate its fulfilment,
 - Shall arrange for availability of social services in accordance with the plan,
 - Shall inform the Ministry about its fulfilment,
- Under Section 101 a regional authority in its delegated competence shall submit an application for subsidy for the provision of social services for providers who are entered in the register,
- Under Section 105 a municipality or region may, in its self-governing competence, provide a specific subsidy to social services providers, who are entered in the register, to fund their current expenditures relating to the provision of social services.

Conflicts concerning the application of self-governing competencies of municipalities, towns and regions and state roles can mostly be seen in the following areas:

¹ Please refer to e.g. *Návrh na zřízení Národního úřadu pro zaměstnanost a sociální správu a vymezení jeho působnosti*. Praha: MPSV, 2007.

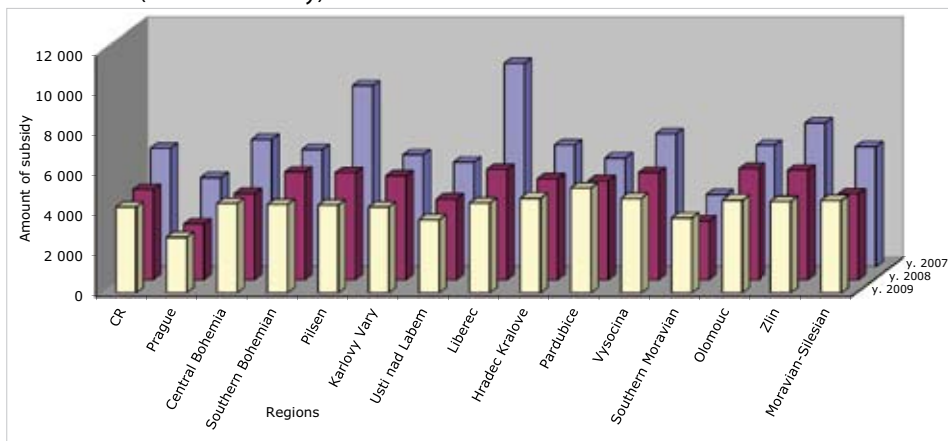
- The decision on care allowance lies with a municipality with extended powers, and while at the same time the municipality itself, in its self-governing competence, is the founder of some social services, it therefore has an interest to award the applicant the allowance of the higher grade so that it would reduce the claims of an organisation providing the services, whose founder it is, for the provisions of subsidies from the municipal budget,
- The regional authority, when drafting an application for the subsidy from the state budget prefers providers, where it acts as a founder in its self-governing competence, as the award of subsidy from the state budget for those providers shall, in the higher grade, reduce the pressure on funding the social services from regional budget.

These conflicts are even more serious, because no implementation law have yet been drafted (a decree of the Ministry of Labour and Social Affairs), which would have set more detailed rules of how the amount of subsidy, purpose of subsidy, its structure and manner of provisions should be determined. The existence of such law is envisaged in Section 101 (7) of Act No. 108/2006 Coll., as amended. For the time being, the subsidies have been provided on the basis of an annually updated order of the Ministry of Labour and Social Affairs.

What are the consequences of the above mentioned conflicts and facts?

1. In the first place, it should be noted that the absence of implementation regulation results in the fact that the amount of the subsidy provided in relation to, e.g. one place in the nursing home is highly differentiated by individual regions (For instance in 2009, the highest subsidy was provided in Pardubice region – and amounted to CZK 5 218 per one place monthly, while the lowest subsidy was granted in the capital city of Prague – and amounted to CZK 2765 per one place monthly; for more detailed information please refer to figure 1).

Figure 1: A comparison of the amount of the state subsidy per bed in nursing homes in 2007 - 2009 (in CZK/monthly)



Source: Průša, L. a kol. (2009) *Poskytování sociálních služeb pro seniory a osoby se zdravotním postižením*.

2. The other impact of this is the different amount of subsidy from the state budget awarded to social services providers depending on the type of provider in comparison with the amount of the original request. While in 2007 the claims of the allowance organisations established by regions were satisfied from 82.7%, the claims of religious legal entities were satisfied only from 59.0%, allowance organisations established by municipalities from 49.8%, citizen associations from 49.6% and public utility companies from 49.5%².
3. Another consequence of this is that some crucial elements of new system of social services are not interconnected – in this regard it means mostly interconnectivity concerning the drafting of the medium-term plans of development of social services, registration of social services providers and the system for their funding. However, many deficiencies can be seen in the drafting of individual elements. For example, when planning the social services, a minimum attention is given to:
 - Analysis and forecasting of the changes concerning the structure of the population,
 - Analysis of the facilities available in the field of social services in a given region and the justification for the variances found from the national or regional average or from the facilities available in the neighbouring regions,
 - Interconnection of social services with related or follow-up areas, in particular the medical care, education, housing and transport services.
4. With regard to the effectiveness of the system for funding social services, maybe the most significant flaw in the whole system of social services can be seen in the absence of interconnectivity between the two crucial activities – on one side, it is the award of care allowance and on the other side, it is the provisions of social services as such. The reason for this is the fact that the payment of care allowance is not conditioned by the necessity to receive the care from the registered provider of social services, or a listed relative who provides the care, or by other relatives. The result of this is that e.g. in December 2009, the total of 70% of the recipients of care allowance received did not receive any service from the registered provider³, which, as a consequence, causes economic problems to social services providers and increases the pressure to provide subsidies from the state budget.

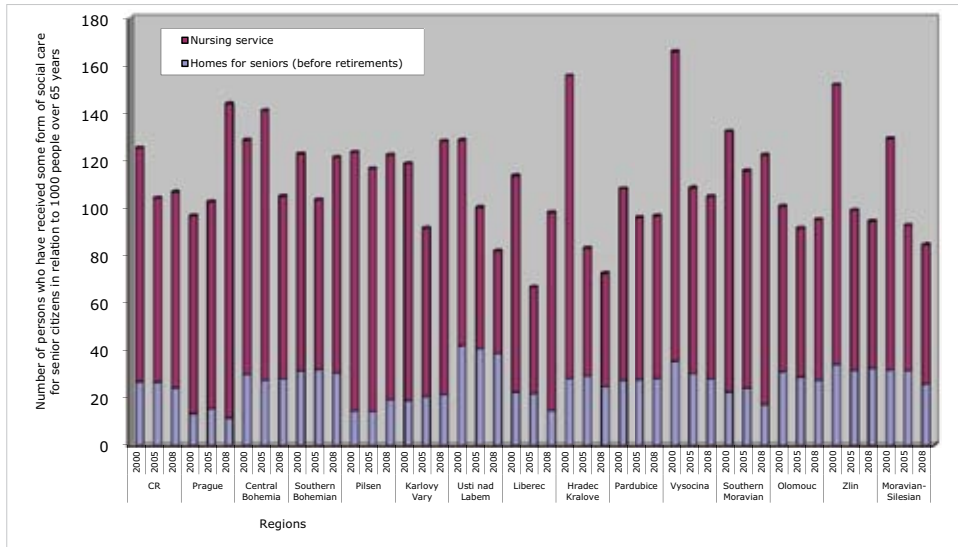
However, many issues result from the fact that the role of the Ministry of Labour and Social Affairs is not fulfilled within the system as a whole. Under Act 108/2006 Coll., on Social Services, as amended, the Ministry of Labour and Social Affairs, is supposed to prepare the medium-term national development plan of social services with the participation of regions, representatives of the social services providers and representatives of persons, to whom the services are provided. This plan has not been approved yet, and there are more versions of the plan, which naturally in return does not contribute to a positive environment for the development of social services in individual regions.

2 Please refer to PRŮŠA, L. *Zamyšlení nad dosavadními výsledky dotačního řízení v oblasti poskytování sociálních služeb. Rezidenční péče č. 1/2007.*

3 In more detail please see: MERTL, J. *Přístupy k hodnocení efektivnosti sociálních služeb v národním hospodářství, 2007.*

Among others, the result of this is that fact that there are still, in the long run, unjustified differences regarding the facilities available for social services in individual regions⁴ (The selected characteristics are given in diagram 2). It cannot also be neglected that there is no development in the desirable field and ambulatory forms of care, mostly for seniors, which is, with a view to foreseen demographics trends, a very alarming fact.

Figure 2: The development facilities of regional social care services for seniors in the years 2000 - 2008 in relation to 1000 people over 65 years



Source: Průša, L. a kol. (2009) *Poskytování sociálních služeb pro seniory a osoby se zdravotním postižením*.

However, the issues, which have been identified regarding the “interconnectivity” of the roles of public administration and self-government at municipalities with extended powers and regions in their delegated competencies in the area of social services, also concern the area of social care allowances. The social care allowances granted on the grounds of assistance in material need are paid by the commissioned municipal authorities, and social care allowances granted on the grounds of disability are paid by the municipalities with extended powers. Both authorities have no interest in the effective provision of these allowances, all expenditures are reimbursed to these authorities from the state budget. The municipalities are neither motivated to save funds for these expenditures nor to chose alternative ways of assistance (The provisions of service is often much more effective, because by this the reasons why a difficult social situation arose can be addressed, while by providing the allowance only consequences can be addressed). As a result of this, social allowances are often abused, as the social workers are practically in many municipalities understaffed, which as a consequence leads to the underestimation of the importance of social work when addressing difficult social situations of the applicants for social allowances.

4 PRŮŠA, L. a kol. *Poskytování sociálních služeb pro seniory a osoby se zdravotním postižením*. Praha: VÚPSV, 2009.

2 Possible Solutions to Existing Problems

When drafting the proposal for action aiming at the elimination of the existing problems we must come out from assumptions that social services shall be seen as an economic category, and therefore set such system for its funding, which would lay down basic pre-conditions for its effective provision.

It is clear that when evaluating the effectiveness of the system of funding and provision of social services, other perspectives must be taken into account concerning the evaluation of effectiveness of social care services, and views regarding social prevention and consulting services. At the same time, we should remember that other aspects regarding the evaluation of the effectiveness of the system of funding and provision of social services are applied by the state, other by regions, towns and municipalities as founders of the vast majority of individual facilities, other by non-government non-profit organisations, and other aspects are applied by the clients as user of individual social services⁵. These facts must be reflected in the different arrangement of each type of social services.

We should pay attention to the concept of effectiveness in economic theory. We must realize that "effectiveness means an absence of wasting the economic resources in order to satisfy needs and desires of the people"⁶, and "such use of economic resource, which would bring the maximum satisfaction achievable given the inputs and technologies"⁷. In this sense, we cannot forget that "an effective market is such where participants can quickly absorb all new information and immediately include them in the market prices"⁸.

From the regional point of view, an important aspect limiting its capacity to influence the effectiveness of the entire system of the provision of social services is the fact that the state (the Ministry) sets by legal regulation (by a decree in this case) the maximum fee for accommodation and board in residential and ambulatory facilities and the level of fee for individual actions of field and outpatient services. In situation when:

- social services are provided by organisations established mostly by self-governing authorities of regions, towns and municipalities and non-governmental non-profit organisations,
- social services are provided under the contract made between the providers and the users,
- level of fee by the client for some actions mostly in the area of field and outpatient services does not reflect the amount of the costs incurred,

5 *In more detail please see: MERTL, J. Přístupy k hodnocení efektivnosti sociálních služeb v národním hospodářství, 2007.*

6 SAMUELSON, P.A., NORDHAUS, W. D., *Ekonomie, 1991, p. 27.*

7 SAMUELSON, P.A., NORDHAUS, W. D., *Ekonomie, 1991, p. 968.*

8 SAMUELSON, P.A., NORDHAUS, W. D., *Ekonomie, 1991, p. 252.*

this is basically only other protective instrument of the client used by the state, while it should be noted that for this purpose, the state has other instruments prescribed by law (Registration of the social services providers, social services quality standards, inspections of social services, an obligation of lifelong education for social workers). The level of these fees is set in such an amount that it ex ante assumes the participation of other entities on funding the social services through subsidies. However, there is no legal entitlement for subsidy according to the budget rules, which puts limitations on development programs of individual social services providers and as a result leads to stagnation of the whole system.

In this sense, the analysis of effectiveness undertaken in the past concerning the individual elements of the system of provision of social services recommended to implement the following actions⁹:

- To change the system for the payment of care allowance so that the recipients in the I. and the II. grade of dependency shall receive the payment (namely in filed and stationary facilities) in the form of vouchers (The citizen shall be awarded care allowance in the form of the allowance in kind – vouchers for services and registered providers, whose services were chosen by the citizen, would be reimbursed by the municipality with extended powers), or to implement a combined method of payment of the allowance where its major portion (Approx. 2/3 – 3/4) would be paid in the form of vouchers and the rest in cash,
- To modify the system for the payment of care allowance in residential facilities so that, according to the law, the provider of the services would be the recipient of care allowance,
- To simplify the administration procedure (Respectively, to implement special regulation of some provisions) so that, in order to improve the effectiveness of the care provided, the period from the moment when an application for care allowance is filed until it is disbursed should be reduced,
- To establish a register of persons – family members who provide care for their close relatives in their households (Among other, because the duration of this care is an alternative time period for the purposes of pension insurance.) and to apply more strict inspections concerning the care provided in this way,
- To revise the level of dependency of persons who received the entitlement for care allowance by reversing the increase of infirmity pension and care allowance received when looking after the close relative.

At the same time, it was noted that effectiveness of the system suffers from the fact that:

- the members of the resistance who are provided, according to the relevant laws, social services for free, can be the recipients of care allowance, which means there is duplicate fulfilment of their claims, an abuse of the allowance respectively,
- the current wording of the Act allows the user of each types services to be ex offa provided even the services, which they do not request.

⁹ PRŮŠA, L. *Efektivnost financování sociálních služeb v domovech pro seniory*, 2008.

The dependency on the provisions of the subsidy prevents the independent development of social services. Therefore, all actions proposed must be seen in the removal of the dependency of social services providers (particularly of the social services for senior citizens and people with disabilities) to be awarded the subsidy from the state budget or from the budget of the founder. Thus, in addition to the above mentioned proposal concerning the modifications of care allowance, the following solutions can be particularly taken into account:

- The lifting of maximum fee for accommodation and subsistence in residential and outpatient facilities and for individual actions in the area of field social services,
- The strict application of maintenance obligation of children towards their parents so that the users of services – mostly in nursing homes – pay for the services provided together with the granted care allowance and the payment for nursing and rehabilitation care from resources of health insurance companies the real amount of costs on operation of a given facility (including the reasonable profit),
- The provisions of material assistance in the form of a loan as part of the system of assistance in material need to those users of social services who live alone and whose children do not have enough funds to pay for the costs of the social services needed (After the death of service user the commissioned municipal authority acting in its delegated competence shall become the party to the inheritance proceedings and if the above mentioned facts were established, the loan would be, from the accounting point of view, be “transferred to an allowance”, in other case the loan would have to be paid up by the heirs, up to the amount of the funds available),
- The strict creation of the “mirror” in the rules for the provision of social services in health care facilities and nursing and rehabilitation care in residential facilities of social services (obligatory registration of health care facilities for the provision of social services and defining quality standards for their provision, the payment of care allowance to clients who have to stay in the registered health care facility for extended periods of time.

If all of the above mentioned actions were taken, it would undoubtedly establish an environment for the development of all types of social care services and for wider involvement of new entities (including the foreign ones) into the system of provision of these social services. There would be a liberalisation of the entire system of social care services, by awarding care allowance and conditioning of its payment by the provision of social service (at least its major part) from the registered provider, there would be a demand for services, which would, according to the market principles, create supply of new social services, and the services would be differentiated (For instance, in the area of residential services, from poorhouses to modern “single bed hotels” with comprehensive services when complying with the legally prescribed newly defined minimum standards).

This differentiation will require a provision of wider range of information on services provided in the territory of individual regions to users, in accordance with modern European trends and therefore new job role shall be established at social service departments with the commissioned municipal authorities, or municipalities with extended powers – care manager – which shall provide the recipients of care allowance with more comprehensive information concerning the offering of social services in the given region, taking in

account the social impact resulting from the adverse health condition or the age of users and their financial means.

The interconnection of the system to the area of planning, registration and financing of social services would also contribute to the development of social services and strengthening of roles of municipalities in their provision (not only in the area of social care services for senior citizens and people with disabilities, but mostly in the area of provision and financing of social prevention services and consulting. Possible action can be seen in the system of planning of social services, in which the municipalities with extended competence shall be included. As part of the social demographic analysis undertaken in the given territory there should be a detailed mapping of the need for provision of individual social services, including the detailed study of the envisaged development of demographic structure of such age groups of the population, which are most concerned by the individual social services. These needs should be, during the preparation of the medium-term plan of development of social services, confronted with opinions of providers and users (eventually with potential users) of individual social services and then the priorities of the social services development should be set, not only in the medium-term, but also in the long run (that for the next 15 years), which should be further broken down in more detail into individual implementation steps and phases.

These steps and phase should be followed by the reassurance of the providers (even potential providers) during their registration process. When financial balance sheet of the services provided is submitted as part of this process, which should clearly show the exact structure of its financing (i.e. , how many funds the service provider expects to receive in the coming term from towns or regions, but also from the Ministry of Labour and Social Affairs as part of the subsidy proceedings), the completion of registration process should also mean that this financial balance sheet is binding and that the funds, which are claimed by the social service provider from the founder or the state are guaranteed by the registering entity to the service provider. If:

- subsidies for social services are to be distributed by regions since 2012,
- registration of organisations established by municipalities and non-governmental non-profit organisations is done by regions, and
- registration of organisations established by regions is done by the Ministry of Labour and Social Affairs,

there would be an interconnection of the system of planning and financing of social services, which shall also contribute to the considerable improvement of the transparency of subsidy process, reassurance of social services providers (From more long-term perspective of financing the social services provided) and improvement in the effectiveness of the funds incurred.

In addition to the above mentioned measure, which directly concerns the area of social services, we must pay attention to many other actions that would be necessary to take in the relating or conditioning areas. In this sense, it is of utmost importance that:

- the individual towns and municipalities shall seek to pay attention, as part of their housing policy, to the development of small area and barrier-free flats, in which the senior citizens and people with disabilities would be effectively provided field social services so that the need for the provision of care in the residential facility would be postponed,
- when setting the amount of rental in municipal flats, the individual towns and municipalities, in particular taking into account the income standing of and the property owned by senior citizens and people with disabilities, should determine in a way to set basic preconditions for the provision of needed field services in their households environments and that there would not be early pressure on the provision of services in residential facilities of social services,
- the building authorities, as part of the approval proceedings shall strictly pay attention that the obligation of having barrier-free access points in all stores, cultural facilities and other buildings providing public services be observed,
- individual regions and commissioned municipalities continually map the transport services in their catchment area so that the senior citizens and people with disabilities, who predominantly rely on the public transport would not be jeopardized by social exclusions (in its most broad sense) as a result of the insufficient quality of such transport.

The implementation of all of the above mentioned measures in its complexity shall contribute to the much needed development of social services and to the removal of all current issues in the area of public administration.

Conclusions

The systems of social services currently face, from the organisation arrangement point of view, many problems, which significantly reduce their effectiveness. The joint model of public administration, which was pushed through as part of the reforms of the public administration with noticeable success at the level of commissioned municipalities, municipalities with extended powers and regions for the provision of social services and social care allowances allow for conflicts between self-governing roles of these authorities and roles, which they perform for the state as part of their delegated competencies. In order to remove these conflicts, it is necessary to implement a whole set of measures, which will also contribute to a significant increase in effectiveness of both systems.

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Prospects of Adopting the Euro in the Czech Republic

Perspektivy přijetí eura v České republice

PETR GOČEV

Abstract

The article explores prospects of adopting the euro in the Czech Republic. Interests and arguments of important stakeholders are discussed, concluding that reasons for diverging attitudes result from conflicting particular economic interests and political preferences on the future course of European integration. Special attention is given to inflationary and distributional consequences of adopting the euro while the Czech Koruna is still appreciating. The article explains why the Czech Republic ceased aiming at the Euro area accession and concludes that the process of the euro adoption may be eventually launched only if political power shifts to eurooptimistic political parties.

Keywords

European Monetary Union, euro, inflation, monetary policy, exchange rate

JEL Classification E52, F33

Abstrakt

Článek se zabývá sporem o zavedení eura v České republice. Diskutovány jsou zájmy a argumenty významných aktérů tohoto sporu, se závěrem, že rozcházející se názory pramení z rozdílných partikulárních ekonomických zájmů a politických preferencí ohledně budoucího kurzu evropské integrace. Zvláštní pozornost je věnována inflačním a distribučním důsledkům přijetí eura v době, kdy má česká koruna stále ještě prostor k apreciaci. Článek se zabývá důvody, proč Česká republika přestala usilovat o začlenění do eurozóny, a uzavírá, že proces eventuálního přijetí eura může být spuštěn v případě posunu těžiště politické moci ve prospěch eurooptimistické politické strany.

Klíčová slova

Evropská měnová unie, euro, inflace, monetární politika, směnný kurz

Introduction

In November 2010, Czech President Václav Klaus expressed his wish that the cabinet should negotiate an opt-out from the obligation to eventually adopt the euro¹. This article traces the history of euro-critical agenda of Václav Klaus and Civic Democratic Party and shows that the

1 <http://www.eubusiness.com/news-eu/czech-economy.781>

euro area accession is perceived by all relevant stakeholders as a decision based on political rather than economic considerations. It is practically impossible to evaluate such issue ripe with trade-offs on economic grounds in a universally acceptable manner. Economic arguments are used in the context of the debate rather as useful rhetorical devices supporting positions motivated by politics. It follows that the eventual adoption of the euro in the Czech Republic is ruled out as long as eurosceptic Civic Democrats remain in power.

The article first traces the development of the official stance of different stakeholders (sections 2 – 4): the government, Czech National Bank, major export business and European Commission. Sections 5 – 7 provide an overview of the conflicting economic arguments for and against the euro area accession, section 8 discusses the impact of the financial and economic crisis.

1 Development of the Government's and Czech National Bank's Official Stance

The Czech Republic was formally bound to eventually adopting the euro by the European Union (EU) accession agreements. The debate as to whether the euro should be introduced sooner rather than later has been going on ever since. During the time of the Social Democratic (ČSSD) government, the official stance was in favor of adopting the euro as soon as possible.² This was reflected in the Czech Republic's Euro-area Accession Strategy, a joint document by the Czech government and the Czech National Bank, approved in 2003. They recommended that the Czech Republic should join the Euro area "... as soon as economic conditions allow for doing so", which they expected to be around 2009–2010. This date was later postponed to 2012 because of general unwillingness to cut the budget deficit in line with the annual government deficit criterion before the elections in 2006.

The official attitude towards adopting the euro changed after a government, led by the eurosceptical Civic Democratic Party (ODS), was formed in 2007. An updated Euro-area Accession Strategy was approved by the new government on August 29., 2007 (Czech National Bank, 2007). In this document, the "as soon as" stipulation was dropped, and no target date was set. When Prime Minister Topolánek was asked whether he personally thought a euro adoption target date should be set, he replied through his spokeswoman: "No. No responsible government gives a date which it cannot influence. Setting a date would be a pure formality." (Petrus, 2007). The dropping of the "as soon as" stipulation is even more significant than the omission to set a prospective entry date. The updated strategy implies that the fulfillment of the Maastricht criteria is not a sufficient condition for a political decision to join the euro. It insists on removing all obstacles to adopting the euro by 2010 but refuses to set a date for actually joining the euro. ODS clearly prefers that the adoption of the euro be postponed ad infinitum, in line with its honorary chairman Václav Klaus' ongoing critique of European integration.³ The reason for continuing rhetorical insistence on the eventual adoption of the euro is twofold:

2 After 1989, Social Democrats used the rhetoric of "a return to Europe" as a legitimization device in an environment of widespread media-bashing of the Left.

3 Václav Klaus views the single currency as a predominantly political project with the objective of furthering political integration of Europe. See also Klaus 2008.

- lip service to the legal (albeit derogated) commitment to adopt the euro
- and utilization of the Maastricht criteria as an argumentation vehicle for furthering unpopular changes in economic policy.

To legitimize budgetary cuts in social spending, the Updated Accession Strategy goes far beyond the Maastricht criteria, as can be seen from the following paragraph:

“35. However, fulfillment of the Maastricht fiscal criteria should in no way be regarded as a sufficiently ambitious goal for the fiscal reforms in the medium term. The only sufficiently ambitious goal is to provably target the public finance deficit – at a rate of at least 0.5% of GDP a year – well below the value of the Maastricht convergence criterion towards fulfillment of the obligation arising under the revised Stability and Growth Pact. In the Czech Republic’s case, this means heading in the medium term towards a structural (cyclically adjusted) public budget deficit of no more than 1% of GDP. Only in this situation will it be possible to consider state fiscal policy as sufficiently able to effectively perform its macroeconomic stabilising role following the loss of independent monetary policy.” (Czech National Bank, 2007: 7)

Another agenda outside the scope of the Maastricht criteria is an insistence on the reduction of workers’ legal protection:

“38. Increasing the flexibility of the Czech economy remains another challenge for economic policy and for the future sustainability of the benefits of adopting the euro in the Czech Republic. [...] In addition to the insufficient stabilising role of public finances, the Czech economy’s main problem in this area is its still limited ability to adjust flexibly in the labour market. [...]

“39. As in numerous Eurozone countries, the Czech labour market suffers from insufficient flexibility, reflecting strict employment protection regulations, a rising minimum wage [currently 8000 CZK, PG] and high labour taxation. Its insufficiently aligned tax and benefit system creates a demotivating environment, especially for the long-term unemployed in low-income families with children. A high ratio of social benefits to incomes in low-income households is also having a negative impact on the stabilising ability of fiscal policy. Enhancing the flexibility of the labour market by increasing the mobility of the Czech labour force also remains a challenge.” (Czech National Bank, 2007: 8)

The willingness of the Czech National Bank to bend its approach regarding the euro in whatever direction is required by the government shows that the decision to join the Euro area is generally regarded as properly political decision (unlike setting interest rates).

2 Business Demands

The demand for a quick adoption of the euro can be heard from companies in the Czech Republic which trade with the EU, but until recently, this was not an important issue. In 2003 Vratislav Kulhánek (head of the managing board of Škoda Auto) argued that, from the perspective of his company, the Euro area accession was an issue of marginal importance since they can hedge against the exchange rate risk and the majority of their busi-

ness transactions are done in euros anyway.⁴ Spikes in the exchange rate appreciation of CZK propelled some corporate demand for adopting the euro, however this was countered with an argument that adopting the euro, albeit ruling out the nominal appreciation, would produce the same reduction of profit margins via correspondingly higher inflation rate in the Czech Republic (Tůma, 2007). However, Tůma's argument hinges on an implicit assumption that the higher inflation would not result in reduction (or deceleration) of real wages, while employers may be hoping to utilize an increased inflation rate as a (at least short-term) buffer against the real wage appreciation (see ČSÚ, 2008).

3 Changed Position of the European Commission

Even the European authorities seem to be reluctant to invite new members to the Euro area, as was indicated by the refusal to accept Lithuania's accession that was planned for January 1, 2007. The official reason for this refusal was the fact that Lithuania failed to meet the price stability criterion by a meager 0.1 %. This selective stringency contrasts to the benevolent approach of the European Commission in response to extensive violations of the Maastricht criteria by countries such as Germany and France. It would be hard to punish new Euro area members for failing to meet the Maastricht criteria in the future, whilst at the same time exculpating old members. This development could be seen to be a sign that the original *Stability and Growth Pact* de facto passed out.

4 Debate among Economists

Economists in the Czech Republic are divided on their opinion as to whether the euro should be adopted sooner (Dědek, 2003) or later (Janáčková, 2002; Janáček; Janáčková, 2004) (or never), leaning towards a later adoption. Economists associated with commercial banks tend to support postponement. Commercial banks would lose out from joining the euro as their profit from exchange operations would be substantially reduced, whilst competitive pressure would increase. Economists at the Czech National Bank are divided into two groups. Both groups use the same arguments for and against quick or postponed euro adoption, but ascribe them different importance to reach opposite conclusions. That may be seen as a reason why the Czech National Bank did not produce an official cost/benefit analysis for adopting the euro, unlike the Slovak National Bank (2006) which supported a quick Euro area accession. An assessment of the preparedness of the Czech Republic towards adopting the euro is provided in Helísek 2009, which concludes that the reasons for postponing the adoption are political rather than economic.

5 Arguments in Support of the Euro Adoption

Frequently used arguments in favor of euro adoption are as follows:

- *Elimination of exchange rate risk with Euro area countries.* This is an issue especially for smaller companies, as the costs of hedging, using financial derivatives, are prohibitive for relatively small transactions. Therefore, both small and medium-sized companies

⁴ The interview is available at http://www.bbc.co.uk/czech/indepth/story/2003/10/031008_kulhanek.shtml.

usually “hedge” against the exchange rate risk by requiring higher margins in the case of crossborder operations. It can be justly argued that the adoption of the euro would produce an increase of trade and specialization within Euro area countries by eliminating both this excess risk margin and costs of hedging, however the extent of such an increase is far from clear (see below).

- *Reduction of transaction costs.* Both households and firms would reduce their costs associated with exchange transactions. In addition, companies would reduce costs related to multiple currency accounting and costs associated with the need to hold liquidity reserves in different currencies.
- *Increased price transparency.* Increased price transparency may increase allocation efficiency.

According to some older studies, an increase in trade caused by a currency union is insignificant (Brada; Mendez, 1988). Therefore, considerable attention was given to a historical analysis by Andrew Rose (2000), who came to the conclusion that establishing a monetary union would cause an increase in trade of 60 to 200 %. Against an attempt to employ this result in advocating the European Monetary Union (EMU), it was argued that the majority of samples in Rose’s statistical model were monetary unions between a colony and its former colonial power. Rose himself later modified his model and yielded a moderated result of trade increases in a range of tens of percents. An analysis from 2003, measuring the trade increase attributable to the EMU, reached even lower values between 2.3 and 6.3 %. (Vicerelli; de Nardis, 2003)

It should be noted that a possible monetary crisis does not play any substantial role in the arguments of supporters of a quick euro adoption. However, supporters of a postponed adoption have been accused of ignoring the globalization risks, and neglecting the impossibility of maintaining independent monetary policy, fixed exchange rate and liberalized capital flows all at the same time.

6 Arguments for the Postponement of Euro Adoption

6.1 Implications of the Lack of Independent Monetary Policy

Although the monetary policy of the Czech National Bank is practically limited to setting the key interest rates for the Czech Koruna, the loss of this power may have serious consequences. The inability to maintain different nominal interest rates in different EU countries will cause problems as long as these countries are experiencing different phases of the business cycle and/or different rates of inflation. In 2002, there was a higher rate of inflation in Spain than in Germany. Spain needed to reduce its rate of inflation by restricting the money supply (by setting a higher interest rate), while Germany needed to increase the money supply (by setting a lower interest rate). But the effect of a constant nominal “one size fits all” ECB interest rate is always exactly the opposite: the real interest rate in Spain was 0.15 %, while in Germany it was 2.15 %. The only solution to this problem would be an alignment of the business cycles and a substantial reduction of inflation rate differentials within the Euro area countries. But in a monetary union this is only possible after price level gaps have been substantially reduced, which in turn requires a higher level of real convergence among EU countries to be achieved.

6.2 Effects of Adopting the Euro on the Official and Perceived Rate of Inflation

It is a generally accepted fact that the introduction of the euro will cause an “inflationary jump” as a consequence of price rounding-up and the transfer of transition costs⁵ to customers. According to the European Central Bank, this inflationary jump was quite negligible in individual countries, in ranging between 0.12 to 0.29 %. This finding is a sharp contrast to the substantial increase of perceived inflation (see Table 1).

Table 1: Mean difference between standardized perceived and actual inflation and perceived inflation before and after the euro changeover

	Perceived-actual inflation		Perceived inflation	
	pre	post	pre	post
Austria	-0.15	0.85	-5.77	33.11
Belgium	-0.09	0.62	22.42	40.94
Denmark	0.31	-0.02	-19.63	-16.28
Finland	-0.09	1.12	-14.40	-2.17
France	-0.09	0.67	-0.38	43.61
Germany	-0.31	1.23	19.63	63.83
Greece	-0.43	0.89	23.70	43.94
Ireland	0.27	0.32	28.35	55.33
Italy	0.11	0.36	17.40	48.06
Luxembourg	.	-0.56	.	35.11
Netherlands	-0.29	1.18	23.07	74.44
Portugal	0.15	0.50	23.38	46.44
Spain	0.04	0.40	13.00	49.39
Sweden	-0.16	0.75	-28.05	-15.33
United Kingdom	0.41	-1.44	2.65	-8.44

Source: Mastrobuoni (2004), p. 30.

Various hypotheses explaining the wide discrepancy between the official inflation rate as measured by the Eurostat methodology and the inflation rate perceived by the public have been suggested. Leaving aside the possibility that the ECB is intentionally playing with the CPI weights to artificially undervalue the inflation rate (see Kohout, 2007; ČSÚ, 2007), some authors argue that the higher rates of perceived inflation should be attributed to an inflationary illusion or even an “inflationary masochism”: Wolfgang Brachinger (2005) argued that the higher rate of perceived inflation is caused by the fact that the inflation rate was relatively higher for goods and services purchased with a relatively high frequency. This is an explanation of how inflationary illusion may occur. Price increases for goods and services purchased with relatively high frequency have higher subjective weight in the formation of inflationary perceptions, while their effect on real income is in line with the official rate of Consumer Price Index change.

While the psychological effects partially explain the discrepancy between the official and the perceived rate of inflation, I believe it is vital to focus on the “real” effects hypotheses:

⁵ Staff training, accounting software upgrades, dual pricing, dual cash reserves and so on.

the official rate of inflation measures the rate of inflation for an average household. However, adopting the euro caused higher price increases for goods and services which are, to a greater extent, to be found in the consumption baskets of households with lower than average income. And, because at least 2/3 of households have a lower than average income, it follows that the inflation rate for a median income household (measured by the perceived inflation surveys) is higher than the official rate of inflation for an average income household (measured by Eurostat).

As early as 1958, Kenneth Arrow noted that, "there should be a separate cost-of-living index number for each income level," (Arrow, 1958) because lower income households are likely to have consumption patterns that differ from those of higher income households.

The United States Congress discussed a proposal to construct a special CPI for the elderly, for the purpose of adjusting Social Security benefits. Several research projects (Garner; Johnson; Kokoski, 1996; Hobijn; Lagakos, 2005) were undertaken, leading to a conclusion that, although there were differences between inflation rates for different types of households, these differences were not substantial and/or persisting. Therefore, these papers concluded, it is possible to continue using the Consumer Price Index for All Urban Consumers as a proxy for inflation rate for all types of households.

In the Czech Republic, the situation is different than in the United States. Here, the CPI rates of change are consistently higher for poorer households and households of the elderly. This is a consequence of relatively higher inflation rates for categories like apartment rental, public transport, energy, health care and so on, which were heavily subsidized during the previous regime and since then have experienced a continuing process of "price narrowing". Needless to say, these groups of services have a lion's share in the consumption baskets of the poorer households. It follows that inflation results in a deterioration of the poorer and elderly households' real income as long as the average inflation rate is used for valorization purposes, making these types of households especially sensitive to the euro accession inflationary jump.

In the specific situation of the Czech Republic, the "inflationary jump" will be accentuated due to the fact that the current price level in the Czech Republic is slightly over 60 % of the euro area average. Convergence of the Czech Republic price level to the average price level in the EU is currently mediated through the ongoing appreciation of the Czech Koruna to the euro. The Czech National Bank's aim to keep the rate of this appreciation at approximately 3% p. a. was dwarfed by rates of appreciation exceeding 10% yoy. In the case of an immediate adoption of the euro, the appreciation channel would be ruled out and the whole rate of appreciation would transform into an increase in the rate of inflation. However, the potential for such an extensive inflationary jump is decreasing by the progress of the real convergence, as the ongoing appreciation of the Czech Koruna is exhausting the scope for future appreciation.

7 Impact of the Financial and Economic Crisis of 2007

Another reason for postponed Euro area expansion on part of both the ECB and prospective Euro area admitees is the unfolding financial and economic crisis. It should be remembered that the mood of financial markets shifts often. While currently the doom

and gloom is raised concerning the future prospects of the euro with respect to possible sovereign debt crisis in Greece, Ireland, Spain, Italy, Belgium or Portugal, the EUR/USD exchange rate is not much different than it was before the financial crisis unfolded.

And again the principal matter of costs and benefits of a monetary union in the light of financial and economic crisis is a subject of debate and ideologically motivated interpretation. While euro may be more stable against speculative attacks than local currencies, the ability to better synchronize the exchange rate with local economic conditions may be valuable in turbulent and uncertain times. However, given that especially private debt of many highly indebted countries is denominated in foreign currency without an exchange rate risk hedge, devaluation of the local currency constitutes a rather costly option. The ability to increase the money supply to prevent the default of a debt denominated in local currency is even less important, as the possibility of inflationary alternative to the default should be perceived by the financial markets as an equal risk. While the current experience of highly indebted European countries fails to provide a clear-cut case against the eventual euro adoption, it certainly warrants caution.

Conclusions

Accession to the Euro area in any foreseeable future is unlikely, as currently there is no sufficiently influential interest group willing to push for quick adoption of the euro in the Czech Republic. While exporters may have reasons to prefer the inflationary scenario (adopting euro soon) over the appreciation scenario (adopting euro later) only when it results in deceleration of real wages, for the same reason politicians together with voters and labour unions tend to prefer the opposite.

Lacking political backing and decisive economic arguments, adoption of the euro in the Czech Republic is ruled out unless political power shifts. While other reasons for maintaining an independent monetary policy may continue to weight against advantages of adopting the euro, their performative importance pales in comparison with that of the future ruling party's political preference on the course of the European integration, these being determined ideologically.

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Career in Business

Kariéra v podnikání

JAROSLAV A. JIRÁSEK

This small country, the Czech Republic, sustains more than seventy universities. That is more than in any commensurate other nation-state in Europe. Questions are asked not as much about abundance, but about the capacity to promote the scientific and pedagogical prominence of research, teaching programs and adjacent agenda.

The University of Finance and Administration, one of the largest private school, with more than five thousand students, has recently been able to conquer one of the leading size in advanced education, however it continues to be much-sought-for by business prone youth in the Czech Lands and also in the neighboring countries (in particular in Russia, Slovakia, Kazakhstan).

Young people have different attitudes before the beginning of their working life. Profession, trade, public service, and teaching provide an opportunity for job satisfaction. At first, young people consider making money, founding a family, using their leisure time. But many of them, and some, already in their teens, look for a career in business.

Years ago, when reflecting the credit of a career, Thomas J. Watson, Jr., the famous head of the International Business Machines Corporation – an affiliation of which survived the protracted Socialist stage in the country, one of 18 foreign firms altogether – composed the following deliberate judgment: “A career is much more than a means of making a living. It becomes a part of us as the years go by. It determines how we spend much of our time. It regulates how we think of ourselves. It affects what other people think of us. Our life must have a personal meaning, and it must make contribution to the world we live in.”

Business contributed to enhancement many of former human needs and wants. In the 20th century, it helped to reduce hard labor, enabled us to move and travel, made room for relaxing and studies, by the end of the century, it introduced an extended data processing and an omnipresent communication networks. As years are passing, the permanent refinement of life is being accelerated.

Economics is the proper field of activities for graduates from finance oriented schools, however, the novel economic and business trends are interwoven with major changes in hard science and engineering. An educated economist should take pride in being active in what is happening in the world. The newest endeavors, discoveries and inventions predict the future reality of society.

By the beginning of the past century, the leading industry was the automotive branch. At almost the same time, it was also the industrial chemistry, fully unfolded during the world wars, when massive crude oil reserves were exploited. Gradually, the large aeronautic industry matured. In the thirties, services began to be obvious, they gradually took the lead and now they make – in the developed countries – up to 80 % of the GDP.

After WWII the world business was almost completely revolved. New sciences appeared, such as cybernetics, theory of systems, electronics, nuclear energy, aerospace, communication and transportation, also automation and robotics, econometrics, electronic microscopy, operations research, strategy, corporate organization. In the fifties, the transistorized computer appeared and soon won a respected role in business. The last decade was dominated by the internet and mobile phone. Really striking is the rapid advancement of biology and medical science. A constant growth over the century was attributed to military armament, machine tools and pharmaceuticals.

Science has expanded its field: with the 21st century it enters nanogauges, that is measurable elements of 1·10⁻⁹m; on the other side billions of light-years, or measures of ultimate space.

A new challenge came in sight: many scientific achievements tend to integrate and create more powerful comprehensive scientific and engineering clusters built in a global territory. For instance, biology undertakes a jump ahead using the support of robotics in surgery or magnetic resonance combined with computer analysis in physical examination.

Most prominent breakthroughs in science and engineering will be attained through a close international cooperation. A persuasive example could be the cooperation of four hundred scientists of the Mayo Clinic in Rochester (Minnesota) and Masaryk University in Brno concerning heart and vascular disorders.

Another perspicuous trend in hard science and engineering is digitality. Many material processes are reformulated to digital models and resolved with a discrepant flexibility. A good example could be the “digital factory” Tritón, LL, in Pardubice, constructed recently with the assistance of European Union’s financial contribution. The firm manufacturing various finished products from sheet aluminum is fully automated from metal selection to final control before expedition. The firm is now one of the five leading in the world.

The “economic speed” for product development and initial marketing has been cut short. Instead of eight to ten years, the average time is now reduced up to six years. The “fast response” to unexpected innovations is still shorter. An educated manager should cover his competitors. Many corporations joined the “competitors (or competitive) intelligence” club (with some five thousand members).

Achievements in science and engineering are translated through business into a higher life-standard. While improvements are impressive, still much more is to be done. There are rich opportunities ahead. Most of them depend on education and knowledge.

President Hoover, once asked about the kind of business in America, responded simply that "American business is business". The Czech society is plunging into business more and more. That increases the responsibility of business studies. Students – and then practitioners - in business are citizens inherently needed for the general advancement of the country.

Business fortifies features of an integrated personality, such as vision (the French number one piecemeal rule in business management is "diriger c'est prévoir" (to manage requires to anticipate), evaluation of for and against, risk taking, interrelation of problem solving and the situational circumstances, reliability of word and action, reputable personality.

There will be a permanent need for trained people with university background, no doubt about that. However, the incessantly growing mutuality between business and science or engineering provokes a shift toward better understanding of the scientific agenda. Timely information, critical evaluation, collaboration with trained experts begins to be a must in any ambitious business.

Business has to keep pace with the general development of the social order. The business of an economic university is knowledge, its creation, permanent cultivation and transmission. Some universities already initiated new approaches to research and teaching.

In a concise enumeration, it consists of concentration of subjects (shortened by one third to one half) in order to acquire skills of thinking in context and connections, mix of oral teaching and IT (one third at least), elaboration and defense of theses or projects.

A priceless source of knowledge will always be reading ideas and memories of successful personalities in business. Modern business people look at business endeavor as a means to develop talents, efficiency and responsibility, as an end to achieve better, fuller life for themselves, for people they work with and for the society.

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PREVIEW /PŘIPRAVUJEME:



Next issue of the scientific reviewed journal ACTA VŠFS will include besides the other papers in theoretical economics the article about redistribution systems and contextual games (authors: **R. Valenčík, P. Budinský**). The article about Impact of Financial Crisis on the Changeover in the Czech Republic (author: **M. Helísek**) will be concerned with the current problems of the Czech economy. Issue of business is devoted the article about Usability Bankruptcy Models on Agricultural Companies (author: **J. Sušícký**). There will be information about conferences on University of Finance and Administration in section **Scientific reports**.

Následující číslo vědeckého recenzovaného časopisu ACTA VŠFS bude obsahovat mimo jiné stati z oblasti teoretické ekonomie **R. Valenčíka a P. Budinského** o redistribučních systémech a kontextuálních hrách. Aktuálním problémům české ekonomky se věnuje stať **M. Helíska** o dopadech finanční krize na zavedení eura v České republice. Podnikové problematice je věnována stať **J. Sušíckého** o použitelnosti bankrotních modelů na zemědělské podniky. V rubrice **Vědecká sdělení** přineseme informace o mezinárodních vědeckých konferencích, které nedávno proběhly na Vysoké škole finanční a správní.

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The length of manuscripts, using the usual structure of research papers, is 15 – 20 PC pages (single spacing). Please submit the manuscripts in good English in electronic format together with a printed copy. Attached, submit the executive summary – abstract (150 words max.) and keywords (6 – 8), both also in Czech.

Please number your notes as you go along. Add a bibliography in alphabetical order, including page numbers when citing magazines or a journal. Inside the text, please use e.g. Afonso (2001), and when citing include the page number. Use the compatible forms for tables and figures. Highlight where pictures, graphs and tables will be placed in the text. Write your contact address: full name and titles, name and address of your work, telephone number and email, including the same for all co-authors.

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The first part of the document discusses the importance of maintaining accurate records of all transactions. It emphasizes that every receipt, invoice, and bill should be properly filed and indexed for easy retrieval. This not only helps in tracking expenses but also ensures compliance with tax regulations.

In the second section, the author provides a detailed breakdown of the company's financial performance over the past year. This includes a comparison of actual results against budgeted figures, highlighting areas of both success and concern. The analysis covers revenue growth, cost management, and overall profitability.

The third section outlines the strategic initiatives planned for the upcoming year. These include expanding into new markets, investing in research and development, and strengthening the company's operational efficiency. The author also discusses the potential risks associated with these initiatives and how they will be mitigated.

Finally, the document concludes with a summary of the key findings and recommendations. It stresses the need for continued vigilance in financial management and a commitment to long-term growth and sustainability. The author expresses confidence in the company's ability to overcome challenges and achieve its goals.