

TEN YEARS OF THE CNB RESEARCH:
JOURNAL ARTICLES OF THE CNB ECONOMISTS

2000-2009

Introductory word

It is 10 years since the Czech National Bank (CNB) established its Economic Research Department (ERD) to coordinate economic research activities throughout the CNB. During those 10 years the ERD – later extended to become the Economic Research and Financial Stability Department (ERFSD) – has had the honour of working with many distinguished researchers affiliated with the CNB and other domestic and international academic institutions and central banks. To commemorate its 10th anniversary, the ERFSD has prepared an electronic publication containing the titles and abstracts of 265 journal articles published by the CNB's economists during this decade. These articles are representative of the research projects conducted under the CNB umbrella and are mostly follow-up papers to CNB Working Papers or CNB Research and Policy Notes. As such, this publication should serve as a useful source of reference for readers interested in the CNB's research.

Antal, Juraj; Filáček, Jan; Frait, Jan; Horváth, Roman; Kotlán, Viktor; Skořepa, Michal (2009): "Monetary Policy Strategies before Euro Adoption: The Art of Chasing Many Rabbits." *AUCO Czech Economic Review*, vol. 3(2), pages 176–198.

This policy paper deals with the main strategic issues for monetary policy in new EU member states before their euro adoption. These are typically rooted in the challenge of fulfilling concurrently of the Maastricht inflation and exchange rate criteria. In this paper we first put forward that these criteria are vaguely defined and distinguish between the wording, written interpretation and 'revealed' interpretation (by the European authorities) of these criteria. Next, the paper contains the comprehensive discussion of the strategic options for monetary policy in the period of fulfilment of these criteria in terms of (i) its transparency, (ii) its continuity with the previous monetary policy regime, (iii) the choice of central parity for the ERM II, (iv) the setting of the fluctuation bandwidth, (v) the probability of fulfilment of both criteria and (vi) the impact on the autonomy of monetary policy.

Babecká-Kucharčuková, Oxana (2009): "Transmission of Exchange Rate Shocks into Domestic Inflation: The Case of the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 59(2), pages 137–152.

This paper aims at estimating the exchange rate pass-through (ERPT) for the Czech Republic. The existing empirical literature does not come to a consensus about the degree of pass-through to Czech inflation. Since there is no unique approach regarding how to measure ERPT, the author uses 11 specifications, including some along the distribution chain in the spirit of McCarthy (2007). She tries to explore the properties of exchange rate shock transmission by comparing impulse responses. In addition, she tries to account for possible variation in time. Finally, she explores how the pass-through differs between tradable (3 sub-groups) and non-tradable goods. She finds that the speed of exchange rate shock transmission to all prices is quite high. However, in absolute terms, ERPT does not exceed 25–30%.

Babecký, Jan; Coricelli, Fabrizio; Horváth, Roman (2009): "Assessing Inflation Persistence: Micro Evidence on an Inflation Targeting Economy." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 59(2), pages 102–127.

The paper provides an empirical analysis of inflation persistence in one of the inflation targeting countries, the Czech Republic, using 412 detailed product-level consumer price indexes underlying the consumer basket over the period from 1994:M1 to 2005:M12. Subject to various sensitivity tests, our results suggest that raw goods and non-durables, followed by services, display smaller inflation persistence than durables and processed goods. Inflation seems to be somewhat less persistent after the adoption of inflation targeting in 1998. There is also evidence for aggregation bias, that is, aggregate inflation is found to be more persistent than the underlying detailed components. Price dispersion, as a proxy for the degree of competition, is found to be negatively related to inflation persistence, suggesting that competition is not conducive to reducing persistence.

Borys Morgese, M.; Franta, M.; Horváth, R. (2009): "The Effects of Monetary Policy in the Czech Republic: An Empirical Study," *Empirica*, vol. 36(4), pages 419–443.

In this paper, we examine the effects of Czech monetary policy on the economy within the VAR, structural VAR, Bayesian VAR with sign restrictions, and factor-augmented VAR, frameworks. We document a well-functioning transmission mechanism similar to the euro area countries, especially in terms of persistence of monetary policy shocks. Subject to various sensitivity tests, we find that a contractionary monetary policy shock has a negative effect on the degree of economic activity and the price level, both with a peak response after one year or so. Regarding prices at the sectoral level, tradables adjust faster than non-tradables, which is in line with microeconomic evidence on price stickiness. There is no price puzzle, as our data come from a single monetary policy regime. There is a rationale in using the real-time output gap instead of current GDP growth, as using the former results in much more precise estimates. The results indicate a rather persistent appreciation of the domestic currency after a monetary tightening, with a gradual depreciation afterwards.

Brada, Josef; Tomšík, Vladimír (2009): "The Foreign Investment Financial Life Cycle." *Emerging Markets Finance and Trade*, vol. 45(3), pages 5–20.

The imputation of reinvested earnings from foreign direct investment (FDI) as a debit in the balance of payments exaggerates the current account deficit. This phenomenon is of major importance for transition economies because they received massive inflows of FDI in the late 1990s. We model the FDI financial life cycle to describe the evolution of profits, reinvested earnings, and repatriated dividends for an FDI project to show that this inflow of investment to transition economies has caused large distortions in their current account deficits. We verify the workings of the FDI financial life cycle and estimate its duration using a sample of eight transition economies.

Cincibuch, Martin; Holub, Tomáš; Hurník, Jaromír (2009): "Central Bank Losses and Economic Convergence." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 59(3), pages 190–215.

This paper discusses central bank losses and develops a formal framework for assessing the sustainability of its balance sheet. Analyzing the consequences of economic convergence in depth, it emphasizes the role played by the risk premium and equilibrium real exchange rate appreciation. A closed-form comparative-static analysis and also numerical solutions of the future evolution of the central bank's own capital are presented. Applying this framework to an example of a converging economy, namely the Czech Republic, the authors find that the Czech National Bank should be able to repay its accumulated loss in about 15 years without any transfer from public budgets.

Horváth, Roman (2009): "Editorial." *AUCO Czech Economic Review*, vol. 3(1), pages 5–6.

The editorial reviews the journal activities in 2008 and discusses the challenges ahead. Next, it introduces the current issue; it consists of a small special issue on public policies in Central Europe.

Horváth, Roman (2009): "The Determinants of the Interest Rate Margins of Czech Banks." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 59(2), pages 128–136.

We examine the determinants of the interest rate margins of Czech banks by employing a bank-level dataset at quarterly frequency in 2000–2006. Our main results are as follows. We find that more efficient banks exhibit lower margins and there is no evidence that banks with lower margins compensate themselves with higher fees. Price stability contributes to lower margins. Higher capital adequacy is associated with lower margins, contributing to banking stability. Overall, the results indicate that the determinants of the interest rate margins of Czech banks are largely similar to those reported in other studies for developed countries.

Horváth, Roman (2009): "The time-varying policy neutral rate in real-time: A predictor for future inflation?" *Economic Modelling*, vol. 26(1), pages 71–81.

This paper examines the time-varying policy neutral interest rate in real-time for the Czech Republic in 2001:1–2006:09, estimating various specifications of simple Taylor-type monetary policy rules. For this reason, we apply a structural time-varying parameter model with endogenous regressors. The results indicate that the policy neutral rate gradually decreased over the sample period to levels comparable to those in the euro area. Next, we propose a measure of the monetary policy stance based on the difference between the actual interest rate and the estimated policy neutral rate and find it a useful predictor of the level as well as the change of the future inflation rate.

Horváth, Roman; Rusnák, Marek (2009): "How Important Are Foreign Shocks in a Small Open Economy? The Case of Slovakia." *Global Economy Journal*, vol. 9(1), pages 1–15.

In this article, we provide evidence on the nature and the relative importance of domestic and foreign shocks – with a focus on monetary shocks – in the Slovak economy based on the block-restriction vector autoregression model during the years 1999–2007. We document a well-functioning monetary transmission mechanism in Slovakia. Subject

to various sensitivity checks, we find that contractionary monetary policy shock has a temporary negative effect on the degree of economic activity and price level. We find that using output gap instead of GDP alleviates the price puzzle. In general, prices are driven mainly by foreign factors and the European Central Bank monetary policy shock on Slovak prices is more powerful than that of the National Bank of Slovakia. The Slovak Central Bank interest rate policy seems to follow the ECB's interest rates. On the other hand, spectacular Slovak economic growth is primarily driven by domestic factors suggesting the positive role of recently undertaken Slovak economic reforms.

Podpiera, J.; Raková, M. (2009): "The Price Effects of Emerging Retail Markets," *Eastern European Economics*, vol. 47(1), pages 92–105.

This paper analyzes the effects of a changing market structure on the price dynamics of final goods in an emerging Czech retail market. We estimate the extent of up-and downstream market power and find that the changing market structure was responsible for an average yearly price decrease of retailed products by 0.8 percentage points during 2000–2005. At the same time, however, we anticipate that a period of mergers and acquisitions that has already started could cause yearly price increases of retailed products by 1.2 percentage points approximately 0.5 percentage points in the consumer price index inflation over the next ten years.

Seidler, J.; Horváth, R.; Jakubík, P. (2009): "Estimating Expected Loss Given Default in an Emerging Market: The Case of Czech Republic," *Journal of Financial Transformation*, pages 103–107.

This article discusses the estimation of a key credit risk parameter – loss given default (LGD) – and calculates it for selected companies traded on the Prague Stock Exchange. The importance of estimating LGD stems from the fact that a lender's expected loss is the product of the probability of default, the credit exposure at the time of default, and the LGD. The Mertonian structural approach is used for LGD estimation. This technique makes it possible to derive LGD for publicly traded companies based on their debt and share prices. Our results indicate that the LGD has increased substantially during the current financial crisis, but not exceeding the levels reached over a decade ago, when the Czech Republic experienced rather unfavorable economic conditions. Next, we put forward that our resulting LGD calculated for main companies traded on the Prague Stock Exchange represents a lower estimate of this parameter for the entire corporate sector. This suggests that credit risk management strategies for the corporate sector should be more conservative than what our estimates imply.

Seidler, J.; Jakubík, P. (2009): "Corporate Insolvency and Macroeconomic Determinants," *Ekonomický časopis*, vol. 2009(7), pages 619–632.

This article deals with the mechanisms of satisfying creditors' claims in the Czech economy and macroeconomic determinants of the corporate failure. The paper briefly characterizes the development of the insolvency in the Czech Republic during 1997–2005 and tests macroeconomic determinants of the corporate failure on the time series of the number of bankruptcy petitions filed. Empirical analysis suggests the causal link between the annual GDP growth rate, interest rates, inflation rate and aggregate debt of the corporate sector on one side and the bankruptcy rate in the Czech Republic on the other side. Estimated model indicates procyclicality in the bankruptcy rate and implies structural changes between 2003 and 2004, which corresponds to the privatization of the banking sector.

Seidler, Jakub; Jakubík, Petr (2009): "Implied Market Loss Given Default in the Czech Republic: Structural-Model Approach." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 59(1), pages 20–40.

This paper focuses on the key credit risk parameter – Loss Given Default (LGD). We describe its general properties and determinants with respect to seniority of debt, characteristics of debtors and macroeconomic conditions. Furthermore, we illustrate how the LGD can be extracted from market observable information with help of the adjusted Mertonian structural approach. We present a derivation of the formula for the expected LGD and show its sensitivity with respect to other structural company parameters. Finally, we estimate the 5-year expected LGDs for companies listed on the Prague Stock Exchange and find that the average LGD for this analyzed sample is in the range of 20–45%. To the authors' knowledge, these are the first implied market estimates of LGD in the Czech Republic.

Antal, Juraj; Hlaváček, Michal; Holub, Tomáš (2008): "Inflation Target Fulfillment in the Czech Republic in 1998–2007: Some Stylized Facts." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 406–424.

This paper provides some stylized facts of inflation target fulfillment in the Czech Republic in 1998–2007. In the first part, it discusses briefly the general macroeconomic conditions of the Czech inflation targeting regime, including an identification of the main shocks affecting its performance. The second part compares the extent of inflation target non-fulfillment in the Czech Republic with the experience of other inflation targeting countries. It turns out that the success rate in terms of inflation target fulfillment has changed over time. While in the early phase of inflation targeting the deviations of inflation from the CNB's targets were high by international comparison, more recently the CNB has converged to the track record of relatively successful inflation targeting central banks.

Antal, Juraj; Hlaváček, Michal; Horváth, Roman (2008): "Do Central Bank Forecast Errors Contribute to the Missing of Inflation Targets? The Case of the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 434–453.

This paper is primarily concerned with assessing the bias of the CNB's predictions in relation to undershooting of the inflation target. We conclude that the inflation prediction error has decreased over time. We further point out that GDP growth and interest rates were, respectively, above and below the forecast most of the time, even in a situation of systematic undershooting of the target. Thus, the undershooting cannot be explained with the help of standard demand mechanisms. Positive supply impulses were admittedly underestimated in the past. According to our findings, about half of the apparent target undershooting in 2003 was due to errors in the predictions of exogenous factors (foreign interest rates, GDP, and inflation). As follows from the distribution of the inflation prediction errors across separate price segments, overpredictions of inflation during most of the period under review were due to mistakes in the prediction of food prices and core CPI ex food, while prediction errors in energy prices mostly fostered convergence to the target. The prediction errors in regulated prices acted in both directions.

Babecký, Jan (2008): "Aggregate Wage Flexibility in New EU Member States." *AUCO Czech Economic Review*, vol. 2(2), pages 123–145.

A fixed exchange rate regime eliminates one degree of freedom in absorbing macroeconomic shocks. Therefore, there is a call for higher labor market flexibility in countries which are members of the monetary union or those which intend to join the monetary union. Focusing on the cross-country analysis of labor markets in the enlarged European Union, this paper aims to assess empirically the role of aggregate wages as a correction mechanism for dealing with economic disturbances. We apply classical time series/panel, state-space and cointegration techniques to determine the extent to which aggregate wages can accommodate shocks in the economy.

Babecký, Jan, Bulíř, Aleš, Šmídková, Kateřina (2008): "Sustainable Exchange Rates When Trade Winds Are Plentiful." *National Institute Economic Review*, Vol. 204(1), pages 98–107.

Estimation and simulation of sustainable real exchange rates in a sample of EU member countries find vulnerabilities connected to the adoption of the euro if the rate vis-à-vis the euro were to be fixed with weak fundamentals and inappropriate policies. Sample countries have benefited from dramatic improvements in their external positions, in part driven by inflows of foreign direct investment. As a result, exchange rate misalignments have narrowed in most countries and, looking ahead, are expected to narrow further. These results are conditional, however, on optimistic projections with respect to world import demand and foreign direct investment inflows.

Babetskaia-Kukharchuk, Oxana; Babetskii, Ian; Podpiera, Jiří (2008): "Convergence in exchange rates: market's view on CE-4 joining EMU." *Applied Economics Letters, Taylor and Francis Journals*, vol. 15(5), pages 385–390.

We empirically analyze currency fluctuations in four central European states (CE-4) against the USD and Euro, employing daily data over 1 January 1994 to 10 October 2005 and constructing a dynamic correlation coefficient based on the estimates of a bivariate generalized autoregressive conditional heteroscedasticity model. We find evidence of convergence in exchange rate volatilities between CE-4 currencies and the Euro. In other words, from the US market's point of view, currencies of the CE-4 region and the Euro tend to behave quite similarly. This degree of synchronicity is in line with the composition of currency baskets and the share of the Euro as a trade-invoicing currency in the CE-4 economies.

Beneš, Jaromír; Hurník, Jaromír; Vávra, David (2008): "Exchange Rate Management and Inflation Targeting: Modeling the Exchange Rate in Reduced-Form New Keynesian Models." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(03–04), pages 166–194.

This paper introduces a strategy for modeling the exchange rate when the monetary authority targets inflation while also managing the exchange rate using interventions. It does so in the framework of a standard reduced-form New Keynesian model of monetary transmission used in many institutions for research, forecasting, and monetary policy analysis. We propose a microfounded modification to the UIP condition which allows for modeling of informal exchange rate bands. Our modeling strategy is useful for most hybrid IT regimes, including those with imperfect control over market interest rates.

Brada, Josef; Mandel, Martin; Tomšík, Vladimír (2008): "Intertemporal Approach to the Balance Of Payments: Relationship between Savings and Investments in the Rich, Poor and Transition Countries." *Politická ekonomie*, vol. 56(2), pages 147–161.

The paper analyses the intertemporal approach to the balance of payments which is based on the intertemporal approach to the relation between domestic saving and investment. A key element of the presented analysis is whether world capital mobility is high enough to hold a condition that the relation between the domestic saving and investment in a country could vary. The paper contributes to this economic theory by the empirical analysis carried out with a large sample of countries as well as by the analysis of saving and investment distinguishing the set of developed, poor, and transition countries. The paper defines and empirically verifies macroeconomic relationships among saving, investment, the balance of trade and services, and the current account of the balance of payments. The authors define their own hypothesis of the relation among domestic saving, investment, and world capital mobility, which is based on the level of economic development of a country. The results of the analysis are discussed within the context of how to conduct monetary and fiscal policies, as well as within the fundamental equilibrium exchange rate theory.

Bulíř, Aleš; Hurník, Jaromír (2008): "Why has inflation in the European Union stopped converging?" *Journal of Policy Modeling*, vol. 30(2), pages 341–347.

The dispersion of European Union inflation rates drifted upward in recent years, after the drive toward the euro pushed it downward sharply in the late 1990s and early 2000s. Inflation accelerated in economies that have either grown faster than their potential output or have failed to liberalize their factor and product markets, generating cost-push pressures and monetary transmission inefficiencies. To the extent inflation performance has been affected by factors outside of the control of the European Central Bank stabilization of inflation around a euro-area target will remain an elusive goal.

Cimburek, Jan, Řežábek, Pavel (2008): "Currency in Circulation: Global Trends and the Situation in the Czech Republic." *Politická ekonomie*, vol. 56(6), pages 739–759.

This paper deals with the evolution of currency in circulation and world trends in selected developed countries. We argue against the opinion that money in their cash form (i.e. notes and coins) will cease to exist within the horizon of fifteen years and that only electronic means of payment will be used in the users' payment mix. We quantify and compare the trend of currency in circulation with main macroeconomic and demographic indicators and focus on finding and defining possible additional qualitative factors that might influence the usage of banknotes and coins. Paper offers a new approach to rising currency in circulation which is not based on quantitative factors but more on the qualitative factors which motivate users to use cash. Furthermore the paper focuses on the regional aspect and describes and compares the cash situation in the Czech Republic. Based on the defined qualitative factors, which are promoting the use of cash and motivating potential users of cash, we come to the conclusion that cash will play its important role in the future as a reliable, safe and user friendly mean of payment.

Cincibuch, Martin; Horníková, Martina (2008): "Measuring the Financial Markets' Perception of EMU Enlargement: The Role of Ambiguity Aversion." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(05–06), pages 210–230.

Market views on EMU enlargement are measured by a new indicator based on the short-term dynamics of forward spreads. Conceptually, this indicator stems from the notion of ambiguity-averse agents in the sense of Knight. Specifically, we attempt to operationalize the incomplete preferences framework, which may allow for multiple equilibria supported by one set of fundamentals. This equilibrium indeterminacy may offer a way to reconcile short-term fluctuations of market prices with a relatively stable underlying economic environment and expectations. The method was applied to data from Central European countries, including the Czech Republic, Hungary, Poland, and Slovakia. Comparing our results with financial market opinion surveys, the results of the proposed method seems to be in accordance with market expectations.

Derviz, Alexis; Podpiera, Jiří (2008): "Predicting Bank CAMELS and S&P Ratings: The Case of the Czech Republic." *Emerging Markets Finance and Trade*, vol. 44(1), pages 117–130.

This paper investigates the determinants of the movements in the capital-assets-management-earnings-liquidity-sensitivity to market risk (CAMELS) and the long-term Standard; Poors (S&P) bank ratings in the Czech Republic during the periods when the three largest banks, representing approximately 60 percent of the Czech banking sector's total assets, were first privatized (1998–2001) and then had sufficient time to operate under new owners (2002–2005). The same list of explanatory variables employed by the Czech National Bank's banking sector regulators, corresponding to the inputs of the CAMELS rating, are examined for both ratings to select their significant predictors. We employ an ordered-response logit model to analyze the long-run S&P rating and a standard panel data framework for the CAMELS rating. We find significant explanatory power for capital adequacy, funding spread, the ratio of total loans to total assets, the value-at-risk for total assets, and leverage.

Fidrmuc, Jarko; Horváth, Roman (2008): "Volatility of exchange rates in selected new EU members: Evidence from daily data." *Economic Systems*, vol. 32(1), pages 103–118.

We examine the daily exchange rate dynamics in selected new EU member states (Czech Republic, Hungary, Poland, Romania, and Slovakia) using GARCH and TARARCH models between 1999 and 2006. Despite these countries' adopted inflation targeting regime, they occasionally tried to manage their exchange rates. We find that the low credibility of exchange rate management implied higher volatility of exchange rates when it substantially deviated from the implicit target rates for all countries. Finally, we find significant asymmetric effects of the volatility of exchange rates in all analyzed countries.

Geršl, Adam (2008): "Productivity, Export Performance, and Financing of the Czech Corporate Sector: The Effects of Foreign Direct Investment." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(05–06), pages 232–247.

The article looks in both theoretical and empirical terms at whether large foreign presence has affected domestic firms. Foreign firms might both intentionally and unintentionally influence the productivity, financing, and export performance of local firms within the same industry or across industries along the production chain via supplier and client linkages. Economic theory does not suggest an unambiguous answer to the question of whether the influence is positive or negative. To answer this question, both firm-level and industry-level data on performance, financing, and exports and interactions of firms within the production chain in the Czech Republic are analyzed.

Geršl, Adam, Heřmánek, Jaroslav (2008): "Indicators of financial system stability: Towards an aggregate financial stability indicator?" *Prague Economic Papers*, vol. 17(2), pages 127–142.

This article sets out to describe and discuss the methodology of selected financial soundness and financial stability indicators, including the attempts to construct an aggregate financial stability indicator. The first part is devoted to discussion of Financial Stability Indicators by the International Monetary Fund and presents also the values of the IMF's core Financial Soundness Indicators for the Czech Republic and other selected countries, using the data from the 2005 pilot study. This part partly covers also other existing approaches to definition and collection of partial financial soundness indicators, such as the indicators regularly assessed by the European Central Bank. In the second part, the article reviews existing approaches to construct an aggregate financial stability indicator. These include alternative approaches using balance sheet and profit and loss data, as well as financial market and regulatory agencies' data. The last part constructs a preliminary composite indicator for the stability of the Czech banking system and discusses its development over time.

Hanousek, Jan; Hájková, Dana; Filer, Randall K. (2008): "A rise by any other name? Sensitivity of growth regressions to data source." *Journal of Macroeconomics*, vol. 30(3), pages 1188–1206.

Measured rates of growth in real per capita income differ drastically depending on the data source. This phenomenon occurs largely because data sets differ in whether and how they adjust for changes in relative prices across countries. Replication of several recent studies of growth determinants shows that results are sensitive in important ways to the choice of data. Previous warnings against using data adjusted to increase cross-country comparability to study within-country patterns over time (growth rates) have been largely ignored at the cost of possibly contaminating the conclusions.

Hlaváček, Jiří; Hlaváček, Michal (2008): "Corporate Social Responsibility (CSR): Only a Proclamation or Economic Necessity?" *Politická ekonomie*, vol. 56(5), pages 579–598.

The theory "corporate social responsibility" (CSR) is characterized in the paper. The paper expresses the authors' opinion, that CSR as a mere proclamation of necessity of the firms' ethical behavior does not enforce this into praxis. The internal economic motivation to CSR is the necessary condition for firms to invest in CSR. The necessary conditions for such motivation are then formulated.

Holub, Tomáš (2008): "Causes of Deviations from the CNB's Inflation Targets: An Empirical Analysis." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 425–433.

This paper provides an empirical analysis of the factors that caused deviations from the CNB's inflation targets during the first ten years of inflation targeting in the Czech Republic. While in the short term, shocks to agricultural producer prices represent the most important factor, exchange rate shocks are clearly the most important medium-term factor. At the same time, it could not be proved that monetary policy created any major shocks contributing to the non-fulfillment of inflation targets, although some role thereof cannot be excluded either.

Holub, Tomáš; Hurník, Jaromír (2008): "Ten Years of Czech Inflation Targeting: Missed Targets and Anchored Expectations." *Emerging Markets Finance and Trade*, vol. 44(6), pages 67–86.

This paper focuses on the Czech Republic's first ten years of experience with its inflation-targeting regime. Under this regime, the Czech Republic has successfully achieved disinflation. However, there were two periods of substantial inflation target undershooting and economic slack, related to two episodes of sharp exchange rate appreciation. Dealing with exchange rate volatility has been a key challenge for inflation targeting in the Czech Republic. Despite the missed targets, though, the regime has been successful at anchoring the inflation expectations of analysts and firms close to the announced targets, suggesting that it has worked well as a nominal anchor for the economy.

Horváth, Roman (2008): "Asymmetric Monetary Policy in the Czech Republic?" *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 470–481.

This paper analyses the hypothesis of whether asymmetric monetary policy could have contributed to the undershooting of the inflation targets of the Czech National Bank in the years 1998–2007. To this end, a non-linear Taylor Rule is estimated. The results indicate that from 1998 to about 2002, the Czech National Bank responded more aggressively to forecasts of inflation exceeding the target than to those below the target. There is, however, no evidence for asymmetric monetary policy in estimates of the monetary policy rule derived from more recent data. This suggests that symmetric handling of the inflation targets prevailed in the past several years.

Horváth, Roman (2008): "Undershooting of the Inflation Target in the Czech Republic: The Role of Inflation Expectations." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 482–492.

This article addresses the role of the inflation target in inflation expectations using the vector error correction (VECM) and block restriction vector autoregression (VAR) models, based on the monthly data of 1999–2007 in the Czech Republic. The econometric analysis identifies nothing to support the "hypercredible" inflation target hypothesis, under which a 1 pp decrease in the inflation target would be accompanied by a decrease in inflation expectations of more than 1 pp. The results, however, do suggest that the inflation target is a major determinant of inflation expectations, its importance for the formation of inflation expectations surpassing even that of current inflation. Another conclusion is that inflation expectations decrease significantly in response to stricter monetary policy and to a lower inflation target. All in all, the results imply that Czech monetary policy has anchored inflation expectations.

Horváth, Roman; Koprnická, Kamila (2008): "Inflation Differentials in New EU Member States: Empirical Evidence." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(07–08), pages 318–328.

In this paper, we examine the determinants of inflation differentials in a panel of the new European Union member states vis-à-vis the euro area in 1997–2007. Our main results are as follows. Exchange rate appreciation and a higher price level in the new EU members is associated with a narrower inflation differential vis-à-vis the euro area, while a fiscal deficit and a positive output gap seem to contribute to a higher inflation differential. Nevertheless, the effect of price convergence on inflation differentials is found to be dominant in these countries, suggesting that a country with a price level 20% below the euro area average is likely to exhibit inflation nearly one percentage point above that in the euro area. Overall, our results indicate that real convergence factors rather than cyclical variation are more important for inflation developments in the new EU members as compared to the euro area.

Hurník, Jaromír; Kameník, Ondřej; Vlček, Jan (2008): "The History of Inflation Targeting in the Czech Republic Through the Lens of a Dynamic General Equilibrium Model." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 454–469.

Using a dynamic general equilibrium model calibrated for the Czech Republic, we first estimate the impact of structural shocks on the observed realizations of the interest rate and inflation, while the main focus is put

on the estimation of monetary policy shocks. These occur whenever monetary policy is not set in accordance with the observed state of the economy and the inflation target. Our results suggest that monetary policy was more restrictive than implied by the observed state of the economy and the inflation target in three periods: 1998Q2–1999Q1, 2001Q3–2003Q2, and 2004Q3–2005Q4. On the contrary, the period from 2003Q3 to 2004Q2 was characterized by relatively loose monetary policy. Based on the assumption that monetary policy focuses on a different inflation target than the officially announced one, we estimate the implicit trajectory of the inflation target for the Czech Republic. This implied target fluctuates between 2 and 3 percent in 2002–2007.

Jakubík, Petr; Heřmánek, Jaroslav (2008): “Stress Testing Of the Czech Banking Sector.” Prague Economic Papers, vol. 17(3), pages 195–212.

The results of stress tests of the Czech banking sector based on credit risk and credit growth models, applied to the household and corporate sector are presented in the paper. The use of these newly developed models enables the stress tests to be linked to the CNB’s official quarterly macroeconomic forecast. In addition, the article updates the stress scenarios, including simple sensitivity analyses of credit risk for individual sectors. Based on the analysis, an answer is sought to the question of whether the observed credit growth to corporate sector and households poses any threat to the stability of the banking sector. The analyses conclude that the banking sector as a whole seems to be resilient to the macroeconomic shocks under consideration.

Juillard, Michael; Kamenik, Ondra; Kumhof, Michael; Laxton, Douglas (2008): “Optimal price setting and inflation inertia in a rational expectations model.” Journal of Economic Dynamics and Control, vol. 32(8), pages 2584–2621.

This paper presents and estimates a new Keynesian monetary model for the US economy. It proposes possible solutions to two problems in this model class, the lack of inflation inertia and persistence in versions of these models that insist on rigorous microfoundations and rational expectations, and the small contribution of technology shocks to business cycles. Price setting takes the form of optimal two-part pricing policies formulated under conditions of upward-sloping firm-specific marginal cost curves. Furthermore, this form of price setting applies not only to prices and wages but also to user costs of capital. In this setting past inflation becomes a key determinant of current inflation, even though price setting is entirely forward-looking. Technology is modeled as a random walk, with technology growth shocks that follow a highly persistent process. The model is estimated by Bayesian methods, and performs significantly better than a Bayesian VAR. It generates inertial and persistent inflation, and technology shocks account for a large share of business cycle variation.

Kollár, M. (2008): “Production Structure in the Context of International Trade.” The Quarterly Journal of Austrian Economics, vol. 11(1), pages 18–42.

This paper deals with the recent empirical phenomenon of intra-industry trade, i.e., trade in similar goods between similar countries. It treats this phenomenon from the point of view of the theory of the structure of production, highlighting the importance of the sequential nature of production and the heterogeneity and specificity of factors of production, as developed by Carl Menger, Eugen von Böhm-Bawerk and their followers of the Austrian School of economics. The reader is first exposed to the historical development of production and capital theory. A simple theory of production structure, along the lines of Austrian economics, is afterwards presented and a useful tool for the analysis of intra-industry trade is developed. In the following discussion of existing theories of intra-industry trade, we make the case for vertical intra-industry specialization, complex manufactured goods and sliced-up production chains across countries. The reader immediately observes the importance of Austrian production structure theory for the analysis of intra-industry trade. We accordingly apply the concepts of the structure of production to intra-industry trade and analyze, in particular, the time- and place-aspects of international production. The concluding section shows the relevance of our approach to intra-industry trade for the analysis of business cycle synchronization across countries, and for the optimum currency areas theory.

Kovac, Eugen; Ortmann, Andreas; Vojtek, Martin (2008): "Comparing Guessing Games with homogeneous and heterogeneous players: Experimental results and a CH explanation." *Economics Bulletin, Economics Bulletin*, vol. 3(9), pages 1–9.

We investigate the decisions of individuals in simple and complex environments. We use a version of the Guessing Game (Beauty-contest Game) as a vehicle for our investigation, employing mathematically talented students. We find that our subjects think in complex environments more carefully before making decisions. We rationalize our findings using the Cognitive Hierarchy (CH) model proposed by Camerer, Ho, and Chong (2002). We relate our results to the emerging literature on the decision making of collective actors.

Kubiček, Jan (2008): "Why A Switch From PAYG to Funded Pension System Has No Link to Demographic Development?" *Politická ekonomie*, vol. 56(1), pages 102–122.

The paper deals with a wide-spread myth that a switch from a PAYG to a funded pension system might solve adverse consequences of the population aging. It is shown, that under additional assumptions the pension debt (which is created during the process of the switch) is exactly equal to the value of assets that the pension funds accumulate. These additional assumptions are following: government imposes additional taxes, which are equal to the difference between the contributions to the former PAYG system and the contributions to the pension funds. Therefore workers contribute less to the pension funds but if the additional taxes are taken into account, they continue paying the same amount. It is shown, that if the additional taxes were permanently lower than what is supposed, the pension debt would grow beyond any limits. The other additional assumption made is that the interest rate paid by government from its pension debt is the same as the interest rate reached by the funds. If this assumption is relaxed, the qualitative conclusions do not change. Hence, demographic development cannot be used as an argument in favour of a switch of the pension system.

Mandel, Marin; Tomšík, Vladimír (2008): "Relative Version of the Theory of Purchasing Power Parity: Problems of Empirical Verification." *Politická ekonomie*, vol. 56(6), pages 723–739.

The article discusses problems of the empirical verification of the relative version of the theory of purchasing power parity based on aggregated price indexes (especially using the consumer price index). The goal of the articles is to compare empirical results obtained from cross-country time series analysis using cointegration analysis, Error Correction Model, as well as VAR analysis. The authors tested 21 currency pairs of the U.S.A., Canada, Japan, Switzerland, the Great Britain, Norway, and Sweden in the period between 1975 and 2007. All tested time series were cointegrated of the first order with the exception of the consumer price index of Switzerland, which was cointegrated of the second order. The results of cointegration analysis are not very robust. This is explained by the authors as follows: existence of high transaction costs in an arbitrage, existence of complementary goods and oligopoly structure of exports, and expected back reaction between exchange rate and inflation.

Mandel, Martin; Tomšík, Vladimír (2008): "External Balance in a Transition Economy." *Eastern European Economics*, 46(4), 5–26.

This paper analyzes the development of the external balance in five Central and East European countries: Czech Republic, Hungary, Poland, Slovakia, and Slovenia. The paper applies, expands, and empirically verifies the ideas of life-cycle theory in the area of the effects of foreign direct investment on the balance of payments in transition countries. The article defines and explores the basic general stages in the external balance of a transition country. The definition of the stages draws from a model of consumer behavior within the life-cycle theory. The external balance stages are defined as follows: young transition economy, mature transition economy, posttransition economy, and expanding economy. The paper develops a model that provides criteria that not only classify the current stage of each transition country, but also evaluate the success in the catching-up process of the country examined.

Novotný, Filip (2008): "Tax Optimization Of Multinational Firms Through Transfer Pricing: A Survey Of Main Theoretical Foundations And Potential Macroeconomic Impacts." *Politická ekonomie*, vol. 56(1), pages 40–53.

If taxes are the same across countries and no tariffs are imposed on international trade, the optimal strategy of a multinational firm is to set transfer prices at marginal costs of its affiliated firms. But in reality we observe trade tariffs and tax differences among countries which lead multinational firms to deviate transfer prices from marginal costs. Multinationals use transfer prices in order to increase profits in affiliates which are located in low tax countries at the expense of affiliates which are located in high tax countries. I demonstrate on a sample of EU countries that the lower the tax rate in a country the higher the profitability of foreign direct investment in that country. As some studies suggest the gross value added and export prices are artificially overvalued in low tax countries and artificially undervalued in high tax countries.

Novotný, Filip; Podpiera, Jiří (2008): "The profitability life-cycle of direct investment: an international panel study." *Economic Change and Restructuring*, Springer, vol. 41(2), pages 143–153.

In this paper we test competing hypotheses about the shape of the time-profile of foreign direct investment profitability on a panel of countries. Using partial linearization method we derive the time-profile of the cumulative profitability for the stock of direct investment from aggregate macroeconomic data. By testing the non-linearity hypothesis of the cumulative profitability life-cycle of direct investment we find a cubic curve.

Podpiera, Jiří (2008): "Monetary policy inertia reconsidered: Evidence from endogenous interest rate trajectory." *Economics Letters*, vol. 100(2), pages 238–240.

By finding small forecastable variability of future policy rates by highly smoothed central bank's endogenous interest rate trajectory, I suggest that market's failure to predict large portion of variability in future rates does not always imply limited policy inertia.

Podpiera, Jiří (2008): "The role of ad hoc factors in policy rate settings." *Economic Modelling*, vol. 25(5), pages 1003–1010.

Policymakers do not always follow a simple rule for setting policy interest rates for various reasons. Thus their behavior can be represented by a standard Taylor type policy rule amended with an additional variable representing an ad hoc factor. Consequently, ignoring the presence of the ad hoc factor causes bias in conventional policy rule estimators. I contrast the unbiased estimates of a procedure that accounts for the ad hoc factors and the bias of least squares on a unique data set of an unconditional inflation targeting episode.

Podpiera, Jiří; Weill, Laurent (2008): "Bad luck or bad management? Emerging banking market experience." *Journal of Financial Stability*, vol. 4(2), pages 135–148.

A large number of bank failures occurred in transition countries during the 1990s and at the beginning of the 2000s. These were related to increases in non-performing loans and deteriorated cost efficiency of banks. This paper addresses the question of the causality between non-performing loans and cost efficiency in order to examine whether either of these factors is the deep determinant of bank failures. We extend the Granger-causality model developed by [Berger, A., DeYoung, R., 1997. Problem loans and cost efficiency in commercial banks. *J. Banking Finance* 21, 849–870] by applying GMM dynamic panel estimators on a panel of Czech banks between 1994 and 2005. Our findings support the bad management hypothesis, according to which deteriorations in cost efficiency precede increases in non-performing loans. Banking supervisors should consequently focus on enhanced cost efficiency of banks in order to reduce the likelihood of bank failures in transition countries.

Pruteanu-Podpiera, Anca; Podpiera, Jiří (2008): "The Czech transition banking sector instability: the role of operational cost management." *Economic Change and Restructuring*, Springer, vol. 41(3), pages 209–219.

In this article we show—using the estimated cost efficiency of banks—that besides the risk (proxied by the share of non-performing loans), the quality of operational cost management was an equally important determinant of bank failure risk during the decade of banking sector transformation in the Czech Republic.

Pruteanu-Podpiera, Anca; Weill, Laurent; Schobert, Franziska (2008): "Banking Competition and Efficiency: A Micro-Data Analysis on the Czech Banking Industry." *Comparative Economic Studies*, vol. 50(2), pages 253–273.

Banking competition is expected to provide welfare gains by reducing monopoly rents and cost inefficiencies, favouring a reduction of loan rates and then an increase in investment. These expected gains are a major issue for transition countries in which bank credit represents the largest source of external finance for companies. With the use of quarterly data for Czech banks, this paper aims to estimate the effects of banking competition in the Czech Republic. First, we measure the level and evolution of banking competition between 1994 and 2005. Competition is measured by the Lerner index on the loan market, using data on loan prices. We find no improvement in banking competition during the transition period. Second, we investigate the relationship and causality between competition and efficiency. We perform a Granger-causality-type analysis that supports negative causality only running from competition to efficiency. Therefore, our results reject the intuitive 'quiet life' hypothesis and indicate a negative relationship between competition and efficiency in banking.

Saxa, Branislav (2008): "Learning-by-Exporting or Managerial Quality? Evidence from the Czech Republic." *Economie Internationale*, CEPII research center, issue 3Q, pages 109–139.

This paper employs firm-level panel data from the Czech Republic to investigate the empirical relevance of the learning-by-exporting hypothesis. To provide convincing estimates, one must be able to disentangle learning-by-exporting from changes in company management that induce the company to both start exporting and introduce productivity increasing measures. Therefore, I compare estimates, which do not control for potential management changes, to estimates based on an instrumental variables strategy. Specifically, I focus on firms that start exporting due to changes in the industry-specific exchange rate and industry-specific ratio of producer prices on domestic and foreign markets. The results suggest that different kinds of productivity enhancements can be attributed to learning-by-exporting on one side and managerial effects on the other side.

Skořepa, Michal (2008): "A Closer Look at Utility Maximised By Economic Agents." *Politická ekonomie*, vol. 56(2), pages 242–256.

The relatively new stream of research on various types of utilities is reviewed and discussed together with some of its implications. The distinction is explained among experienced utility, remembered utility and predicted utility as three candidates for decision utility. Examples of selected empirical findings are given which show discrepancies, first, between past experienced utility and remembered utility and, second, between predicted utility and actual future experienced utility. Some critical reactions to the findings are briefly mentioned as well as implications for the debate on some important moral issues such as paternalism and HIV testing. It is concluded that there may be some methodological doubts about the empirical evidence available so far but even so, the evidence indicates that the tendency of models in economics to work with "the" utility to be maximised may be an overly simplified picture of the actual process of evaluation of outcomes.

Šmídková, Kateřina; Bulíř, Aleš; Čihák, Martin (2008): "Hits and Misses: Ten Years of Czech Inflation Targeting (Introduction)." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 58(09–10), pages 398–405.

The first 10 years of Czech Republic's inflation targeting regime have been remarkable by the persistent undershooting of the inflation targets. This article is an introduction to a special issue aimed at analyzing the factors of the undershooting. The articles in this issue explore the following hypotheses: the impact of a series of counter-inflationary shocks; a biased forecasting system; a faulty decision-making system; and the role of inflation expectations. Based on a "meta-analysis" of the articles, this introduction suggests that the undershooting cannot be explained by a single factor, although counter-inflationary shocks are identified most frequently. The impact of the undershooting on central bank credibility was modest, partly because the forecasts were accompanied by explicit discussions of the forecast risks.

Spěváček, Vojtěch, Vintrová, Růžena, Zamrazilová, Eva, Hájek, Mojmír, Žďárek, Václav (2008): "The Czech Economy after Its Entry into European Union." *Politická ekonomie*, vol. 56(3).

Economic growth of the Czech Republic differed strongly in two periods: 2001–2003 and 2004–2006. While in the first period the average annual rate of growth of GDP reached only 2.7%, in the second period the growth accelerated to 5.7%. The economic growth measured by the indicators of real income (namely of real gross domestic income) was faster. This was caused by positive contribution of the terms of trade. On the supply side the main contributing factors were labour and total factor productivity. On the demand side the growth was pulled by domestic demand which grew in the period 2001–2003 even faster than GDP. The contribution of foreign trade becomes positive in the years 2004–2006 with very strong contribution in the year 2005. Macroeconomic stability of the Czech economy improved substantially in the field of foreign trade. The trade balance becomes positive from the year 2004 and growing imbalance persists in the balance of income. The negative gap between savings and investments is caused mainly by households and general government. The process of real convergence accelerated in the years 2000–2006 and was based on the growth of labour and total factor productivity. In 2006 the GDP per capita in purchasing power standards reached almost 80% of the average level in EU-27. The comparative price level of the Czech Republic in this year reached only 61% despite accelerated process of catching-up.

Turnovec, František; Gregor, Martin; Schneider, Ondřej; Horváth, Roman (2008): "Editorial." *AUCO Czech Economic Review*, vol. 2(1), pages 005–006.

The editorial discusses the reasons for launching new economics journal and introduces a special issue based on the Sixth Europeam workshop held at the Charles University.

Turnovec, František; Gregor, Martin; Schneider, Ondřej; Horváth, Roman (2008): "Editorial." *AUCO Czech Economic Review*, vol. 2(3), pages 195–196.

The editorial provides an introduction to the special issue on the game theory. The special issue consists of five papers, which deals with theoretical, applied as well as technical topics of game theory.

Antal, Juraj; Holub, Tomáš (2007): "Exchange Rate Arrangements Prior to Euro Adoption." AUCO Czech Economic Review, vol. 1(3), pages 312–323.

This paper discusses the exchange rate policies in the three stages of the euro adoption process. In the first stage, i.e., after EU accession but before ERM II entry, the exchange rate becomes a matter of "common concern" according to the Treaty. The paper argues that in the modern conditions, this has no real meaning besides mutual consultations on macroeconomic policy issues. In the second stage, common concern becomes institutionalized under the ERM II mechanism. Its main advantages and risks are discussed, and the arguments for minimizing the length of this stage are presented. In the third step, the exchange rate stability criterion is assessed before the country is allowed to adopt the euro. The paper discusses the open issues in the interpretation of this criterion. Finally, the current state of the Czech euro adoption strategy is described.

Babetskii, Ian; Komárek, Luboš; Komárková, Zlataše (2007): "Financial Integration of Stock Markets among New EU Member States and the Euro Area." Czech Journal of Economics and Finance (Finance a úvěr), vol. 57(7–8), pages 341–362.

The paper considers the empirical dimension of financial integration among stock-exchange markets in four new European Union member states (Czech Republic, Hungary, Poland, and Slovakia) in comparison with the euro area. The main objective is to test for the existence and determine the degree of the four states' financial integration relative to the euro currency union. The analysis is performed at the country level (using national stock-exchange indices) and at the sectoral level (considering banking, chemical, electricity, and telecommunication indices). Our empirical evaluation consists of (1) a harmonization analysis (by means of standard and rolling correlation analysis) to outline the overall pattern of integration; (2) the application of the concept of beta convergence (through the use of time series, panel, and state-space techniques) to identify the speed of integration; and (3) the application of so-called sigma convergence to measure the degree of integration. We find evidence of respective stock-market integration on both national and sectoral levels between the Czech Republic, Hungary, Poland, and the euro area.

Brůha, Jan; Ionascu, Delia; Jeong, Byeongju (2007): "Organized Labor and Restructuring: Coal Mining in the Czech Republic and Romania." Czech Journal of Economics and Finance (Finance a úvěr), vol. 57(5–6), pages 272–291.

The authors examine the role of organized labor in the restructuring experience of two coal-mining regions in the Czech Republic and Romania in the 1990s. Under similar external circumstances, the Ostrava region of the Czech Republic undertook early gradual restructuring, whereas the Jiu Valley region in Romania did not undertake restructuring until 1997, which was followed by massive layoffs in the sector. The authors conduct a quantitative exercise that accounts for mine productivity, labor-market conditions, and constraints in compensating laid-off miners. They show that the belated restructuring in the Jiu Valley was inefficient: gradual restructuring with reasoned compensation would have benefited both the miners and the state. An important factor in the delayed restructuring was the miners' resistance to it. The authors discuss what motivated the miners' opposition and the consequences.

Čihák, Martin; Heřmánek, Jaroslav; Hlaváček, Michal (2007): "New Approaches to Stress Testing the Czech Banking Sector." Czech Journal of Economics and Finance (Finance a úvěr), vol. 57(1–2), pages 41–59.

This paper provides an overview of the stress testing of the Czech banking sector conducted by the Czech National Bank. The paper begins by updating historical and hypothetical stress-testing scenarios. It also includes a sensitivity analysis of the interest-rate risk and new presentation forms of such. The results of interbank contagion tests (both simple and combined) based on Czech banks' exposures on the interbank market are offered. Finally, the paper integrates the stress testing with CNB macroeconomic forecasts (i.e., the quasi-phase-matching model). The authors' stress testing was also integrated with the macroeconomic credit-risk model, with the impact on individual bank portfolios, and with interbank contagion. One baseline and three alternative

scenarios were tested they have shown that the Czech banking sector was relatively resilient to the shocks. However, the exercise also revealed certain limitations of the stress-testing approach, to which the authors offer recommendations for the further development of this apparatus.

Derviz, Alexis (2007): "Cross-Border Risk Transmission by a Multinational Bank." *AUCO Czech Economic Review*, vol. 1(1), pages 87–111.

A model of international banking, with a stress on manager human-capital (borrower monitoring) and majority-shareholder human capital (manager auditing) is constructed to study the impact of exogenous shocks in one country on credit creation in another. I show that the presence of the two cited categories of non-transferable skills in banking technology reduces the role of the standard portfolio-diversification motive in the cross-border transmission of disturbances. At the same time, this bank-specific market friction creates a separate channel of shock propagation, a function of bank shareholder and manager incentives. It can even happen that the impact of an exogenous shock on credit has a different sign in the "relationship" as opposed to the "arm's-length" banking environment. This phenomenon, caused by the marginal effect of the human-capital management in the bank operation, is present in those bank branches with relatively small loan volumes. When the loan volume is large, the direction of the reaction of the manager-auditing bank to shocks abroad is the same as that of an arm's-length lender.

Dybczak, Kamil; Flek, Vladislav (2007): "Supply-Side Adjustments in the Czech Republic: A Cross-Sector Perspective." *Eastern European Economics*, vol. 45(6), pages 29–45.

We calculate production functions for the key productive sectors of the Czech economy (agriculture, industry, etc.), exploring the growth-accounting approach and decomposition of total factor productivity (TFP) growth. We establish that the growth in real value added over the period 1996–2005 has been driven mainly by increases in TFP. Our analysis shows, however, that this aggregate long-term growth pattern does not hold for all productive sectors. Furthermore, from 1996 to 2005, the Czech economy generally suffered from a structural burden in that all growth in TFP was due exclusively to better utilization of resources, given the initial structure of their allocation, with a negative contribution of resource reallocation.

Filáček, Jan (2007): "Why and How to Assess Inflation-Target Fulfillment." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 57(11–12), pages 577–594.

The ex post analysis of inflation-target fulfillment plays an important role in the inflation-targeting framework. The major benefits of ex post analysis are threefold. First, it improves forecast accuracy. Knowledge of the main sources of previous forecast inaccuracies helps to better understand the current state of the economy and prevents a central bank from producing systematically biased forecasts. Second, it elucidates the abilities and limitations of forecasts used in central-bank decision making. Third, it enhances monetary-policy transparency and credibility. The primary aim of the paper is to propose a methodological framework for assessing inflation-target fulfillment based on partial simulations, as applied in the Czech National Bank. In order to demonstrate the applicability of this framework, the authors analyze the performance of the bank between 2002 and 2006. They show that inflation targeting in this period might have been negatively affected by biased variables describing external developments.

Filáček, Jan; Komárek, Luboš; Král, Petr (2007): "Why Central Bankers Should Disclose: Interest Rate Forecast." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 57(11–12), pages 558–576.

This paper deals with theoretical and empirical dimension of publishing interest rates projections by central banks. Its first goal is to review arguments in favor of and against this decision and to illustrate the debate using experience of four central banks which publish or used to publish interest rates forecast. The second objective is to evaluate the Czech National Bank's capability to efficiently use publishing of its interest rates forecasts to increase further its transparency, accountability and credibility. The authors argue that (i) the CNB meets all requirements needed for making its interest rate forecast public; (ii) more specifically, they do not find any evidence of significantly worse CNB's performance in interest rates forecasting compared to other institutions;

(iii) it is not clear whether the risk assessment in combination with verbal description of interest rate forecast currently used has always been sufficiently precise guidance for the market participants; (iv) after the CNB starts publishing interest rates forecasts in 2008, market expectations will probably move closer to the CNB's view which should in turn enhance accountability and credibility of the CNB's forecasts and improve the efficiency of its monetary policy conduct at all.

Frait, Jan; Komárek, Luboš (2007): "Monetary Policy And Asset Prices: What Role For Central Banks In New EU Member States?" Prague Economic Papers, vol. 16(1), pages 3–23.

The paper deals with the relationship between monetary policy and asset prices. Besides surveying the general discussion, it attempts to extend it to recent developments in the New Member States of the EU (NMS), namely the Czech Republic, Hungary, Poland and Slovakia (the EU4). After a brief description of the current macroeconomic situation in the NMS, the appropriate reaction of monetary policy to asset price bubbles is analysed and the main pros and cons associated with this reaction are summarized. Afterwards, the risks of asset market bubbles in the EU4 countries are evaluated. Since the capital markets are still underdeveloped and the real estate price boom seems to be a natural reaction to the initial undervaluation, the risks are viewed as rather small. The conclusion is thus that it is crucial for central banks in mature economies as well as in the NMS to conduct their monetary policies as well as their supervisory and regulatory roles in a way that does not promote the build-up of asset market bubbles. In exceptional times, central banks of small open economies must be ready to use monetary policy steps as a kind of insurance against the adverse effects of potential asset market bubbles.

Galušćák, Kamil; Münich, Daniel (2007): "Structural and Cyclical Unemployment: What Can Be Derived from the Matching Function?." Czech Journal of Economics and Finance (Finance a úvěr), vol. 57(3–4), pages 102–125.

We explain movements in the U-V (unemployment and vacancy) space – that is, the relationship between stocks of unemployment and job vacancies, known as the Beveridge curve – in the Czech Republic during 1995–2004. While the Beveridge curve is described by labor-market stocks, we explain shifts in the Beveridge curve using gross labor-market flows by estimating the matching function. We interpret parameter changes of the matching function during the business cycle, distinguishing cyclical and structural changes to the unemployment rate. We find that the labor-market flows are good coincidence predictors of business-cycle turning points. We show that the Czech economy suffers hysteresis (path dependency) on the labor market, which is common in many other developed market economies in the European Union.

Geršl, Adam (2007): "Foreign Banks, Foreign Lending and Cross-Border Contagion: Evidence from the BIS Data." Czech Journal of Economics and Finance (Finance a úvěr), vol. 57(1–2), pages 27–40.

The paper discusses the role of foreign banks and foreign lending in central and east European countries from the financial-stability perspective using Bank for International Settlements data on global banking. The pattern of foreign bank involvement in the region is analyzed and the risk of cross-border contagion explored, focusing on three topics: the maturity of cross-border exposures, the concentration of foreign creditors, and the existence of common creditors.

Geršl, Adam (2007): "Political Economy of Public Deficit: Perspectives for Constitutional Reform." AUCO Czech Economic Review, vol. 1(1), pages 67–86.

The paper uses a dynamic inconsistency model known from monetary policy to assess three alternative proposals how to reform fiscal constitution in order to limit government's incentive to use fiscal policy for maximizing political support. The return to ever-balanced-budget rule, state-contingent rules, and the establishment of an independent Fiscal Policy Committee with power to set public deficit with the aim of stabilizing the economy are discussed from the constitutional perspective, analyzing different incentives that these proposals create for government and alternative means to enhance credibility of the arrangement.

Geršl, Adam; Hlaváček, Michal (2007): "Foreign Direct Investment, Corporate Finance, and the Life Cycle of Investment." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 57(9–10), pages 448–464.

This article discusses the effect of foreign direct investment on the corporate sector in the Czech Republic. The analysis uses subaggregated corporate data from a unique Deutsche Bundesbank database containing an almost complete sample of German enterprises that invested in the Czech Republic between 1996 and 2004. Attention was given to two issues: the role of intra-group financing in foreign-owned corporations and the life cycle of direct investments.

Hájková, Dana; Hurník, Jaromír (2007): "Cobb-Douglas Production Function: The Case of a Converging Economy." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 57(9–10), pages 465–476.

The Cobb-Douglas production function is often used to analyse the supply-side performance and measurement of a country's productive potential. This functional form, however, includes the assumption of a constant share of labor in output, which may be too restrictive for a converging country. For example, labor share in the Czech Republic gradually increased over the last decade. In this paper, we test whether this fact renders the application of the Cobb-Douglas production function unreliable for the Czech economy. The authors apply a more general form of production function and allow labor share to develop according to the empirical data. For the period 1995–2005, the authors do not find significant difference between the calculation of the supply side of the Czech economy by the Cobb-Douglas production function and a more general production function.

Hlaváček, Jiří; Hlaváček, Michal (2007): "Demand for Insurance: Comparison of von Neumann-Morgenstern's and Kahneman-Tversky's Approaches." *AUCO Czech Economic Review*, vol. 1(2), pages 116–134.

This paper presents the results of a comparison of an original theoretical concept of modeling human decisions under risk with two well-known models. In the paper the demand function for insurance is constructed for the model of maximization of the probability of agent's (economical) survival. This demand function is compared with the demand function in two other models: the expected-utility theory (von Neumann, Morgenstern) and the asymmetric value function (Kahneman, Tversky). While in the expected-utility model the poorest agents are most interested in insurance, in the Kahneman-Tversky model the poorest agents do not buy insurance because of their liking for risk. The model of maximization of the probability of survival corresponds better to the real structure of the insured: neither extremely rich people, nor extremely poor people accept insurance contracts. The former do not accept the game because of the negative expected value of the gains. For the latter the insurance is too expensive in relation to their income.

Horváth, Roman (2007): "Modelling Central Bank Intervention Activity under Inflation Targeting." *Economics Bulletin, Economics Bulletin*, vol. 6(29), pages 1–8.

Using daily data from the Czech Republic in 1/1/1998–31/12/2002, we find that foreign exchange intervention activity is determined by the degree of exchange rate misalignment and lagged intervention. Additionally, inflation targeting regime is a binding constraint of intervention activity.

Horváth, Roman (2007): "Ready for Euro? Evidence on EU new member states." *Applied Economics Letters, Taylor and Francis Journals*, vol. 14(14), pages 1083–1086.

This article estimates optimum currency area (OCA) index for the EU New Member States (NMSs). We find that, as compared to the current Euro area countries, the NMSs meet OCA conditions largely and in this respect, are likely good candidates for Euro adoption.

Horváth, Roman; Komárek, Luboš (2007): "Equilibrium Exchange Rates in The EU New Members: Methodology, Estimation And Applicability To ERM II." Prague Economic Papers, vol. 16(1), pages 24–37.

In this paper we discuss the estimation and methodology of the real equilibrium exchange rate partial equilibrium models and analyze to what extent the resulting estimates are applicable for setting the central parity prior to ERM II entry in the New EU Member States. Given the uncertainty surrounding the estimates, we argue that they are informative in the sign rather than the size of the misalignment of the exchange rate, but may still serve as useful consistency checks for the decision on the setting of the central parity. We argue that policy makers should consider the estimates in their decision-making only if the real exchange rate is substantially misaligned.

Hurník, Jaromír, Hájková, Dana (2007): "Supply-side performance in the Czech Republic: A macroeconomic view (1995–2005)." Prague Economic Papers, vol. 16(4), pages 319–335.

In this paper, we apply the aggregate production function to approximate the path of potential output and decompose it into its determinants. Based on the decomposition we evaluate the supply side performance from a macroeconomic perspective. We use a time-varying NAIRU to derive the amount of potential labour and a newly developed measure of capital services to account for the productive impact of capital. In addition, trend total factor productivity is estimated. During 1995–2000, the growth in potential output was constrained by a gradual increase in the NAIRU, a temporary drop in investment activity and, most importantly, by only a modest rise in total factor productivity. For the period 2001–2005, we observe substantial improvements in the supply-side performance, except for the functioning of the labour market.

Jakubík, Petr (2007): "Credit Risk and the Finnish Economy." AUCO Czech Economic Review, vol. 1(3), pages 254–285.

The significance of credit risk models has increased with the introduction of the New Basel Accord, known as Basel II. The aim of this study is to examine default rate modeling. This paper follows two possible approaches to macro credit risk modeling, empirical models and a latent factor model based on Merton. We employ data over the time period from 1988 to 2003 for the Finnish economy, including time series of bankruptcy, numbers of firms and industry-specific data. Linear vector autoregressive models are used in the case of a dynamic empirical model. We examine how significant macroeconomic indicators determine the default rate in the whole economy and in industry-specific sectors. Since these models cannot provide microeconomic foundations, we employ a model with one latent factor, although multi-factor models are also considered. This estimation helps us to understand the relationships between credit risk and macroeconomic indicators. Both models can be used for default rate prediction or stress testing by central authorities.

Jakubík, Petr (2007): "Macroeconomic Environment and Credit Risk." Czech Journal of Economics and Finance (Finance a úvěr), vol. 57(1–2), pages 60–78.

The importance of credit-risk models has increased with the introduction of the New Basel Capital Accord (Basel II). This paper follows Merton's approach to structural analysis, toward default-rate modeling. A latent-factor model is introduced within this framework. Estimation of this model can help further our understanding of the relationship between credit risk and macroeconomic indicators. The results have been used for stress testing the Czech banking sector.

Kollár, Miroslav (2007): "Structure of Production, Intraindustry Trade and Their Relevance for the Optimum Currency Areas Theory." Politická ekonomie, vol. 55(5), pages 603–624.

This paper deals with the recent empirical phenomenon of intraindustry trade, i.e. trade in similar goods between similar countries. It treats this phenomenon from the point of view of the theory of structure of production, highlighting the importance of sequential nature of production and heterogeneity and specificity of factors of production, as developed by Carl Menger, Eugen von Boehm-Bawerk and their followers of the so-called

Austrian school of economics. Simple theory of production structure, along the lines of Austrian economics, is presented and a useful tool for the analysis of intraindustry trade is developed. In the following discussion we make the case for vertical intraindustry specialization, complex manufactured goods and sliced-up production chains across countries. The reader immediately observes the importance of Austrian production structure theory for the analysis of intraindustry trade. We accordingly apply the concepts of the structure of production on intraindustry trade and analyze, in particular, the time- and place-aspects of international production. Finally, we show the relevance of our approach to intraindustry trade for the analysis of business cycle synchronization and Optimum currency areas theory.

Komárková, Zlatuše, Komárek, Luboš (2007): "Integration of the Foreign Exchange Markets Of the Selected EU New Member States." *Politická ekonomie*, vol. 55(3).

The article deals with the evaluation of the foreign exchange market integration of the new EU Member States – the Czech Republic, Hungary, Poland and Slovakia. The main aim of this paper is to introduce and to test, if the Central-European sentiment on the foreign exchange market exists and how strong it is. We apply the analysis of harmonizing (by means of standard and rolling correlation analysis), the concept of beta-convergence (through the use of the standard and rolling correlation analysis, state-space model and panel regression analysis), which could identify the speed of financial integration and the concept of sigma-convergence, which could extrapolate the degree of financial integration. We find that from the entry to the EU in May 2004 the mutual relationship with Central-European currencies relative to euro significantly increase.

Melecký, Martin; Komárek, Luboš (2007): "The Behavioral Equilibrium Exchange Rate of the Czech Koruna." *Transition Studies Review, Springer*, vol. 14(1), pages 105–121.

The behavioral equilibrium exchange rate (BEER) model of the Czech koruna is derived in this paper and estimated by three methods suitable for nonstationary time series. The considered potential determinants of the real equilibrium exchange rate are the productivity differential, the interest rate differential, the terms of trade, net foreign direct investment, net foreign assets, government consumption, and the degree of openness. We find that the Czech koruna was on average undervalued over the period from 1994 to 2004 by about 7 percent with respect to the estimated BEER. The significant determinants of the equilibrium exchange rate of the Czech koruna appear to be the productivity differential, the real interest rate differential, the terms of trade, and the net foreign direct investment.

Pruteanu-Podpiera, Anca (2007): "The role of banks in the Czech monetary policy transmission mechanism." *The Economics of Transition*, vol. 15(2), pages 393–428.

With this work, I aim to enrich the knowledge about the monetary policy transmission mechanism in the Czech Republic with empirical evidence on the impact of monetary policy on bank lending. Using a panel of quarterly time series for Czech commercial banks for the period 1996–2001, I study the overall effect of monetary policy changes on the growth rate of loans and the characteristics of the supply of loans. The characterization of the credit market's supply side allows us to make inferences on the operativeness of the credit channel (the bank lending channel and the broad credit channel) of the monetary transmission mechanism. I find that changes in monetary policy alter the growth rate of loans, with considerably stronger magnitude in the period 1999–2001 than in the period 1996–1998. From the analysis intended to capture the characteristics of the supply of loans, I conclude that the lending channel was operative in the period 1996–1998: I find cross-sectional differences in the lending reactions to monetary policy shocks due to the degree of capitalization and to liquidity. For the subsequent period 1999–2001, the results also show distributional effects of monetary policy due to bank size and its bank's proportion of classified loans. In the context of steadily decreasing interest rates, this can bolster the supposition of financial frictions between borrowers and lenders and hence, that of an operative broad credit channel.

Skořepa, Michal (2007): "Doubts about the Descriptive Validity of the Expected Utility Theory." *Politická ekonomie*, vol. 55(1), pages 106–120.

This paper summarizes the major events in the recent history of modelling human decisions under risk. After presenting the basics of expected utility theory, the key pieces of evidence are described which showed that under certain circumstances, this theory is not descriptively valid. The most promising alternative, cumulative prospect theory, is then presented in some detail, including a brief discussion of how it avoids violations of stochastic dominance and how it explains the above evidence. It is pointed out that there are other empirical observations which cannot be explained by cumulative prospect theory either, so that a model which would explain all evidence on decisions under risk is still to be found.

Skořepa, Michal (2007): "Expected utility theory versus cumulative prospect theory: An empirical view." *AUCO Czech Economic Review*, vol. 1(2), pages 180–195.

This paper pits expected utility theory and cumulative prospect theory against each other as regards their descriptive accuracy. Some older as well as newer pieces of evidence are described which show that under certain circumstances, expected utility theory is not descriptively valid. The most promising alternative, cumulative prospect theory, is then presented in some detail, including a brief discussion of how it avoids violations of stochastic dominance and how it explains the above evidence. It is pointed out that there are other empirical observations which cannot be explained by cumulative prospect theory either. It is concluded that expected utility theory is likely to remain the core instrument for modeling human decision-making under risk at least in the near future.

Skořepa, Michal (2007): "Transitivity and dominance: normative and empirical position of two cornerstones of economic models of decision-making." *Politická ekonomie*, vol. 55(2).

Transitivity and dominance are key concepts built deep into the fundamentals of most economic models of decision-making. One of the arguments in favour of using the two concepts is that they are normative, i.e., symptomatic of perfect, rational decision-making. This paper describes several specific axioms stemming from these concepts and appearing in axiomatic models of decision-making, gives possible arguments speaking for or against the normativeness of a given concept and adds examples of empirically observed violations of the concept by human decision-making. In the conclusion, it offers an assessment of whether the use of transitivity and dominance in economic models of decision-making is justified or not.

Šmídková, Kateřina; Bulíř, Aleš (2007): "Striving to Be "Clearly Open" and "Crystal Clear": Monetary Policy Communication of the CNB." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 57(11–12), pages 540–557.

The Czech National Bank has a respectable track record in terms of its policy actions and the corresponding inflation outturns. The authors analyze its main communication tools – inflation targets, inflation forecasts, verbal assessments of the inflation risks contained in quarterly inflation reports, and the voting within the CNB Board – to assess clarity of communication. They find that these tools provided a very clear message in about three out of every four observations in our 2001–2005 sample.

Brůha, Jan; Derviz, Alexis (2006): "Macroeconomic Factors and the Balanced Value of the Czech Koruna/Euro Exchange Rate." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 56(7–8), pages 318–343.

The authors study the dependence of the Czech koruna's exchange rate to the euro on risk factors that cannot be reduced to standard macroeconomic fundamentals. For this purpose, they construct an international asset-pricing model in which the exchange rate is codetermined by a risk factor imperfectly correlated with other priced risks in the economy. The model embeds the standard no-arbitrage setup. It also contains an additional equation that links the autarchic currency price with the foreign-exchange order flow. In the state-space form, the unobserved variables that determine the dynamics of the asset markets, the autarchic exchange rate, and the FX order flow span a number of macroeconomic and latent risk factors. The model for the Czech koruna/euro exchange rate uses Kalman filter techniques. The results indicate the existence of a "non-fundamental" source of systematic divergence between the observed and the autarchic (i.e. fundamental) FX returns.

Bulíř, Aleš; Hurník, Jaromír (2006): "The Maastricht inflation criterion: How unpleasant is purgatory?" *Economic Systems*, vol. 30(4), pages 385–404.

The Maastricht inflation criterion, designed in the early 1990s to bring "high-inflation" EU countries in line with "low-inflation" countries prior to the introduction of the euro, poses challenges for both new EU member countries and the European Central Bank. While the criterion has positively influenced the public stance toward low inflation, it has biased the choice of the disinflation strategy toward short-run, fiat measures – rather than adopting structural reforms with longer-term benefits – with unpleasant consequences for the efficiency of the eurozone transmission mechanism. The criterion is also unnecessarily tight for new member countries as it mainly reflects cyclical developments.

Cincibuch, Martin; Podpiera, Jiří (2006): "Beyond Balassa-Samuelson: Real appreciation in tradables in transition countries." *The Economics of Transition*, vol. 14(3), pages 547–573, 07.

We decompose real appreciation in tradables derived from producer price indexes in three Central European countries between the pricing-to-market component (disparity) and the local relative price component (the substitution ratio). Appreciation is only partially explained by local relative prices. The rest is absorbed by disparity, depending on the size of the no-arbitrage band. The observed disparity fluctuates in a wider band for differentiated products than for commodity like goods.

Dybczak, Kamil (2006): "Generational Accounts in the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 56(7–8), pages 298–317.

The generational accounting approach used in this paper incorporates projected demographic development and the parameters of current Czech fiscal policy into an intertemporal government budget constraint. Compared with public-debt and deficit data, the economic indicators based on generational accounting are forward looking and yield additional information about fiscal policy. To assess the sustainability of Czech public budgets, the authors constructed the first set of generational accounts for the Czech Republic. They found that, for 2004, a representative agent obtained more benefits than paid taxes; that is, the generational account of the representative agent was negative. In addition, the total amount of government liabilities resulting from the current fiscal policy, projected to 2150, was estimated at about 300 percent of the national GDP in 2004. The authors conclude that Czech fiscal policy is not sustainable; current taxes and benefits should be modified in line with demographic projections in an effort to stabilize public budgets.

Egert, Balazs; Komárek, Luboš (2006): "Foreign exchange interventions and interest rate policy in the Czech Republic: Hand in glove?" *Economic Systems*, vol. 30(2), pages 121–140.

This paper studies the impact of daily official FX interventions on the Czech koruna's exchange rate vis-à-vis the euro (the German mark) from 1997 to 2002. Both the event study methodology extended with official interest rate moves and a variety of GARCH models reveal that FX interventions, especially koruna purchases, were relatively ineffective from 1997 to mid-1998. From mid-1998 to 2002, however, koruna sales turned out to be effective in smoothing the path of the exchange rate for up to 60 days. Nevertheless, the event study approach also indicates that the success of FX interventions depends crucially on the coordination of intervention and interest rate policies.

Foltýnová, Hana; Brůha, Jan (2006): "A Note on the Optimal Taxation Theory." *Politická ekonomie*, vol. 54(3), pages 366–381.

This paper is focused on the theory of optimal taxation applied to environmental regulation. The first part summarizes the current state of knowledge in this field; especially it concentrates on the so called double dividend hypothesis. The second part of the paper defines the concept of triple dividend in transport, which is modeled in the normative neoclassical framework. Based on econometric estimation, we calibrate a model and empirically investigate this hypothesis on the Czech data.

Frait, Jan; Komárek, Luboš (2006): "Half a Century of the World Money Development." *Politická ekonomie*, vol. 54(3), pages 307–325.

The article provides a general description of the world money development in both developed and developing countries during the second half of 20th century. We were primarily focusing on the long run trends in dollar gold prices, monetary aggregates (broad and narrow money), foreign exchange reserves, inflation and interest rates. We found that after relatively tranquil periods of fifties and sixties, next three decades witnessed dramatic changes in the world economy. The emphasis that was given to the analysis of the relation of the dollar gold prices to the world reserve currencies (EUR, CHF, GBP and JPY) by means of state-space model confirmed negative correlation between these variables. Subsequently we discussed a concept of neutrality and superneutrality of money in the light of GDP dynamics during monitored period and practical aspects of monetary policy. In spite of some recent empirical findings, we express our belief in the long-run neutrality and superneutrality of money and in relative non-activistic monetary policy with price stability as its primary goal.

Geršl, Adam (2006): "Development of Formal and Informal Institutions in the Czech Republic and Other New EU Member States Before Their EU Entry: Did the EU Pressure Have Impact?" *Prague Economic Papers*, vol. 15(1), pages 78–90.

The paper compares the quality of the institutional framework of the Czech Republic with other new EU Member States and the EU-15 average using the World Bank data on Governance Indicators and argues that the pressure from the EU institutions during the accession negotiation period to reform the legal framework was not sufficient to improve significantly the business environment. Among factors that prevented the improvement of institutions the influence of strong interest groups, ineffective enforcement of legal rules and corruption are discussed and empirically illustrated using data on 'state capture'.

Geršl, Adam (2006): "Political Pressure on Central Banks: The Case of the Czech National Bank." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 56(1–2), pages 18–39.

As the independence of national central banks in the European Union is one of the main institutional features of the EU's monetary constitution, this paper considers whether central-bank monetary policy is conducted independently or if it is affected by political pressure. Specifically, the author applies Thomas Havrilesky's methodology to measure political pressure on the Czech National Bank in testing whether taken monetary policy was influenced by outside pressure.

Geršl, Adam (2006): "Testing the Effectiveness of the Czech National Bank's Foreign-Exchange Interventions." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 56(09–10), pages 398–415.

This article reviews several approaches to testing the effectiveness of foreign-exchange interventions and applies some of these to data on interventions made by the Czech National Bank in 2001 and 2002. The reaction function of the CNB and the impact of interventions on exchange rates and on conditional and implied volatility are estimated, and the successfulness of interventions is discussed within the event-study approach. The results indicate that the interventions by the central bank had only a minor, short-term effect on exchange rates and, to a certain extent, contributed to increased conditional and implied volatility.

Geršl, Adam; Holub, Tomáš (2006): "Foreign Exchange Interventions under Inflation Targeting: The Czech Experience." *Contemporary Economic Policy, Western Economic Association International*, vol. 24(4), pages 475–491.

This article discusses the role of foreign exchange interventions in the inflation-targeting regime, focusing on the Czech experience since 1998. We find some evidence that the interventions had a statistically significant, but short lived and economically not very important, impact on the koruna's exchange rate and its volatility. We also discuss consistency of the interventions with the inflation-targeting framework. All the Czech intervention episodes are judged to be consistent with the inflation targets and output developments, but for two episodes not fully consistent regarding the mix of monetary conditions.

Hájková, Dana; Nicoletti, Giuseppe; Vartia, Laura; Yoo, Kwang-Yeol (2006): "Taxation and Business Environment as Drivers of Foreign Direct Investment in OECD Countries." *OECD Economic Studies*, 2006(43), pages 7–38.

How important are differences in corporate taxation for the investment decisions of multinational enterprises (MNEs)? Over the past decade, interest in this issue has been growing in parallel with the increasing mobility of capital and internationalization of businesses. Standard models of the MNEs predict that corporate taxation can influence foreign direct investment (FDI) by creating a wedge between the pre- and post-tax returns on investment. The relevant tax wedge, however, depends on whether MNEs' investment is incremental or involves the creation of entirely new plants.

Hlaváček, Jiří, Hlaváček, Michal (2006): "Principal-Agent Problem in the Context of the Economic Survival." *Acta Oeconomica Pragensia*, vol. 2006(3), pages 18–33.

This paper analyses problems within the asymmetric information models (principal agent models) where we replace standard assumption of maximisation of expected income by maximisation of probability of economic survival. This paper concentrates on two basic models – adverse selection model and moral hazard model. In both cases the effect of asymmetry of information gets weaker or even disappears. Contrary to standard approach the competitive Pareto effective equilibrium could exist in both models with pooled contract with full coverage of possible accident by the principal.

Skořepa, Michal, Kotlán, Viktor (2006): "Inflation Targeting: To Forecast or To Simulate?" *Prague Economic Papers*, vol. 15(4), pages 300–314.

Perhaps the most notable development in the area of monetary policy over the last decade is the growing popularity of inflation targeting. This regime is based to a great extent on communication and, more specifically, on using and communicating assessments of future inflation. The central banking literature, however, devotes surprisingly little attention to some important issues connected with such assessments. There are some non-trivial choices that need to be made regarding future inflation assessments on three distinct levels: construction, decision making and communication. One of the most important choices relates to the treatment of central bank's behaviour within the assessment. We differentiate between forecast and simulation as two basic ways of assessing future inflation and we discuss the pros and cons of using the two ways of assessing future inflation on the three above-mentioned levels.

Slavík, Michal (2006): "The Czech Pension System and the Perspectives of Its Reform." *Prague Economic Papers*, vol. 15(3), pages 214–230.

This essay describes the Czech pension system, provides a brief history of its modern transformation and mentions some of its drawbacks which should be the subject of a future policy debate. Particular attention is devoted to the third pillar and to the importance of a well-functioning capital market as one of the key conditions for the further development of funded pillars. The question of the timing of the enhancement of the funded pillars in a robustly growing economy with a limited capital market is opened. A lack of new private shares and bonds issues on the domestic capital market may be one of the arguments for postponement of the funded pillars' strengthening. A focus of policymakers who will set up the pension system reform strategy should be concentrated on comparing transitional and transaction costs of each reform alternative and on the building of an efficient regulatory and supervisory infrastructure. They should, instead of enforcing involuntary savings in pension funds, seek measures that will help to create a savings-friendly and growth-oriented economic environment.

Vojtek, Martin; Kočenda, Evžen (2006): "Credit-Scoring Methods." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 56(3–4), pages 152–167.

The paper reviews the best-developed and most frequently applied methods of credit scoring employed by commercial banks when evaluating loan applications. The authors concentrate on retail loans – applied research in this segment is limited, though there has been a sharp increase in the volume of loans to retail clients in recent years. Logit analysis is identified as the most frequent credit-scoring method used by banks. However, other nonparametric methods are widespread in terms of pattern recognition. The methods reviewed have potential for application in post-transition countries.

Babetskii, Ian (2005): "Trade integration and synchronization of shocks." *The Economics of Transition*, vol. 13(1), pages 105–138, 01.

According to the European Commission (1990), closer integration leads to less frequent asymmetric shocks and to more synchronized business cycles between countries. However, for Krugman (1993) closer integration implies higher specialization and, thus, higher risks of idiosyncratic shocks. Drawing on the evidence from a group of transition countries, this paper tries to determine whose argument is supported by the data. This is done by confronting estimated time-varying coefficients of supply and demand shock asymmetry with indicators of trade intensity and exchange rates. We find that (i) an increase in trade intensity leads to higher symmetry of demand shocks: the effect of integration on supply shock asymmetry varies from country to country; and (ii) a decrease in exchange rate volatility has a positive effect on demand shock convergence. The results confirm 'The European Commission view' and also the argument by Kenen (2001) according to which the impact of trade integration on shock asymmetry depends on the type of shock.

Babetskii, Ian; Égert, Balázs (2005): "Equilibrium Exchange Rate in the Czech Republic: How Good is the Czech BEER?" *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(5–6), pages 232–252.

The paper investigates the equilibrium exchange rate of the Czech koruna using the reduced-form equation of the stock-flow approach advocated by, for example, Faruqee (1995) and Alberola et al. (1999). We investigate whether the observed real exchange rate of the Czech koruna is close to its equilibrium value over the period from 1993 to 2004. Our empirical approach is tantamount to the behavioral equilibrium exchange rate (BEER), popularized by MacDonald (1997) and Clark and MacDonald (1998), in that the Czech real exchange rate vis-à-vis the euro is regressed on the dual productivity differential; and the net foreign assets position, based on which actual and total misalignment figures, are derived in a time-series context. In other words, we check the quality of the Czech BEER. We also study the impact of a possible initial undervaluation on the estimated equilibrium exchange rate. Employing monthly time series from 1993, and applying several alternative cointegration techniques, we identify a period of an overvaluation in 1997 and in 1999, an increasing overvaluation afterwards, an undervaluation in 2003, and a correction toward equilibrium in the second half of 2004.

Bulíř, Aleš; Šmídková, Kateřina (2005): "Exchange rates in the new EU accession countries: What have we learned from the forerunners?" *Economic Systems*, vol. 29(2), pages 163–186.

Estimation and simulation of sustainable real exchange rates in some of the new EU accession countries point to potential difficulties in sustaining the ERM II regime if entered too soon and with weak policies. According to the estimates, the Czech, Hungarian, and Polish currencies were overvalued in 2003. Simulations, conditional on large-model macroeconomic projections, suggest that under current policies those currencies would be unlikely to stay within the ERM II stability corridor during 2004–2010. In-sample simulations for Greece, Portugal, and Spain indicate both a much smaller misalignment of national currencies prior to ERM II, and a more stable path of real exchange rates over the medium term than can be expected for the new accession countries.

Čech, Zdeněk; Horváth, Roman; Komárek, Luboš (2005): "Exchange-Rate Convergence and Entrance to the Eurozone III – Selected Problems of New Member States." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(9–10), pages 483–505.

The paper contains a general analysis of the exchange rate convergence process of new European Union member states and candidate countries. Following an introduction, we discuss exchange rate strategies applied during periods of economic transition. Emphasis is given to a hypothetical evaluation of the exchange rate criterion. We review the exchange rate strategies of transition countries using an analytical framework similar to the EU member states, and discuss the selected strategies presented in the "Pre-accession Economic Programmes" and convergence programs. In light of the exchange rate experience of EU-15 countries, we summarize the main determinants of exchange rate movement in transition countries. Finally, we discuss factors which will influence ERM II accession.

Čihák, Martin; Holub, Tomáš (2005): "Price Convergence in EU-Accession Countries: Evidence from the International Comparison." *Economie Internationale*, CEPII research center, issue 2Q, pages 59–82.

The authors analyse price convergence in new EU countries. They estimate the price level elasticity with respect to the GDP in PPP to be 0.7–0.9 percent. They also analyze additional sources of price level convergence, such as terms-of-trade changes or price deregulation. The average speed of real exchange rate appreciation is estimated at about 3 percent a year, and its implications for fulfilling the Maastricht criteria are discussed. Focusing on adjustments in the structures of relative prices, the authors find that it may take about 10–25 years for the new EU countries to converge to that of the least developed EU countries.

Filáček, Jan (2005): "Inflation Expectations and Monetary Policy." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(7–8), pages 380–394.

This paper shows that an economy's behavior differs significantly according to assumptions made on the formation of inflation expectations. We analyzed the behavior of an open economy in a regime of explicit inflation targeting with commitment. The economy is exposed to three different shocks – demand, supply, and exchange rate – and its reaction is analyzed under three different assumptions on inflation-expectations formation: naive, rational, and adaptive learning. The economy in which rational expectations were assumed showed the least volatile development and minimized the central bank's loss function. The stabilizing effect of this forward-looking type of expectation was most evident in the case of supply shock. When naive expectations were assumed, the economy reacted to all shocks with significantly bigger and longer-lasting fluctuations. The worst results were obtained assuming adaptive-learning expectations, where shocks lead to large oscillations and the economy stabilized only several years after the shock.

Flek, Vladislav; Večerník, Jiří (2005): "The Labour Market in the CR: Trends, Policies and Attitudes." *Czech Journal of Economics and Finance (Finance a úvěr)*, 2005, vol. 55(1–2), pages 5–24.

The Czech Republic is no longer an employment haven, the site of what had been declared as an "unemployment miracle." What happened? In this paper, the authors gather various statistical and sociological data on employment and unemployment trends, wage development, and workers' opinions and their labor market strategies, taken from various surveys. In such manner, not only is the history of the Czech labor market over the past decade written, but also the reasons for the deteriorating labor market performance are addressed, and an appropriate policy agenda is outlined. In particular, the authors identify existing labor market rigidities and show that high unemployment here proceeds in an ever-widening gyre, resulting in the emergence of the unemployment trap and benefit dependency. Active labor market policy measures alone appear to be insufficient to deal with this problem.

Frait, Jan (2005): "Inflation Targeting, Expectations and Uncertainty in Monetary Policy (Guest editor's summary)." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(7–8), pages 314–315.

The text introduces a single topic issue of the Czech Journal of Economics and Finance focusing on the experience of the Czech National Bank with the fully-fledged inflation targeting regime. It summarizes the impact of the regime on monetary policy predictability, agents' expectations and long-term interest rates.

Galuščák, Kamil; Münich, Daniel (2005): "Regional Wage Adjustments and Unemployment: Estimating the Time-Varying Wage Curve." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(1–2), pages 68–82.

This paper investigates the flexibility of real wages at the regional level by estimating the wage curve, the relationship between regional unemployment, and the regional level of wages. For this purpose the authors use a sample of annual district-level unemployment and wage data in the Czech Republic from 1993 to 2001. Previous estimates of the wage curve for the Czech Republic suggested that the regional flexibility of real wages is extraordinarily

low. Taking into account the endogeneity of unemployment, the authors' results indicate that regional real wages are flexible at the level observed in most developed and developing economies. The temporary deterioration in the regional flexibility observed during the 1997–99 Czech recession is explained by the standard efficiency wage model. Some indication of weakening elasticity since the end of the 1990s is probably associated with the sharp rise in the incidence of long-term unemployment. As this trend is expected to continue, it could further attenuate the elasticity and complicate adjustment processes if adverse shocks appear in the future, particularly after the Czech Republic's anticipated entry into the European Monetary Union.

Hlaváček, Jiří; Hlaváček, Michal (2005): "Cruel Altruism." Prague Economic Papers, vol. 14(4), pages 363–374.

This article shows that the altruism of the donator could have different forms. The specific form of his optimisation criterion significantly influences his decision making concerning the allocation of his resources among recipients. Moreover, even within one chosen criterion we could report sudden changes in strategy of a rational donator. This donator, even if he is so called 'hard altruist' (i.e. subject preferring community interests to his individual interests), he could be forced to make a 'gambit', when he sacrifices one from the subjects supported in favour of survival of the community as a whole. This preferring of whole community to individual interests could lead to liquidation of the least resistant member of the community. This is quite surprising as this member of the community was the most heavily supported before. Altruism could be cruel.

Holinka, Tomáš (2005): "Determinants of Long-Term Interest Rates in the Czech Republic." Czech Journal of Economics and Finance (Finance a úvěr), 2005, vol. 55(7–8), pages 363–79.

The paper analyses the factors leading to the fall of long-term interest rates in the Czech Republic – respectively, the long-term interest rate differential in the Czech Republic and the Eurozone – between 1998 and 2003. The selection of factors is determined by the Fisher equation, UIP, PPP, expectation hypothesis and neoclassical growth theory. The paper suggests that falling long-term interest rates may have been affected by an expectation of lower short-term rates due to falling inflation expectations and inflation premiums. The decrease of CZK/EUR long-term rate differentials from 4% to 0% can approximately be explained by the one-third decrease of inflation expectations in the Czech Republic and by the 50% decrease of the relative inflation premium. In the long term, the effect of Czech National Bank monetary policy is dwindling vis-à-vis European Central Bank policy, i.e., euro interest rates. Another factor is the anticipated entry of the Czech Republic into the Economic Monetary Union. The real interest-rate differential has no effect.

Horníková, Martina; Hurník, Jaromír; Kotlán, Viktor (2005): "Spontaneous euroization in the Czech Republic (is it a problem and why not?)." Prague Economic Papers, vol. 14(2), pages 99–108.

The paper offers a preliminary analysis of possible spontaneous euroization in the Czech economy. After a brief general introduction of the issue of currency substitution it specifically discusses two things. First, the transmission channels of potential spontaneous euroization, through which the process could possibly complicate the implementation of domestic monetary policy. Second, it analyses the degree of euroization. Among the transmission channels, attention is paid to interest rate and exchange rate channels. The circumstances under which the transmission would be sub-optimal are discussed. Besides the impact on the monetary policy transmission, another risk of progressive spontaneous euroization is seen in the shift of the exchange rate risk from bigger to smaller enterprises in the economy. The available data do not allow a precise measurement of the degree of euroization. Nevertheless, both the ratio of euro-denominated over koruna-denominated deposits and the CNB's survey in 2003 suggest that euroization is not an obstacle for the Czech monetary policy at the moment.

Horváth, Roman (2005): "Exchange rate variability, pressures and optimum currency area criteria: some empirical evidence from the 1990s." *Applied Economics Letters, Taylor and Francis Journals*, vol. 12(15), pages 919–922.

This paper estimates the medium-term determinants of the bilateral exchange rate variability and exchange rate pressures for 20 developed countries in the 1990s. The results suggest that optimum currency area criteria explain the dynamics of bilateral exchange rate variability and pressures, to a large extent.

Horváth, Roman; Kučerová, Zuzana (2005): "Real Exchange Rates and Optimum Currency Areas: Evidence from Developed Economies." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(5–6), pages 253–266.

In this paper, the authors link real exchange rates and optimum currency area criteria. The authors examine the hypothesis that countries not fulfilling optimum currency area criteria in full will tend to have volatile bilateral real exchange rate. The authors find that, based on a study of data from developed economies from the 1990s, optimum currency criteria (such as trade integration, asymmetry of shocks, openness) help explain bilateral real exchange-rate variation.

Hurník, Jaromír; Navrátil, David (2005): "Labor-Market Performance and Macroeconomic Policy: Time-Varying NAIRU in the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 55(1–2), pages 25–40.

During the second half of the 1990s, the Czech economy experienced a sharp increase in the unemployment rate. The authors attempt to determine whether this was caused by structural changes, worsening labor-market performance, or by the changing business-cycle position. This has direct implications for both monetary and fiscal policy. The authors use NAIRU (non-accelerating inflation rate of unemployment) estimates using time-varying NAIRU. The estimates indicate that the NAIRU increased between 1996 and 2002 by approximately 1.5 percent. Estimated increases in the NAIRU can be associated with the worsening of labor-market efficiency.

Hurník, Jaromír; Navrátil, David (2005): "Potential Output In The Czech Republic: A Production Function Approach." *Prague Economic Papers*, vol. 14(3), pages 253–266.

This paper deals with the Czech economy supply side performance from the macroeconomic point of view. In order to evaluate the supply side behaviour we calculate the potential output dynamic path and contribution of its particular determinants using the production function method. The results show that the potential output growth was rather slow around 2 per cent. This implies that e. g. even 3 per cent growth can cause macroeconomic imbalances. Increase of the non-accelerating-inflation-rate of unemployment (NAIRU), weak growth of the capital stock and weak growth of total factor productivity appear to be the reasons for the constrained ability of the Czech economy to grow steadily and converge to EU level.

Juillard, Michel; Kumhof, Michael; Kameník, Ondra (2005): "Optimal price setting and inflation inertia in a rational expectations model." *Proceedings, Board of Governors of the Federal Reserve System (U.S.)*.

This paper presents and estimates a new Keynesian monetary model for the US economy. It proposes possible solutions to two problems in this model class, the lack of inflation inertia and persistence in versions of these models that insist on rigorous microfoundations and rational expectations, and the small contribution of technology shocks to business cycles. Price setting takes the form of optimal two-part pricing policies formulated under conditions of upward-sloping firm-specific marginal cost curves. Furthermore, this form of price setting applies not only to prices and wages but also to user costs of capital. In this setting past inflation becomes a key determinant of current inflation, even though price setting is entirely forward-looking. Technology is modeled as a random walk, with technology growth shocks that follow a highly persistent process. The model is estimated by Bayesian methods, and performs significantly better than a Bayesian VAR. It generates inertial and persistent inflation, and technology shocks account for a large share of business cycle variation.

Kadlčáková, Narcisa; Keplinger, Joerg (2005): "Credit Risk and Bank Lending in the Czech Republic." *ICFAI Journal of Risk and Insurance* 2005, vol. 2(3), pages 34–78.

This project undertakes an empirical analysis in credit risk modeling using a data sample representative of bank lending to the Czech corporate sector. A rating system is constructed using a proprietary database (Creditreform) that provides a solvency index for a large number of Czech firms. Several methods for the calibration and validation of a rating system are described and tested in practice. On the basis of a representative portfolio for Czech industries, systemic predictions of regulatory and economic capital are obtained and compared. The methodologies formulated by the latest Consultative Document of the NBCA (April 2003) and by the Credit Metrics and CreditRisk+ models are applied. The main contributions of this project can be briefly summarized as follows, (a) it shows in an applied manner that input data problems in credit risk modeling can be overcome, (b) it sheds light on regulatory issues that are gaining increasing relevance, and (c) it outlines the most important features of two credit risk models.

Kameník, Ondřej (2005): "Solving SDGE Models: A New Algorithm for the Sylvester Equation." *Computational Economics, Springer*, vol. 25(1), pages 167–187.

This paper presents a new numerical algorithm for solving Sylvester equation involved in higher order perturbation method used for solution of stochastic dynamic general equilibrium models. The new algorithm is better than methods used so far (esp. very popular doubling algorithm) in terms of computational time, memory consumption, and numerical stability. Further, the paper applies the algorithm in a simulation of a large macroeconomy model providing a simple welfare analysis of a few monetary rules. The welfare analysis compares household's lifetime expected utility.

Matalík, Ivan; Arlt, Josef (2005): "Use of Statistics in the Monetary Policy of the Czech National Bank: The Case of a Country in Transition." *International Statistical Review*, vol. 73(1), Pages: 59–72.

In the presented text the authors judge the importance of statistics in the monetary policy of the Czech National Bank (CNB) over the course of the economic transformation process, with particular consideration of changing statistical needs and the possibilities and limits of statistical data exploitation in the monetary analyses. The importance of statistics lies on the level of collection and processing of statistical information and on the level of use of statistical methods to analyse data. Since the start of the 1990s the requirements for statistics were significantly influenced by monetary policy. In the period 1990–1997, monetary targeting was the primary influential factor. Since 1998, the monetary policy is influenced by inflation targeting. Statistical priorities switched from monetary data to economy and financial market data. Much progress has been made in the use of statistical methods for analysing data. Statistics available at present cover the CNB's standard monetary-policy requirements and are on par with those in developed countries. Its further development will reflect the standard changes taking place in the more advanced countries.

Matalík, Ivan; Slavík, Michal (2005): "Debt management in the Czech Republic (formation in the 1990s and the current state)." *Prague Economic Papers*, vol. 14(1), pages 33–50.

This paper describes the development and the current state of debt management in the Czech Republic. The basic principles on which it was built during the 1990s and the importance of the monetary and fiscal policy coordination in effective debt management implementation are discussed. The authors try to explain the main factors that are behind the substantial state debt increases in the course of several recent years and to discuss some of the topical issues connected to the debt management targets and procedures. The paper provides a basic description of the instruments used and the conceptual and institutional framework of the Czech Republic debt management system with a particular emphasis on the role of the central bank.

Rutarová, Radka; Slavík, Michal (2005): "The Simulation of the Future Development of Expenditure and Revenue of the Czech Pension Security Scheme Up To 2050." *Politická ekonomie*, vol. 53(2).

The long-term sustainability of the public finance in the context of population ageing is becoming a hot topic in most of the European countries including the Czech Republic. Moreover the Czech population will be one of the oldest in the world according to the forecasts of different institutions (UN, OECD, etc.). It poses challenge for the Czech pension security scheme. This paper presents possible scenarios of the future development and illustrates future fiscal impacts of the ageing assuming a preservation of the current Czech pension security scheme in the period up to 2050. The analysis is based on a detailed one-year age structure. This allows us to simulate the influence of the changes in component parameters of the current scheme on its future situation (for example, changes in retirement age limits). The main conclusion is that there is a rather small impact of these parameters changes on the expected future imbalance of the Czech pension system. Therefore a more fundamental reform of the current pension system should be considered.

Skop, Jiří (2005): "Why Central Banks Undershoot Their Inflation Targets." *Politická ekonomie*, vol. 53(2), pages 185–201.

The goal of this article is to explain why central banks undershoot their inflation targets as we can observe also in the case of the Czech Republic. In other words, I am trying to find out if this undershooting is due to unpredictable desinflation shocks or due to asymmetric behaviour of central banks. Specifically, positive deviations from the target (i.e. overshooting) are weighted more in central bank's loss function than the negative ones. It is shown that the Czech National Bank is asymmetric in its preferences but not so much as in the case of Canada, Sweden and the United Kingdom. On the other hand, some part of undershooting attributes to desinflation shocks hitting the Czech economy.

Slavík, Michal (2005): "Introduction To Time Series Modeling: State Space Models And Kalman Filter." *Politická ekonomie*, vol. 53(1).

This contribution undertakes to outline the state space models and the recursive technique called the Kalman filter to a wider audience of the Czech economics readers. One can find both terms in a whole range of empirical studies from recent years. Following this approach also allows us among other things to model unobservable variables such as the potential output or the natural rate of unemployment. The primary motivation of this article is to bring a basic introduction to the reader who does not deal with the time series analysis on an everyday basis and to sketch the roots of state space models and the Kalman filter. Those who are interested can find more proper and rigorous description in the original literature.

Slavík, Michal; Rutarová, Radka (2005): "Contribution To Discussion On Reform Of Pension System." *Politická ekonomie*, vol. 53(3), pages 349–367.

This essay focuses on the pension system and highlights some of its key elements. The first part deals with the economic principles connected with the social security system. Eatwell's model is utilized to give some basic intuition of terms and concepts used in the pension reform discussion. The second part classifies pension systems from different perspectives and discusses some of the factors relevant for the Czech reform effort. The last part brings the main arguments of the pay-as-you-go supporters that seem to be missing in the current Czech debate. The aim of the authors is to show that a pension reform is a rather complex problem where no fast, simple and impartial view solutions exist. Rather than giving any particular recommendations, the authors try to stimulate the current pension reform debate by stating some controversial issues.

Šmídková, Kateřina (2005): "How Inflation Targeters (Can) Deal with Uncertainty." Czech Journal of Economics and Finance (Finance a úvěr), vol. 55(7–8), pages 316–332.

The paper argues that a well-designed methodology for dealing with uncertainty improves the quality of interest-rate decisions taken by inflation targeters. A well-planned methodology is also more easily communicated to the general public, and the subsequent greater transparency makes inflation targeting more efficient. Therefore, it is relevant for an inflation targeter to consult with or consider information from other inflation targeters, researchers, and relevant decision makers when designing or improving upon their methodology. The paper also summarizes the results of a recent survey on methods for dealing with uncertainty for inflation targeters. The results are presented in a framework designed in line with decision analysis. The paper summarizes which methods are commonly used by inflation targeters and what lessons can be learnt from economic research and from decision makers.

Šmídková, Kateřina; Bulíř, Aleš (2005): "Would Fast Sailing Towards The Euro Be Smooth? What Fundamental Real Exchange Rates Tell Us." Prague Economic Papers, vol. 14(4), pages 291–316.

Computed fundamental real exchange rates in four new EU members point to difficulties in jointly entering the ERM II soon after the EU entry. Three currencies out of the four were overvalued prior to EU entry. Computations suggest that it is unlikely that the Czech, Hungarian and Polish economies will maintain low inflation during 2004–2010 and at the same time keep their currencies within the ERM II easily. Moreover, the experience of Greece, Portugal and Spain – viewed through fundamental real exchange rate goggles – indicates more stable real exchange rate paths and smaller currency misalignments prior to euro adoption than can be expected from the newcomers in the forthcoming years. If the newcomers sail too fast towards the euro, their sailing may not be as smooth as that of the front runners.

Andrle, Michal; Brůha, Jan (2004): "The Role Of Discounting Type In Economic Modelling." *Politická ekonomie*, vol. 52(6), pages 757–771.

This paper reviews important approaches to discounting in economic modelling. It summarizes historical approaches and discusses why exponential discounting has been adopted as a widely accepted benchmark. The article then presents hyperbolic discounting as an alternative, while stresses different interpretation of discounting in positive and normative economics. In positive economics, the paper uses recent evidence to show that some observed regularities implied by exponential discounting are counterfactual and we illustrate different implications of the two approaches to discounting using numerical simulations of a stylized model of investment-consumption behaviour. It also concerns with applications of discounting in normative models of environmental economics. Many authors claim that exponential discounting, when used for long-term project evaluation, leads to an unfair treatment with generations living in a far future. We construct a model of optimal non-renewable resource exploitation to illustrate different normative implications of exponential and hyperbolic discounting.

Arlt, Josef; Guba, Milan; Radkovský, Štěpán (2004): "Implementation of Monetary Overhang/Shortfall Measure for Indication of Inflation Risks." *Politická ekonomie*, vol. 52(2), pages 183–89.

The ECB concept of analysis of deviation of actual money stock development from its long run equilibrium development is based on the assumption that bigger deviation signalizes risks for the price stability. The ECB considers three measures of this deviation: nominal money gap, real money gap and monetary overhang/shortfall. The calculation of gap between the actual and the equilibrium development of money stock in nominal and real expression is not reasonable at the present time in Czech Republic. The calculation of monetary overhang/shortfall, which is based on the long run equilibrium value of money stock given by model of money demand, seems to be more employable.

Babetskaia-Kukharchuk, Oxana; Maurel, Mathilde (2004): "Russia's accession to the WTO: the potential for trade increase." *Journal of Comparative Economics*, vol. 32(4), pages 680–699.

This paper investigates the impact of institutions on trade and estimates the potential for trade increase between the Commonwealth of Independent States (CIS) and the European Union (EU). The latter is computed from a gravity equation using the procedure introduced by Hausman and Taylor [1981. Panel Data and Unobservable Individual Effects. *Econometrica* 49 (6) 1377–1398]. We find that CIS trade is still characterized by a large trade diversion effect, which implies that trade with non-CIS countries could increase considerably in the long run. Another source of deepening the level of the European trade integration comes from the convergence of institutions towards the EU standards in light of Russia's application to join the WTO.

Babetskii, Ian; Boone, Laurence; Maurel, Mathilde (2004): "Exchange rate regimes and shocks asymmetry: the case of the accession countries." *Journal of Comparative Economics*, vol. 32(2), pages 212–229.

This paper reviews the pros and cons of an early EU enlargement that includes the Central and Eastern European countries (CEECs). The analysis of Maastricht criteria and real convergence enables us to distinguish the subset of transition countries that have succeeded in stabilizing and restoring economic growth from a second subset that failed to do so. For the former group, business cycles symmetry is an important issue. Using the Kalman filter, we compute the time varying correlation of demand and supply shocks in Ireland, Portugal, Spain and eight CEECs, namely the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia. Our results emphasize an ongoing process of convergence of demand shocks, but divergence of supply shocks.

Babetskii, Jan (2004): "EU Enlargement and Endogeneity of Some OCA Criteria: Evidence from the CEECs." *Economie et Prevision* (163), pages 33–49.

There are two opposite points of view on the link between economic integration and business cycle synchronization. De Grauwe (1997) classifies these competing views as 'The European Commission View' and 'The Krugman View'. According to the European Commission (1990), closer integration leads to less frequent asymmetric shocks

and to more synchronized business cycles between countries. On the other hand, for Krugman (1993) closer integration implies higher specialization and, thus, higher risks of idiosyncratic shocks. Drawing on the evidence from a group of transition countries which have experienced a notable increase in trade openness and economic integration with the European Union during the past decade, this paper tries to determine whose argument is supported by the data. This is done by confronting estimated time-varying coefficients of supply and demand shock asymmetry with indicators of trade intensity and exchange rates. We find that (i) an increase in trade intensity leads to higher symmetry of demand shocks; the effect of integration on supply shock asymmetry varies from country to country; (ii) a decrease in exchange rate volatility has a positive effect on demand shock convergence. The results for demand shocks can be interpreted in favor of 'The European Commission View', also known as the endogeneity argument by Frankel and Rose (1998) in the OCA criteria discussion, according to which trade links reduce asymmetries between countries. Overall, our results support Kenen's (2001) argument that the impact of trade integration on shock asymmetry depends on the type of shock.

Barrell, Ray; Holland, Dawn; Šmídková, Kateřina (2004): "Monetary policy choices in the pre-EMU period." *International Advances in Economic Research*, vol. 10(4), page 338.

The new members of the European Union must choose between a fixed and floating exchange rate in the period prior to joining EMU. The appropriate choice is not necessarily uniform across countries. Some countries are more sensitive to the loss of an independent monetary policy that can help cushion the economy against shocks, while others gain more from the benefits of greater price stability and lower risk premiums often associated with a fixed regime. Simulations with a global econometric macromodel, NiGEM, offer insight into which countries may benefit most from postponing membership of ERM II. The appropriate choice of regime depends upon: expected developments of the real exchange rate; the anticipated rate of productivity convergence; the relative openness of the economies; the degree of fiscal consolidation required; the need to import monetary stability; economic stability; and the financial maturity of the economy. Results suggest that the Czech Republic has the most to gain from postponing membership. The costs to Poland of early membership are smaller, although Poland may be restrained by the Maastricht criteria. There are some arguments for delaying membership in Hungary and Slovenia, although Hungary is more flexible and hence, less sensitive to the choice of regime.

Bauerová, Jaroslava (2004): "The New Basel Capital Accord and Czech Banks." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(11–12), pages 500–519.

Commercial-bank risk management is fundamental in determining bank profitability, or indeed bank failure. Capital adequacy is widely considered the final safeguard of a bank's solvency. Capital adequacy has been regulated chiefly according to the framework put forward by the Basel Committee on Banking Supervision in 1988, this known as the Basel Capital Accord. Since 1991, the committee has published a series of consultative papers toward a new capital-adequacy concept, the so-called New Basel Capital Accord, or Basel II. This new capital-adequacy concept includes several important changes on the original accord. This paper attempts to gauge the impact of Basel II on Czech commercial banks.

Cincibuch, Martin (2004): "Distributions implied by American currency futures options: A ghost's smile?" *Journal of Futures Markets*, vol. 24(2), pages: 147–178.

A new and easily applicable method for estimating risk-neutral distributions (RND) implied by American futures options is proposed. It amounts to inverting the Barone-Adesi and Whaley method (BAW method) to get the BAW implied volatility smile. Extensive empirical tests show that the BAW smile is equivalent to the volatility smile implied by corresponding European options. Therefore, the procedure leads to a legitimate RND estimation method. Further, the investigation of the currency options traded on the Chicago Mercantile Exchange and OTC markets in parallel provides us with insights on the structure and interaction of the two markets. Unequally distributed liquidity in the OTC market seems to lead to price distortions and an ensuing interesting ghost-like shape of the RND density implied by CME options. Finally, using the empirical results, we propose a parsimonious generalization of the existing methods for estimating volatility smiles from OTC options. A single free parameter significantly improves the fit.

Cincibuch, Martin; Bouc, Pavel (2004): "An Interpretation of Czech FX Options." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(7–8), pages 286–304.

This paper opens with a brief description of the Czech FX options market. Several case studies of the Czech koruna option market illustrate how options reflect market sentiment and structural breaks. Risk-neutral implied distributions are suggested as a monitoring tool. Moreover, clear indications of the rational, forward-looking behavior of option prices were identified before the Czech Republic's 1997 currency crisis, and the results of statistical tests support the rational market hypothesis.

Dědek, Oldřich (2004): "Adopting the Euro: Brake on or Engine for True Convergence?" *Eastern European Economics*, vol. 42(2), pages 45–62.

This article examines the desirability of the Czech Republic's adoption of the euro as its currency shortly after joining the European Union (EU). The author stresses that the theory of optimum currency areas merely provides guidelines for evaluating the costs and benefits of such a decision, but it does not provide quantitative criteria. Moreover, while the benefits are obvious, the costs are in some ways both vague and embedded in an environment that is either archaic or hypothetical. The author thus suggests that the Czech Republic should adopt the euro as its currency as soon after accession to the EU as possible.

Dědek, Oldřich (2004): "Four Reflections on Practising Inflation Targeting in the Czech Republic." *Politická ekonomie*, vol. 52(2), pages 147–69.

The paper consists of four parts each of them devoted to a practical aspect of inflation targeting as conducted by the Czech National Bank. The first part outlines the reasons that led to the adoption of this monetary regime and summarizes other advantages for effective and transparent decision-making. The second part addresses the issue of missing inflation targets. It is argued that simple confrontation of targets with actual behaviour of inflation may give a distorted view about the actual performance of monetary policy. The third part discusses a subtle methodological controversy about the difference between so-called escape clauses on the one hand and net inflation on the other. In the last section the author presents his critical view about the role of unconditional forecast in its capacity to indicate future interest rate decisions and to provide a realistic description of transmission mechanism in a small open economy.

Derviz, Alexis (2004): "Asset return dynamics and the FX risk premium in a decentralized dealer market." *European Economic Review*, vol. 48(4), pages 747–784.

The paper proposes a continuous time model of an FX market organized as a multiple dealership. The dealers have costly access to best available quotes. They interpret signals from the joint dealer–customer order flow and decide upon their own quotes and trades in the inter-dealer market. Each dealer uses the observed order flow to improve the subjective estimates of relevant aggregate variables, which are the sources of uncertainty. The risk factors are returns on domestic and foreign assets and the size of the cross-border dealer transactions in the FX market. These uncertainties have diffusion form and are dealt with according to the principles of portfolio optimization in continuous time. The model is used to explain the country, or risk, premium in the uncovered national return parity equation for the exchange rate. The two country premium terms that I identify in excess of the usual covariance term (consequence of the "Jensen inequality effect") are: the dealer heterogeneity-induced inter-dealer market order flow component and the dealer Bayesian learning component. As a result, an "order flow-adjusted total return parity" formula links the excess FX return to both the "fundamental" factors represented by the differential of the national asset returns, and the microstructural factors represented by heterogeneous dealer knowledge of the aggregate order flow and the fundamentals.

Dvorný, Zdeněk (2004): "Efficiency of the Secondary T-Bill Market." Prague Economic Papers 2004, vol. 13(1), pages 17–25.

The article analyzes efficiency of the Czech treasury T-bill market and the interbank deposit market over period 1993 to 1999. An efficient market-expectation hypothesis and alternative preferred habitat hypothesis were selected to compare both the markets and to determine the extent to which they are affected by macroeconomic fundamentals. The results reveal that the treasury T-bill market is more effective compared to the interbank deposit market. This finding has strong implication in the sense that only the treasury market over the given period is appropriate to be empirically investigated.

Geršl, Adam (2004): "Foreign Exchange Intervention: The Theoretical Debate and the Czech Koruna Episode." Czech Journal of Economics and Finance (Finance a úvěr), vol. 54(3–4), pages 94–116.

The strong appreciation of the Czech koruna over 2001–2002 and the foreign exchange interventions conducted by the Czech central bank under its inflation-targeting regime provide a good opportunity to consider the pros and cons of FX intervention, an often-controversial monetary-policy instrument. This article considers the koruna's said appreciation, possible causation, and the policy measures taken by the central bank then to counter the appreciation. The theoretical channels through which foreign exchange intervention may influence the exchange rate, and empirical evidence of their effectiveness are presented. Finally, the FX interventions of the Czech National Bank are discussed and those conducted in a rather secret manner over July–September 2002 assessed as relatively effective.

Hlaváček, Jiří; Hlaváček, Michal (2004): "Economic Irrationality of the Donator Arising from His Low Confidence in Donation Recipient." Czech Journal of Economics and Finance (Finance a úvěr), vol. 54(3–4), pages 138–54.

This paper tries to address the problem of donator's efficiency. In spite of the fact, that social services and public goods are not fully determined by market forces, they are not beyond the subject of economics. The state or other donator can allocate grants among recipients either efficiently or inefficiently. In the paper the authors demonstrate the idea, that if a donator does not trust in grant recipients and states too strict limits for them, he/she risks the lower allocation efficiency. Two models are analyzed: one in which postponing of grant funds to the next budget period is not allowed and second with maximum of allowed portion for overhead cost. It is shown that such limits could be contraproductive as far as the initial donator's aim (maximization of the probability of survival of the recipients) is concerned.

Hlaváček, Jiří; Hlaváček, Michal (2004): "St Petersburg Paradox and Cardinal Utility Function." Politická ekonomie, vol. 52(1), pages 48–60.

The St Petersburg paradox could be used as an extreme demonstration of the utility function cardinalisation in case of stochastic utility. In this article we reassume the von Neumann and Mongernstern explanation to this paradox based on the risk aversion expressed by the strict concavity of the expected utility function. We suggest the utility function derived from the Pareto distribution of the probability of downfall of the subject in danger. Our cardinal utility function is based on the economically reasonable economic assumption. In contrast to the other often used cardinal utility functions it does not need the specification of its parameters ad hoc. Other advantage of our utility function is its explanation of the difference in decision making of different "players" in the St Petersburg casino, based on their wealth (including the explanation of the situational risk seeking behaviour of players under the boundary of survival).

Hlédik, Tibor (2004): "Quantifying the Second-Round Effects of Supply-Side Shocks on Inflation." *Prague Economic Papers*, vol. 13(2), pages 121–41.

This paper uses a small-scale dynamic rational expectations model based on an open-economy version of Fuhrer-Moore-type staggered wage setting to quantify the second-round effects of selected supply-side shocks and of shocks to the nominal exchange rate on wages and subsequently on inflation. In order to analyse the desired reaction of the central bank to these shocks, optimal time-consistent policy rules are derived within the presented New-Keynesian framework. The conclusions presented in the paper suggest that the second-round effects of shocks to import prices and the nominal exchange rate on inflation should not be ignored in practical policy-making.

Holinka, Tomáš; Stiller, Vladimír (2004): "The Impact of the Regime-Shift Premium on Forward Interest Rates and Inflation Expectations in the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(5–6), pages 190–201.

The article analyzes the factors leading to the fall of forward interest rates in the Czech Republic between 1999 and 2003. A key point in this regard is the existence of a term and a regime-shift premium associated with the country's anticipated entry into the eurozone. The paper suggests that the shift into a credible low inflation regime, accompanied by a decreased regime-shift premium, may have affected Czech forward rates. Inflation expectations are subject to regime shifts and cyclical economic development, and to expectations of lower central-bank inflation targets.

Hurník, Jaromír (2004): "Fiscal consolidation in general equilibrium framework (the case of the Czech Republic)." *Prague Economic Papers*, vol. 13(2), pages 142–158.

Within the non-stochastic dynamic general equilibrium model framework this paper examines the implications of alternative fiscal consolidation programs for small open economy. The calibrated model enables realistically quantify the impact of the deficit financing and fiscal consolidation on consumption and saving of households, investment of firms and thereby on the capital stock and real interest rates. Through the interest rate link the impact of deficit financing and fiscal consolidation on cyclical and long-term properties of monetary policy set-up can be observed. Several fiscal consolidations were simulated in order to demonstrate the comparative statics and differences in dynamic paths of above mentioned variables.

Kejak, Michal; Seiter, Stephan; Vávra, David (2004): "Accession trajectories and convergence: endogenous growth perspective." *Structural Change and Economic Dynamics*, vol. 15(1), pages 13–46.

In this paper we analyze qualitatively and quantitatively the potential effect of the EU accession on the development of several Central and Eastern European (CEE) countries (specifically, the Czech Republic, Hungary, and Poland). To achieve the task we design a small open economy version of the two-sector endogenous growth model of the Uzawa-Lucas style with knowledge diffusion. The model is first calibrated and validated to stylized facts of the economic development during the accession process in the EU periphery countries. We then calibrate the model according to the data on the CEE countries above and simulate their behavior using alternative scenarios in several dimensions. The interplay of various initial conditions and the parameters of the accession generate different accession patterns and also rather different speeds of convergence to the EU average. The model outcomes do not only provide us with these quantitative estimates but also improve our understanding of the economic mechanisms, which underpin those transitions.

Komárek, Luboš (2004): "Monetary Policy during Very Low Inflation." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(1–2), pages 64–67.

The article summarizes the main points discussed at the seminar on Monetary Policy during Very Low Inflation, held by the Czech Economic Association in June 2003. There were two main speakers at the seminar. The first was Jan Frait (Czech National Bank), who summarized the main ideas of quantitative easing and the role of

a central bank during a period of deflation combined with low nominal interest rates. He was also focused on Japan and on an evaluation of its monetary policy of the last ten years. The second speaker Miroslav Singer (PricewaterhouseCoopers) presented the main results from an IMF research into low inflation and its implication for the Czech economy. The presentation was largely based on material available in Czech Economic Association Bulletin no. 46, which can be found at www.cse.cz.

Komárek, Luboš; Melecký, Martin (2004): "Money Demand in an Open Transition Economy." *Eastern European Economics*, September–October 2004, vol. 42(5), page 73.

This article offers an internationalized view of the demand for money as applied to the Czech Republic. The traditional money demand function, consisting purely of domestic variables, is extended to include certain foreign determinants that likely affect the demand for money in a small open transition economy. In this respect, both narrow and broad money are considered. Several estimation techniques, DOLS, DGLS, the Johansen method, and ARDL, are applied to increase robustness of the results acquired. The stability of the estimates obtained is tested to study changes in the estimated relations during the transition period. Finally, estimates of the possible effects of money market disequilibria on prices and output are presented. The results suggest that international variables are significant mainly in the context of broad money demand and that liquidity gaps significantly influence prices and output dynamics.

Navrátil, David (2004): "Systematic Part of CNB's Monetary Policy in Inflation Targeting Regime." *Politická ekonomie*, vol. 52(5), pages 623–36.

In the inflation targeting regime the central bank makes a decision about interest rate adjustment based on a forecast, primarily of inflation. Thus a big part of the decisions on interest rate adjustments corresponds to systematic response of central bank to expected economic development. The systematic part of monetary policy – the decision pattern of central bank (similarly as behaviour of other economic agents) must be approximated for purposes of creating a forecast. The aim of this article is to approximate it through estimated monetary policy rule.

Novotný, Filip (2004): "Foreign Direct Investment Earnings and Their Division in the Czech Republic." *Politická ekonomie*, vol. 52(6), pages 741–755.

The Czech economy has been characterized by a rapidly increasing external income balance deficit since 1998, which was caused by an increasing outflow of FDI earnings. The paper analyses factors, which determine the total amount of FDI earnings in a host economy and their subsequent division into reinvested earnings and repatriated profits. Three main factors are examined: total FDI stock in the economy and its structure, the FDI rate of return and the FDI financial life cycle. Growing total FDI stock, which reaches 51% of Czech GDP, is the most influential factor because the FDI rate of return has been approximately stable exceeding 10%. An outstanding amount of reinvested earnings in the Czech economy negatively influences the current account deficit, which exceeds the GDP 5% benchmark rate, although reinvested earnings do not represent actual financial outflows.

Pasalicová, Renata; Stiller, Vladimír (2004): "Credit and Household Consumption." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(11–12), pages 520–40.

The paper emphasizes how changes in credit conditions in the Czech Republic are likely to influence aggregate consumption. Aggregate consumption plays an important role in macroeconomic fluctuations and in the transmission mechanism. Czech household debt has increased in the past five years. The empirical analysis presented in the paper is based on the Life Cycle/Permanent-Income Hypothesis, including a standard model of consumption and incorporating credit supply. We first concluded that credit conditions have a significant impact on household consumption, and that consumption is acutely sensitive to disposable income. Our models further confirmed the acute effect real interest rates have on household consumption. We ultimately concluded that inflation level, growth of real disposable income, and low interest rates support household credit growth.

Procházka, Petr (2004): "The New ECB Governing Council Voting-Modalities Scheme: An Outside View." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(3–4), pages 117–37.

With the accession of 10 new European Union member states in May 2004, much attention is being placed on the governance of European Community institutions. This article focuses specifically on discussions of European Central Bank (ECB) governance, particularly as regards the ECB's amendment of voting modalities in the ECB's governing council. The article first discusses the potential conflict between the political and economic weight of individual member states in the ECB's monetary-decision-making process. It discusses both the complexity of the decision-making process in the current model, and compares existing models in different countries. The article then describes the new voting modalities scheme and analyzes the related pro and con arguments. While much criticism has been levied on the new voting system, the consensus reached by the EU after almost two years of discussion was an important achievement. On the other hand, the rather hectic timing of the reform's adoption, with a deadline prior to EU enlargement, has sent a mixed signal to the accession candidates, which have been excluded from its designing.

Pruteanu, Anca (2004): "Was There Evidence of Credit Rationing in the Czech Republic?" *Eastern European Economics*, vol. 42(5), pages 58–72.

This work contributes to the assessment of the credit rationing hypothesis in the Czech Republic. We estimate the demand for, and supply of, new loans denominated in Czech koruna over the period 1:1997–6:2002 in a disequilibrium framework, specifically allowing the interest rate not to necessarily adjust such that demand equals supply. Based on our estimations, we suggest that the market for new loans denominated in Czech koruna was characterized by a state of moderate excess demand, hence credit rationing, only in the period 1:1999–12:2000. The remaining period appears to be characterized by excess supply.

Říkovský, Milan (2004): "Entrepreneurship and the Competitive Market Process in the Austrian School of Economics and in the Work of J. A. Schumpeter." *Politická ekonomie*, vol. 52(2), pages 221–45.

The aim of this paper is to introduce the market process as a central concept of Austrian economics as opposed to the general-equilibrium approach of the neoclassical school. In the first part the author shortly reviews the theme of entrepreneur and understanding of entrepreneurial function in the history of economic thought. In the second chapter the formation of the Austrian view of the market as an entrepreneurially driven process and simultaneous emergence of criticism of mainstream theory is explained. The chapter three describes the Austrian understanding of the market process based upon twin concepts of sheer ignorance and entrepreneurial discovery. The last chapter introduces the entrepreneurial market process theory of Schumpeter. Schumpeter's theory is subsequently compared with Kirzner's approach. The author also surveys and compares modern discussions about market process within the Austrian school of economics.

Říkovský, Milan (2004): "Methodology of the Austrian School of Economics." *Politická ekonomie*, 2004, vol. 52(6), pages 823–47.

One of the distinctive features of the Austrian school of economics is its emphasis on the methodological foundations of economics and social sciences in general. The two pillars of the approach of this school are methodological individualism and subjectivism. The purpose of this essay is not only to identify a few of the principles with which most Austrians are in agreement but also to emphasise significant diversity within their common viewpoint. An accent is put on praxeology introduced by Mises and Hayek's requirement of "empirical elements" concerning the processes of human learning. It is further emphasised that within this diversity has run and continues to run a common thread of emphasis on man as an intentional, creative being, an actor rather than a mere passive responder to given constraints and circumstances. The essay treats the development of the Austrian methodology mainly under the separate heads of its individual contributors.

Rutarová, Radka (2004): "Demographic Development and Czech Labour Supply in 1993–2002 and Future Prospects up to 2050." *Politická ekonomie*, vol. 52(3), pages 356–74.

The main object of this paper is to explain the significance of the key factors which determined the labour force of the Czech population in the period 1993–2002. These key factors are the age structure irregularities and the changes in the labour force participation rates by age. The first part is focused on the description of the demographic development in the Czech Republic. The second one contains the analysis of the Czech labour force. The changes in the labour force participation rates by age had negative effect, while age structure irregularities had positive effect on labour supply in 1993–2002. But it is possible that in the near future the age structure will become worse because of the ageing of the Czech population. For this reason the expected demographic development of the Czech population up to 2050 and its implications for future labour supply of the population are also discussed in this paper.

Slavík, Michal (2004): "Contemporary Macroeconomics and Optimal Control Theory." *Politická ekonomie*, vol. 52(4), pages 532–542.

The paper presents the optimal control theory and the maximum principle technique that is suitable for solving dynamic optimization problems in continuous time. Modern mainstream macroeconomics stresses microeconomics principles of solved problems. However, the application of the standard microeconomic approach – the static optimization – needs to be replaced in macroeconomics by more sophisticated methods. The maximum principle is one of the possible tools. This text briefly introduces the basics of this method to Czech readers. More detailed treatment can be found in the original literature. The maximum principle method can be applied not only in solving macroeconomic problems, but also in many different areas that deal with the optimization in continuous time, e.g. finance or engineering.

Slavík, Michal (2004): "Demand for Fuel and Its Consequences for Indirect Taxation: A Microeconomic View." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 54(5–6), pages 202–33.

The author uses microeconomic theory, particularly demand theory, and econometrics to investigate the impact of proposed tax changes on the consumers. The effect of taxation can be investigated in two ways: the first possibility is to construct a multi-equation model able to analyze all taxes simultaneously. The second is to create a partial model for a specific tax, which would register subtler effects. The second approach is adopted here, with an exclusive focus on fuel-product excise taxes and their microeconomic impact. Two alternative approaches, instrumental variables and the Heckman two-step selection model, are used to estimate the demand function for fuel. The estimated demand function is then used toward a tax simulation and an investigation of the tax-change effects on different segments of the population.

Šmídková, Kateřina (2004): "Adoption of the euro: Why is the Czech approach cautious?" *Atlantic Economic Journal, International Atlantic Economic Society*, vol. 32(4), pages 302–311.

When published, the Czech Euro-area Accession Strategy signaled a rather cautious approach to adopting the euro in comparison to the intentions of other EU acceding countries. The euro adoption was scheduled around 2010 and the ERM II was viewed only as a waiting room. The Czech strategy was attuned to specific features of the Czech economy. Although inflation and nominal interest rates converged to the EMU levels before EU entry, large fiscal deficits and the need for significant fiscal reform did not make it possible to meet the Maastricht criteria soon. Moreover, real convergence was viewed as a priority for the forthcoming years and, consequently, the strategy was aimed at maintaining nominal flexibility in order to cushion consequences of price and wage rigidities during the peak period of the catch-up process.

Šmídková, Kateřina (2004): “Targeting Inflation under Uncertainty: Policy Makers’ Perspective.” India, the ICFAI Journal of Monetary Economics, Vol. 2(3), pages 54–95.

Monetary policy makers need to build two pillars for their inflation targeting strategy. Firstly, a methodology for producing the central forecast should be developed, since the whole decision process is more easily organised around a model forecast. Secondly, a methodology for dealing with uncertainties is equally important, because a poor evaluation of uncertainties can significantly reduce the quality of monetary policy decisions. Reflecting the further progress of the methodological debate inside the CNB, this paper aims to provide suggestions to policy makers as to which methods could be used to assess uncertainty during the monetary policy decision process. Suggestions for each stage of the process are summarised in the final chapter. These take into account the findings of surveys of three very distinct sources – the economic literature on monetary policy under uncertainty, the managerial literature on decision analysis, and the real-life strategies of five central banks. The lessons from these three surveys are presented in separate chapters.

Barrell, Ray; Holland, Dawn; Šmídková, Kateřina (2003): "When to Join the Eurozone: An Empirical Analysis." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(3–4), pages 98–112.

The paper is the first part of a broader empirical study that considers the entry timing of accession economies into the eurozone and their exchange-rate regimes between the EU entry and prior to the eurozone entry. The presented empirical analysis is based on model simulations and on the outcomes of previous work related to panel estimates of model equations for five accession economies. The first conclusion is that it is not possible to search for one-for-all answers as to timing and exchange-rate regimes. Each of the accession countries should decide in accordance with specific country characteristics. According to our analysis, Poland could benefit most from entering the eurozone relatively quickly, while the Czech Republic and Hungary may benefit from a more cautious approach. This diversity reflects different characteristics such as openness, flexibility, and financial wealth. Postponing entry after 2009 would likely carry fewer additional benefits, however.

Barrell, Ray; Holland, Dawn; Šmídková, Kateřina (2003): "Which Exchange-Rate Regime in the EMU Accession Period: An Empirical Analysis." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(5–6), pages 243–64.

This study is the second part of larger empirical work focused on the timing of European Monetary Union (EMU) accession and on the selection of a pre-accession exchange-rate regime. The tool of our empirical analysis used in both studies is a model simulation that benefits from a consistent macro framework and estimated model equations. Five accession countries were studied. The results demonstrate that it is important to design pre-EMU exchange-rate regimes independently, according to the characteristics of each accession country, such as openness, flexibility, or level of financial wealth. Following the European Exchange-rate Mechanism (ERM II) as a core monetary-policy strategy for the whole of the pre-EMU period may be beneficial only for some accession countries. While Poland would benefit from introducing a fixed-rate regime for the pre-EMU period, for example, the Czech Republic and Slovenia would benefit more from maintaining a floating exchange rate. For Estonia and Hungary, both options have comparable benefits.

Barry, Frank; Bradley, John; Kejak, Michal; Vávra, David (2003): "The Czech economic transition." The Economics of Transition, vol. 11(3), pages 539–567, 09.

The processes that will drive the next stage of the Czech transition are likely to be similar to those promoting real convergence in the countries of the EU periphery. We draw on previous modeling research on these latter economies to construct and calibrate a small macrosectoral model of the Czech Republic. Model simulations explore some key policy issues facing CEE-country decision-makers: labour market reforms, disinflation and industrial development. Our analysis suggests that much can be learned from the experience of countries like Ireland and Portugal which have converged substantially towards EU average living standards.

Bezděk, Vladimír; Dybczak, Kamil; Krejdl, Aleš (2003): "Cyclically Adjusted Fiscal Balance – OECD and ESCB Methods." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(11–12), pages 477–509.

The paper considers the impact of the business cycle on Czech fiscal balance in the past decade. The authors employed two different calculation methods in their analysis: an OECD and an ESCB method. Two crucial findings emerged from the analysis. First, the estimates of cyclically adjusted deficits in the Czech Republic proved their robustness, because both our calculation methods, although being philosophically different, provided very similar results. Sharply deteriorating Czech budget deficits are basically structural in nature, i.e., they are independent of the business cycle. Moreover, another hypothesis was confirmed: Czech fiscal policy exhibits mainly pro-cyclical features. As the paper further documents, both basic assessments held true even when quasi-fiscal deficits were included in the analysis.

Bezděk, Vladimír; Dybczak, Kamil; Krejdl, Aleš (2003): "Fiscal Implications of Population Ageing." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(11–12), pages 562–91.

The paper explores the long-term fiscal implications of population aging in the Czech Republic. The results, although bearing a significant margin of uncertainty due to the very long-term character of the projection exercise, do not impart encouraging fiscal outlooks for the Czech Republic. This is hardly surprising given that the Czech Republic is facing pronounced population ageing. Moreover, the fiscal position of the Czech Republic is presently very poor, in spite of its (still) low level of debt and debt interest payments. The Czech Republic's high primary deficit will foster a rapid rise in debt irrespective of population ageing. Therefore, to cope with the expected fiscal pressures, it is necessary not only to overhaul the pension and health-care systems in the medium term, but also to immediately start an intensive strategy of consolidation aimed at significantly reducing the high primary deficit.

Cahlík, Tomáš; Geršl, Adam; Hlaváček, Michal; Berlemann, Michael (2003): "Predictions Using Experimental Markets." Politická ekonomie, vol. 51(6), pages 838–850.

According to the effective market theory, the stock price on an effective market is the best estimate of the stock's current value. This is the basic assumption for predictions using experimental markets. This article describes the first experimental market organised in the Czech Republic, the experimental political market for Czech parliamentary elections in June 2002. In the beginning we briefly describe the methodology of the predictions via electronic markets. Then we give some description of our market- number of traders, their individual results, development of the market activity in time, etc. Finally we compare the result of our election market with the traditional opinion polls. On the basis of his comparison we discuss the advantages and the limitations of the prediction using the experimental markets.

Dědek, Oldřich (2003): "Adoption of Euro: Obstacle or Engine of Real Convergence?" Politická ekonomie, vol. 51(4), pages 505–15.

The article arrives to the following conclusions. First, the optimal currency area theory cannot deliver critical (objective) values of tests, whose passing would guarantee that costs of adoption of euro would be lower than the benefits. Second, several empirical observations strongly support the hypothesis that early adoption of euro by the Czech Republic would not incur any substantial losses. Third, several recent studies focused on testing the synchronization of Czech business cycle vis-à-vis Eurozone do apply analytical techniques inappropriately, which implies biased results. Fourth, the Czech economy has enough experience with excessively volatile exchange rate. The greatest advantage of adoption of euro will consist in a replacement of exchange rate fluctuations and substantially higher stability of inflation. In quantitative terms, the weight of accession countries in Eurozone will be too small to influence the overall inflation and thus co-determine the European Central Bank monetary policy.

Dvorný, Zdeněk (2003): "An Institutional Setup of the Czech Market for Treasury Securities." Prague Economic Papers, vol. 12(2), pages 145–53.

This theoretical paper maps the transition experience of the financial sector using evidence from the Czech money market. Especially, the respect is paid to the structure of interest rates during the period from 1993 to 2001. The main components of the money market that mostly determine the term structure are the interbank deposit market and the market for short-term securities. The study abstains from interbank market survey and provides a detailed description of the default-free short-term securities market and its impact on past interest rate movements.

Dvorný, Zdeněk (2003): "Inflation Convergence: CEFTA and European Union [Panel Method Estimation]." Politická ekonomie, vol. 51(2), pages 212–20.

The study is an empirical investigation of inflation convergence between CEFTA and EU countries. The question of both groups' convergence as well as convergence of each individual country within those groups is particularly discussed in the paper. Detailed analysis was carried out by use of panel estimation in the individual and in

the time setup. The study reveals an unambiguous convergence of all CEFTA inflations towards the EU levels between 1993 and 2000.

Flek, Vladislav; Marková, Lenka; Podpiera, Jiří (2003): "Sectoral Productivity and Real Exchange Rate Appreciation: Much Ado about Nothing?" Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(3–4), pages 130–53.

Using panel data for selected national economies, we estimate relative price changes stemming from fluctuations in sectoral productivity. Subsequently, we calculate the cross-country CPI-inflation differentials implied by sectorally unbalanced productivity growth, taking into account country-specific weights of nontradables in consumption (value added) and assuming there are no adjustments in nominal exchange rates. We find that sectoral productivity developments have a statistically significant impact on relative prices in the EU countries and also in the Czech Republic, but the magnitude of the impact is not as strong as the Balassa-Samuelson Effect (BSEF) would predict. The final impact of relative productivity on inflation (on the real exchange rate) is even weaker and, moreover, in the case of the Czech Republic the impact is negligible. Thus, contrary to the prevailing view, we question the meaning of the BSEF as a plausible explanatory variable of (equilibrium) real exchange rate determination in the Czech Republic. The same situation we simulate for the future, provided productivity growth in the traded sector does not accelerate dramatically.

Heřmánek, Jaroslav; Podpiera, Jiří (2003): "Interest and Noninterest Profits and Profitability in the Czech Banking Sector." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(7–8), pages 316–33.

This study explores bank's transformation in the Czech Republic from the point of view of their profit. It considers factors that influenced domestic banks and income structure of peer groups. Under conditions of equal competition, the peer groups showed different characteristics in terms of profitability, pricing policy, yield mark-up, and profit structure. A comparison of the behavior of major domestic banks with a peer group of foreign-owned banks showed how the large domestic banks reacted to competitive pressures. In particular, the study focused on the volatility and substitution of interest and noninterest profits in the two peer groups. The testing of the convergence in these variables confirms a different pattern of behavior. Speculating about future developments, we believe that the big Czech-owned banks will be forced to bring in line their profit policies similar with those of the foreign-owned banks.

Holub, Tomáš; Čihák, Martin (2003): "Price Convergence: What Can the Balassa-Samuelson Model Tell Us?" Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(7–8), pages 334–55.

The article contributes to the theory of convergence in the price level and relative prices. The authors present a model integrating the Balassa-Samuelson model of real equilibrium exchange rate with a model of capital accumulation and with the demand side of the economy. They also show how the Balassa-Samuelson model can be extended to the case of more than two goods. The predictions of the Balassa-Samuelson model are generally consistent with empirical findings in Central and Eastern European countries. The authors show how the model can be used toward projecting price convergence in a transition economy.

Komárek, Luboš (2003): "Banking System Stability." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(9–10), pages 449–51.

The article summarizes the main points discussed at the seminar on Banking System Stability, organized by the Czech Economic Association in May 2003. There were three speakers at the seminar. The first was Martin Čihák (International Monetary Fund), who presented the problem of macrofinancial stability and its measurement. The second speaker was Jan Hanousek (CERGE-EI), who chiefly presented the main results from the study Detection of Banking Failure: the Case of the Czech Republic (co-authored with Gerard Roland, UC Berkeley). The final speaker, Petr Dvořák (University of Economics, Prague), summarized the main trends in the Czech and European banking sector. The presentations were largely based on materials available in Czech Economic Association web page www.cse.cz.

Komárek, Luboš (2003): "The Nobel Memorial Prize Laureats 2002." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(5–6), pages 267–69.

The article summarizes the main points discussed at the seminar on "The Nobel Memorial Prize Laureats 2002." held by the Czech Economic Association (CEA) in March 2002. There were two main speakers at the seminar: The first was Michal Skořepa (Czech National Bank and Charles University), who presented a lecture on the work of 2002 Nobel Memorial Prize in Economic Science co-winner Daniel Kahneman, and the second speaker was Ondřej Rydval (CERGE-EI), who summarized the main ideas of the work of the 2002 Nobel prize co-winner, Vernon Smith. The presentations were largely based on material available in the Czech Economic Association Bulletin no. 44, which can be found on the Internet at www.cse.cz (a Czech-language site).

Komárek, Luboš; Melecký, Martin (2003): "Currency Substitution in a Transitional Economy with an Application to the Czech Republic." Eastern European Economics, vol. 41(4), pages 72–99.

Currency substitution appears to be an important issue affecting the design of monetary policy, especially in transition economies. This article strives to analyze the particular relevance of the currency substitution phenomenon in the Czech Republic. We initially discuss the role of currency substitution in small open economies in transition with some illustrations relating to the Czech Republic. We distinguish and analyze a locally and globally substituting currency from substituted ones and discuss the consequences of euroization. Further, we estimate a modified Branson and Henderson portfolio model for the Czech Republic. This provides a multiperspective approach to currency substitution in the broad sense. We attempt to improve the robustness of our estimations by applying several cointegration techniques, namely, the Johansen procedure, ARDL, DOLS, and ADL. Finally, we discuss the potential implications of currency and asset substitution according to our estimates for the Czech economy.

Kotlán, Viktor; Navrátil, David (2003): "Inflation Targeting as a Stabilisation Tool: Its Design and Performance in the Czech Republic." Czech Journal of Economics and Finance (Finance a úvěr), vol. 53(5–6), pages 220–42.

The article focuses on the development and performance of inflation targeting in the Czech Republic. It is shown that the particulars of the Czech inflation-targeting regime developed from a rather specific setting toward a framework based on international best practices. Its performance is evaluated using three methods. The results suggest that even though inflation targets have been missed more often than met, the practice of inflation targeting has significantly contributed to the stabilization of the Czech economy.

Novotný, Filip (2003): "Effect of Czech Crown Appreciation on Czech Corporate Sector." Politická ekonomie, vol. 51(5).

The Czech economy was characterized by a high nominal and real appreciation which was caused by great foreign direct investment inflow in 2002. The paper analyzes the effect of the Czech currency appreciation on industrial branches and the industry as a whole using a simple model based on a corporate accounting. The outcome of the model is then compared with actual y-o-y data of non-financial corporations in 2002. There is significant difference between industrial branches in sensitivity to appreciation. Foreign owned branches are able to limit the negative impact of appreciation, whereas the worst situation is in branches owned only by residents and public. The property structure and in addition the labor intensity of production have had a great effect on corporate finance after the rapid crown appreciation.

Pissarides, Francesca; Singer, Miroslav; Švejnar, Jan (2003): "Objectives and constraints of entrepreneurs: evidence from small and medium size enterprises in Russia and Bulgaria." Journal of Comparative Economics, vol. 31(3), pages 503–531.

We analyze the principal objectives and constraints of small and medium enterprises (SMEs), using data from a survey of 437 top managers (CEOs) of SMEs in Russia and Bulgaria. The CEOs display similar views and identify

a small number of specific constraints as being the most important ones. The constraint on external financing is a particularly serious one, while payments for licenses or government services (insecure property rights) are not. Our analysis indicates that characteristics of the entrepreneur, the firm and the firm's environment are important but varying determinants of which constraints are most important. The nature of both the disruption of production and the financial constraints after the fall of planning also appears to have been more ubiquitous in Russia than in Bulgaria.

Silberová, Zuzana (2003): "Management and Regulation of Foreign Exchange Risk." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 53(7–8), pages 282–315.

This work examines specific issues concerning the prudential management and regulation of foreign exchange risk. It begins with a description of the basic components of foreign exchange risk management. A central but frequently forgotten point of foreign exchange risk is that the key to its effective management lies in the bank risk management system itself. This management system should begin with an effective and efficient scheme of internal controls, based on stringent accounting and informational standards, with a clear allocation of responsibilities. The methods applied for the regulation of foreign exchange risk are described and analyzed together with demonstrative example

Šmídková, Kateřina; Barrell, Ray; Holland, Dawn (2003): "Estimates of Fundamental Real Exchange Rates for the Five EU Pre-Accession Countries." *Prague Economic Papers*, vol. 12(4), pages 291–318.

Are there indications of real exchange rate misalignment in the case of the five pre-accession countries? Will stable real exchange rates, required by two of the Maastricht criteria, be in line with economic fundamentals in the pre-EMU period? In order to address these questions, we employ the concept of the fundamental real exchange rate (FRER). The FRER model approximates the integration gain with the impact of foreign direct investment on trade and allows for larger current account deficits if external debt is below a safety limit. According to the FRERs, there were signs of overvaluation for all the pre-accession economies, with the exception of Slovenia, at the end of 2001. The second main finding is that stability of real exchange rates will not automatically be in line with economic fundamentals in the forthcoming period. This suggests that some flexibility of exchange rates will be needed in the pre-EMU period.

Tůma, Zdeněk (2003): "Monetary policy towards E(M)U accession: A central banker's view." *Atlantic Economic Journal*, vol. 31(4), pages 297–302.

This paper gives a brief overview of the main economic issues related to the forthcoming integration of the new EU member countries into the euro area. Subsequently, it will discuss in more detail three broad issues concerning the monetary side of EU enlargement. First addressed is the timing of euro area enlargement and monetary policy regimes in the run up to the EMU. The next focus is on the ERM II as an interim step towards the euro area. Third, the author expresses his views on the future of the ECB and the euro area, which the Czech Republic will have an opportunity to co-determine after its entry.

Arlt, Josef; Cutková, Jindra; Radkovský, Štěpán (2002): "Selected Aspects of Consumption Function in the Czech Republic in the Nineties." *Politická ekonomie*, vol. 50(1), pages 3–23.

The character of the consumption function analysis in the Czech Republic is determined by short and non-stable period of the last ten years. The development of consumption in 1990–2000 can be divided into four partial different periods. The time series used in the econometric analysis are short. There are two principal econometric approaches to consumption function: Davidson, Hendry, Srba, Yeo approach and rational expectation approach based on the Hall's and Flavin's work. The permanent income hypothesis tests follow the rational expectation framework. The econometric models of consumption function based on the disposable and labor income reject the permanent income-life cycle hypothesis in the condition of the Czech Republic.

Beneš, Jaromír; Vávra, David; Vlček, Jan (2002): "Medium-Term Macroeconomic Modeling and Its Role in the Czech National Bank Policy." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(4), pages 197–231.

This paper introduces a strategy for modeling the exchange rate when the monetary authority targets inflation while also managing the exchange rate using interventions. It does so in the framework of a standard reduced-form New Keynesian model of monetary transmission used in many institutions for research, forecasting, and monetary policy analysis. We propose a micro-founded modification to the UIP condition which allows for modeling of informal exchange rate bands. Our modeling strategy is useful for most hybrid IT regimes, including those with imperfect control over market interest rates.

Brůha, Jan (2002): "Applied General Equilibrium Models." *Politická ekonomie*, vol. 50(3), pages 407–417.

This article focuses on applied general equilibrium models and explores main features of these models. Examples of successful applications of these models are demonstrated and appropriateness of the applied computable general equilibrium models in policy evaluation is assessed. Conditions of existence and uniqueness of equilibrium are considered and techniques for finding such equilibrium are discussed. The task of calibration of parameters for these models is dealt with. Dynamic forms of applied equilibrium models are shown to be useful tools for policy evaluation.

Čech, Zdeněk; Komárek, Luboš (2002): "Exchange Rate Convergence and the Entrance to Eurozone [I]: Do Alternative Choices Exist for the Candidate Countries?" *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(6), pages 322–37.

The article is a general analysis of the exchange rate convergence process for EU and Eurozone candidate countries. The introduction states that exchange rate strategies of candidate countries have to be consistent with the „acquis communautaire” from beginning to end. For these countries, this spans the period from accession to the future introduction of the euro, according to the European authorities overseeing the process. The second part features a detailed analysis of institutional and legislative rules. The third part discusses the exchange rate convergence criterion, especially its definition, time frames and possible room for interpretation based on previous experience from official national reports. The final part summarises institutional and legislative problems for EU/EMU entry in light of limited options in the pursuit of exchange rate strategies.

Čech, Zdeněk; Komárek, Luboš (2002): "Exchange Rate Convergence and Entry to the Eurozone [II]: A Comparison of Experiences from Member States of the European Union." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(10), pages 522–38.

The article contains a general analysis of the exchange rate convergence process of EU and eurozone-candidate countries. Emphasis is given to an analysis of the exchange rate policy of member states within the ERM/ERM II mechanism (beginning several years before the introduction of the euro) and to the evaluation of exchange rate criteria. Following an introduction, the second part features a discussion of ERM and ERM II, while the third part

provides a detailed analysis of the exchange rate convergence process in EU countries. The fourth and final part summarizes the main experiences of EU/eurozone countries with exchange rate convergence within the ERM and ERM II period.

Dědek, Oldřich (2002): "Managing Economic Convergence and Financial Stability in the Czech Republic." Prague Economic Papers, vol. 11(2), pages 121–34.

This article addresses the issue of macroeconomic policies in the pre-accession period. The key theme is an assessment of the relationship between the real and nominal convergence of the candidate countries towards the EU. Support for real convergence cannot proceed on a long-term basis in contradiction to the nominal convergence criteria. Despite a renewal of growth in 1999, a whole range of persisting structural problems, chiefly in the fiscal area, confirm the benefit of voluntary pursuance of the nominal convergence criteria. For the central bank, the inflation criterion is particularly relevant. The issue of catching-up with the EU price level is discussed from this point of view. Neither the theoretical models (the law of one price and the Balassa-Samuelson effect) nor the empirical evidence provide arguments for abandoning the efforts for price stability. The most appropriate monetary policy regime linking the interests of monetary policy and government economic policy is inflation targeting.

Dědek, Oldřich (2002): "The Czech Economy and the Euro." Politická ekonomie, vol. 50(3), pages 361–75.

The article discusses issues concerning the prospects for euro adoption in the Czech economy. Once the Czech Republic becomes the member of the EU, it also must become – sooner or later – the member of the EMU. There are not too many options: in fact the freedom is only in the speed of euro adoption and partly in the bargaining about the central parity upon entering the ERM II. The article discusses objections regarding the sacrifice of autonomous monetary policy and similarly the problem of the nominal vs. real convergence. It further summarises major insights of the optimum currency area approach. The author does not find any strong arguments against an earlier euro adoption which would outweigh the benefits of the single currency for the Czech economy. Also the historical comparison with several EU countries in situation before joining the EMU shows the realistic background of the fast track strategy.

Derviz, Alexis (2002): "The Uncovered Parity Properties of the Czech Koruna." Prague Economic Papers, vol. 11(1), pages 17–39.

The paper studies the compliance of the CZK-EUR exchange rate with the uncovered parity of returns on assets denominated in the two named currencies. A comparison with the same property for the euro-dollar rate is made. An uncovered total return parity (UTRP) formula is derived from the equilibrium in a portfolio optimization model with liquidity constraints. It is shown that the uncovered parity of total returns, and not of short-term money market rates, is a natural outcome of stochastic equilibrium asset pricing models that generalize the International Consumption-based Capital Asset Pricing Model. Accordingly, the traditional uncovered interest rate parity should be replaced by UTRP in empirical analysis. UTRP tests for the CZK/EUR and the USD/EMU currency pairs are conducted using yields of long-term government bond yields. UTRP typically holds, although the time horizons and measures of exchange rate movements, for which it becomes visible, may vary.

Dvorný, Zdeněk (2002): "Transmission of the Key Interest Rates in the Czech Economy." Politická ekonomie, vol. 50(6), pages 780–92.

The presented study is an empirical investigation of interest rates transmission on the Czech financial market. Transmission was simulated by means of VAR model, built up to evaluate an impact of impulse change of one interest rate on the behaviour of the others in the given sample. The study shows that transmission from repo rates through PRIBORs to the yields on treasury bills can be determined. Next, transmission from repo rates to short interbank rates was proven as an important channel used by the Czech National Bank to stabilize unfavourable development on the money market in the middle 1997.

Frait, Jan (2002): "Moral Hazard and Orderly Bank Exit." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(2), pages 102–04.

This article summarizes a seminar of the Czech Economic Association devoted to problems of banking supervision. The background paper was delivered by Professor David Mayes, an advisor to the board of the Bank of Finland. The presentation and the discussion afterward focused primarily on the legal procedures in place to deal with distressed banks. Due to the involvement of moral hazard, it is necessary to have a system of regulation that pre-commits the authorities to credible, rapid and progressive measures in the event of difficulty, and that provides them sufficient power to take effective action. The system of regulation has to be supported by the structure of market-based incentives that would lead banks to an inherently prudential management of risk.

Frait, Jan; Komárek, Luboš (2002): "The Czech Economy in Macroeconomic Models." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(4), pages 190–96.

The introduction to Volume 52, Number 4 (and 5) of *Czech Journal of Economics and Finance (Finance a úvěr)*'s selected topic: macroeconomic modelling in the Czech Republic. The authors introduce the issue with a survey of macroeconomic modelling in Czech economic literature. The journal's articles are mostly devoted to the results of the long-term activities of the Czech National Bank's monetary department and its external collaborates. Five papers are introduced that consider key Czech National Bank macroeconomic modeling tools: quarterly projection models, small macroeconomic models with interest-rate term structures, models estimating potential product via augmented Phillips curve, and estimates of the parameters of a small open-economy monetary model via the maximum-likelihood method.

Frait, Jan; Melecký, Martin; Horská, Helena (2002): "Recession, Deflation, Bank Crisis and Liquidity Trap in Japan." *Politická ekonomie*, vol. 50(2), pages 263–280.

During 1990s' the economy of Japan slipped into a long-sustained recession with strong deflation pressures. The aim of the paper is not to analyse this particular development in detail. It focuses on some specific aspects of macroeconomic development of the Japanese economy that gave birth to a new wave of interest in some nearly forgotten pieces of Keynesian macroeconomics, instead. One of them is liquidity trap that was highlighted by Paul Krugman's writings in the Japan's case. The paper thus presents some of his rather unconventional opinions and confronts them with the Japan's economic developments in the last few years. The structure of the paper evolves from the discussions of methodological aspects of deflation and liquidity trap in closed and open economies to the suggestions of various macroeconomic policies to cope with them. We conclude that Paul Krugman's view, though rather controversial, offers highly valuable ideas for Japanese policy-makers.

Hampl, Mojmir; Matousek, Roman (2002): "Credit Contraction Causes and Effects: The Czech Republic." *Zagreb International Review of Economics and Business*, vol. 5(1), pages 45–68.

Between 1997 and 1999, the Czech economy had undergone a fundamental shift in its lending practices. This particular development is most often referred to as a credit crunch. Nevertheless, owing to the unique nature of this credit phenomenon in the relatively short history of the Czech economy, defining and applying this term to Czech conditions has caused a number of complications. The paper deals the said issue.

Hanousek, Jan; Tůma, Zdeněk (2002): "A test of the permanent income hypothesis on Czech voucher privatization." *The Economics of Transition*, vol. 10(2), pages 235–254.

This paper tests the permanent income hypothesis using the natural experiment of Czech voucher privatization. This' form of privatization moved state assets to individuals and represented an unexpected windfall gain for participants of the privatization scheme. Whether the windfall was consumed or saved provides a clear test of the permanent income hypothesis. Analysis based on data from a sample survey suggests that only a small number of transferred assets were cashed in and spent on consumption. This result supports the concept of the permanent income hypothesis.

Hanousek, Jan; Tůma, Zdeněk (2002): "Permanent Income Hypothesis and Voucher Privatization in the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(7–8), pages 408–27.

In 1992 the Czech Republic privatized state assets, which resulted in some citizens receiving an unexpected windfall. Whether the windfall was consumed or saved provides a clear test of the permanent income hypothesis in a transitional economy. Analysis of data from a survey conducted specifically to test this hypothesis indicates that only a small number of transferred assets were consumed, a finding which is consistent with the permanent income hypothesis.

Hlaváček, Jiří; Hlaváček, Michal (2002): "A Comparative Study of Existing and Surviving Firms in the Czech Economy in the Late 1990s." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol 52(9), pages 502–14.

We address the issue of whether the development of the bankruptcies assisted the general recovery of the Czech economy in the late 1990s. Several similarities were observed between exiting and surviving firms in, for example, 1999 in terms of operating results (labor productivity, value-added per employee, average wage). We believe, rather, that firms' privatization histories and the financial costs connected to these histories, not the operating results, were the most relevant factors for the exiting process. We also compared surviving and exiting firms with regards to branch, territorial, and institutional structure. Surprisingly, the most resilient were the agriculture and energy sectors, and the highest degree of bankruptcies was documented in the Prague region, which has the highest GDP per capita.

Hlaváček, Jiří; Hlaváček, Michal (2002): "Producer's Optimum under Unremitting Increase of Returns to Scale." *Politická ekonomie*, vol. 50(5), pages 689–698.

This paper is an attempt to grasp and model the problem of optimal strategy of a firm under conditions of unremitting increase of returns to scale and multiple threats of firm's downfall. The firm in our model has to pay high fixed costs to enter the market and its marginal costs are insignificant (zero). The firm is threatened by two threats at one time: by too low profit and by an entrance of a new firm to the market. We have shown that this problem has (either for uniform or for normal distribution of probability of survival) only one solution. This enables us to construct the supply function. In case of absence of the new entry threat, this supply function is in fact the supply function in the standard neoclassical microeconomics.

Horváth, Roman; Komárek, Luboš (2002): "Theory of Optimal Currency Area: A Framework for Discussions of Monetary Integration." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(7–8), pages 386–407.

The optimum currency area (OCA) theory tries to answer an almost prohibitively difficult question: what is the optimal number of currencies to be used in one region. The difficulty of the question leads to a low operational precision of OCA theory. Therefore, we argue that the OCA theory is a framework for discussion about monetary integration. We summarize theoretical issues from the classical contributions to the OCA literature in the 1960s to the modern "endogenous view". A short survey of empirical studies on the OCA theory in the connection with the EMU and the Czech Republic is presented. Finally, we calculate OCA-indexes for the Czech Republic, EU, Germany and Portugal. The index predicts exchange rates variability from the view of traditional OCA criteria and assesses benefit-cost ratio of implementing common currency for a pair of the countries. We compare the structural similarity of the Czech Republic and Portugal to the German economy and find that the Czech economy is closer. The results are reversed when the EU economy is considered as a benchmark country.

Hurník, Jaromír (2002): "Supply-Side Economics and Economic Level." *Politická ekonomie*, vol. 50(6).

This article analyses the impact of different types of taxes on economic growth. Taking into account inter-temporal substitution we develop an economic model originally stemming from the Ramsey model. Using the dynamic

optimization we search the balanced trajectories of consumption and capital stock to the new steady state after tax adjustment. The results show the negative impact of tax on capital on economic growth. The impact of consumption tax and payroll tax depends on the concrete parameters of the utility function of the representative agent, exactly on agent's evaluation of consumption and leisure. The influence of low taxes on economic growth may be positive, while the influence of high taxes may become negative. The analysis shows that there might be the identical economic growth for two different tax levels.

Kobzová, Lucie (2002): "Regulatory Requirements and the Estimation Techniques of Loan Losses in the Czech Republic." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(12), pages 698–718.

This paper examines estimations of the expected losses of loans and the provisioning techniques imposed by Czech regulatory norms. The current Czech regulatory guidelines define the criteria for loan classification and specify the minimum coefficients used for creating provisions. These coefficients correlate each individual loan with an expected loss. Anticipating the implementation of the New Basel Capital Accord on banking in the Czech Republic, it can be argued that it will be necessary to revise not only the capital adequacy framework, but also procedures connected with provisioning. The estimation procedures of both expected and unexpected losses should interact. This paper emphasizes the potential weak points of the current regulatory framework in the Czech Republic concerning the estimation technique of expected losses and its relation to the estimation technique of unexpected losses.

Komárek, Luboš (2002): "Inflation Targeting: Lessons from the International Experience." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(10), pages 566–69.

This article summarizes the main points discussed at the seminar held by the Czech Economic Society in April 2002, „Inflation Targeting: Lessons from the International Experience“. The keynote speaker was the noted American economist, Frederic Mishkin, of Columbia University's Graduate School of Business. Professor Mishkin discussed the function of a nominal anchor in the economy and the theory of inflation targeting, focusing on experiences and lessons taken from inflation-targeting countries. Professor Mishkin dealt specifically with the operational design of inflation-targeting strategy and in this regard he discussed the IMF programs' conditionality.

Komárek, Luboš (2002): "Long-Term Unemployment and the Entry of the CR into the EU: Lessons from the Spanish and Swedish Experiences." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(5), pages 307–09.

The article summarizes the main points discussed at the seminar on: „Long-Term Unemployment and the Entry of the CR into the EU: Lessons from the Spanish and Swedish Experiences“ held by the Czech Economic Association in December 2001. Seminar papers presented both theoretical and empirical analyses (experiences in the Czech Republic and two EU countries, Spain and Sweden) of long-term unemployment as an economic phenomena. An introductory speech by Štěpán Jurajda summarized the main points related to the topic. Three main speakers followed: Miroslav Příbyl, who presented the main trends in the development of long-term unemployment in the Czech Republic; Henrik Huitfeldt, who summarized the main Swedish experiences and the relatively successful Swedish policy of combating long-term unemployment; and Jan Švejnar, who compared the Spanish and Czech experiences regarding long-term unemployment.

Komárek, Luboš (2002): "Recent Developments in Macroeconometric Modelling." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(1), pages 51–52.

The article summarizes the main points discussed at the seminar on "Recent Developments in Macroeconometric Modelling for Policy Analysis" held by the Czech Economic Association (CEA) in September 2001 with Kenneth F. Wallis from the University of Warwick as the main speaker. The purpose of the seminar was to discuss important issues of macroeconometric modeling including recent trends and new promising approaches.

Komárek, Luboš; Horváth, Roman (2002): "Argentina: Rise and Decline." Czech Journal of Economics and Finance (Finance a úvěr), vol. 52(10), pages 570–72.

The article summarises the main points discussed at the seminar on „Argentina: Rise and Decline,” held by the Czech Economic Society in May 2002. The keynote speaker, Jiri Jonas, an advisor to the executive director of the International Monetary Fund, summarized the Argentinean financial crisis at the end of the 1990s. His presentation concentrated on the crisis sources and was structured in five parts: (i) introduction, (ii) the rise and decline of the Argentine economy, (iii) plan of convertibility, (iv) the Mexican economic crisis in comparison, and (v) Argentina’s short recovery and subsequent new crisis.

Kotlán, Viktor (2002): "The Term Structure of Interest Rates and Monetary Policy in a Small Macro Model." Czech Journal of Economics and Finance (Finance a úvěr), 2002, vol. 52(4), pages 232–54.

Using a simple single-equation approach, many studies have shown that the term structure of interest rates or its approximation – the term spread is a potentially useful indicator of future inflation and/or future real economic activity. We argue that these results may be biased due to the insufficiencies of the single-equation approach and that the predictive ability must be analyzed from within a model framework. Simple general equilibrium macroeconomic model of a small open economy is introduced and the indicative properties of the term structure are discussed from within its framework. Our main contribution to the literature is threefold. First, we show that the predictive ability of the term spread is not structural but monetary policy dependent. Second, we argue that the term spread’s predictive ability with regard to future inflation (real economic activity) increases with increasing weight on inflation (real economic activity) stabilization in central bank’s reaction function. Third, we show that understanding the way expectations are formed is an important prerequisite for using the term structure as an indicator for monetary policy. Apart from these general findings, the predictive power of the term spread is examined in the case of the Czech economy. It is shown that the term spread between one year and three month PRIBOR interest rates of one percentage point indicates that agents expect inflation to be almost one percentage point above the target six quarters ahead.

Pasalícová, Renata; Stiller, Vladimír (2002): "The Impact of Monetary Policy on the Bank Lending." Czech Journal of Economics and Finance (Finance a úvěr), 2002, vol. 52(6), pages 338–54.

This article analyses the impact of monetary policy on bank lending in the Czech Republic. The paper firstly discusses the theoretical and empirical aspects of the credit channel in the monetary-transmission mechanism. The authors then examine credit development and its determinants in the Czech Republic. Changes in monetary policy affect the costs of banking credits and, consequentially, real economic activity. An econometric analysis of the monetary policy impact on the economy is then presented and reveals the significant impact of monetary policy on the volume of bank lending to firms under foreign control and to households in the past three years.

Sedláček, Petr (2002): "Post-Keynesian Theory of Money – Alternative View." Politická ekonomie, vol 50(2), pages 281–92.

The post-Keynesian theory is an alternative view on money. The assumptions of this theory are uncertainty, historical time and importance of money. The source of money is demand of businessmen and households for credits. Money is endogenous and is determined by its demand a pulled by credits. Post-Keynesian theory is not homogenous and therefore this article deals with a horizontal and structural view of endogenous money and views of post-Keynesian proponents considering money as partly endogenous and partly exogenous. Post-Keynesian theory does not present recommendations for overall economic policy – but among the most interesting are recommendations aimed at regulation of the financial sector, banking supervision and inflation.

Šmídková, Kateřina (2002): "Transmission Mechanims of Monetary Policy in the Beginning of the Third Millennium." *Czech Journal of Economics and Finance (Finance a úvěr)*, 2002, vol. 52(5), pages 287–306.

In last decade, three important challenges – the introduction of new strategies for monetary policy, the observed differences in anatomy of financial crisis between developed and emerging economies, and the emergence of the EMU – gave rise to new focus of debate about transmission mechanism of monetary policy. Three stages of transmission have been distinguished more clearly. The emphasis has been given to several transmission channels that had not been in the core of the previous debate. The differences in transmission mechanism of monetary policy across countries have been analyzed, and consequently, more attention has been paid to risks when deriving lessons from one country experience for another economy. An overview of the theoretical foundations, three main stages and channels of transmission mechanism provides background for illustrations of cross-country differences. The specific problems of transmission mechanism of monetary policy in emerging economies are discussed in more detail.

Vašíček, Osvald; Fukáč, Martin (2002): "Macroeconomic Model of Non-accelerating Inflation Product." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(5), pages 258–74.

In this paper the authors try to measure production gap in the Czech Republic and, consequently, non-accelerating inflation product (NAIP) as an approximation of potential product. NAIP is treated as an unobservable variable, to which an augmented Phillips curve plays a key role in its identification. The analysis is conducted on quarterly economic data provided by the Czech Statistical Office. An iterated extended Kalman filter is employed as an estimation method. The results indicate that the supply side of the Czech economy is more flexible than has been suggested in previous literature on the topic.

Vlček, Jan (2002): "Estimation Methods in the State Space Form." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 52(5), pages 275–86.

The paper demonstrates estimation methods for parameters and initial states of models in the state space form. Special attention is devoted to the maximum-likelihood method using the Kalman filter for likelihood function computation. The method is relative simple and is practical in estimating the parameters and initial states of models in state-space form. In the second part of the paper this method is used for a parameter estimation of a small open economy model. The model is grounded in microeconomic foundations and the estimates as per the prezented method are derived from the Czech Republic's data sets.

Arlt, Josef; Radkovský, Štěpán (2001): "The Lag Analysis in Modelling of Relationship of Economic Time Series." *Politická ekonomie*, vol. 49(1), pages 58–73.

The distributed lags models enable the construction of the lag mean, median and variance. The estimators of parameters of the distributed lags models and the autoregressive distributed lags models enable to create the estimators of these basic characteristics. It is obvious that the values of estimators depend on the form of the time series transformation. The methodology of selection of suitable transformation of time series is based on the principle of maximization of the likelihood function. The computation of basic characteristics of the lags in the econometric model is illustrated on the example of the analysis of relationship between the interest rates on new granted credits and 1R PRIBOR. This analysis revealed some changes in character of dependency of time series and changes of values of estimators of basic lag characteristics in the period since 1993. In this connection the recursive analysis gave valuable information.

Bezděk, Vladimír (2001): "On One of Possible Scripts of Pension System Reform in the Czech Republic (Polemic)." *Politická ekonomie*, vol. 49(2), pages 241–50.

This article represents a critical response to the paper of J. Kubalčík and R. Zbořil published in *Politická ekonomie*, 2000, No. 4. It reviews some of the authors' assumptions and conclusions regarding the pension system reform in the Czech Republic. The attention is put on some macroeconomic issues as savings, labour market and tax systems with respect to the pension system reform. Also the microeconomic aspects are significant and should be taken into account when discussing the pension system reforms. The article concludes that pension system reform is a very difficult and complex task. That is why it is highly recommended to develop more detailed and sophisticated models covering the whole range of pension system benefits.

Čihák, Martin; Holub, Tomáš (2001): "Price Convergence toward the EU: A Few Open Issues." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(6), pages 331–49.

This article attempts to answer a few open questions related to price convergence in the Czech Republic and in other Central and Eastern European Countries toward prices in the European Union. The authors address the following issues: First, what, from the theoretical viewpoint, should the quantitative relationship be between price level and GDP? Second, does the existing empirical data allow for a clear distinction between tradable and non-tradable commodities, as assumed by standard theory? Third, what is the relationship between price levels and coefficient measuring differences in the structures of relative prices in individual countries? Fourth, what are the likely forms of relative price convergence in the Czech Republic toward accession to the European Union? Fifth, what is the reason for the significantly negative residual of the Czech economy in the cross-country regressions of the average price level on GDP.

Cincibuch, Martin, Vávra, David (2001): "Toward the European Monetary Union – A Need for Exchange Rate Flexibility?" *Eastern European Economics*, vol. 39(6), pages 23–63.

We address the question of exchange rate regime for the Czech Republic before it enters the EU and the EMU. We classify macroeconomic impacts of a single currency regime according to the traditional OCA theory. Using quantitative measures, we find the degree of macroeconomic convergence between the Czech and German (EU) economies high enough not to form a major obstacle to a common currency regime. In addition, we look at transitional specificities of the Czech economy. We analyse the real appreciation of the Czech currency and its relationship to competitiveness and find that development of cost factors exercise depreciatory pressures on the exchange rate. Conversely, a fixed regime may alleviate problems of the foreign capital influx and ensuing nominal appreciation – another idiosyncrasy of the Czech economy. However, once labour market rigidities are removed, a fixed regime may become a source of a sustainable competitive advantage, growth, and convergence.

Dědek, Oldřich (2001): “Challenges for Nominal and Real Convergence.” *Politická ekonomie*, vol. 49(6), pages 755–69.

This article addresses the issue of macroeconomic policies in the pre-accession period. The key theme is an assessment of the relationship between the real and nominal convergence of the candidate countries towards the EU. Support for real convergence cannot proceed on a long-term basis in contradiction to the nominal convergence criteria.

Dvorný, Zdeněk (2001): “The Role of the Czech National Bank Monetary Instruments in Interest Rates Targeting during Transition.” *Prague Economic Papers*, vol. 10(1), pages 13–33.

In this paper, the recent development of Czech interest rates during the Czech Republic's transition to a market economy is discussed. First, the situation in the economy and in the banking sector, as well as the monetary policy of the central bank during the period of 1990–1999 is presented. However, the main focus is on monetary policy instruments and their application during transition. The paper also describes the targeting of the central bank's policy by using direct limitations in banking during 1990–1991 and refinancing instruments exploited during the period of 1991–1992. Finally, the central bank's orientation towards free market operations, starting in 1993, is discussed.

Flek, Vladislav (2001): “The Impact of Labour and Financial Costs on Firms.” *Politická ekonomie*, vol. 49(2), pages 209–26.

A simple model is developed with the aim of testing the efficiency of cost control in the key branches of Czech entrepreneurial sector (labour and financial costs are solely subject to analysis). In the period 1996–1999 the share of profits and depreciation in value added increased slightly, predominantly due to a relative decrease in financial cost. At the same time, the impact of labour costs control on enterprise recapitalisation was rather insignificant. In general, producers failed in enforcing such a level of profitability which would a) diminish dramatically their dependency on external financial resources; b) increase the attractiveness for capital allocation vis-à-vis risk free assets such as government bonds.

Flek, Vladislav; Hájek, Mojmír; Hurník, Jaromír; Prokop, Ladislav; Racková, Lenka (2001): “Supply-Side Performance and Structure.” *Politická ekonomie*, 2001, vol. 49(6), pages 771–96.

This paper deals primarily with supply-side performance of the Czech economy. Macroeconomic part of the analysis points out very low growth rate of total factor productivity, as well as very high sensitivity of imports to real GDP growth. It also demonstrates “undesirable” shifts of the short-run Phillips curve in the very recent period which indicates the diminishing ability of the economy to employ its resources in a non-inflationary environment. The remaining parts of the paper indicate rigidities in the resource allocation, low efficiency of investment, insufficient employment elasticity of industrial output and, finally, limitations of higher competitiveness of domestic producers. As a result, there prevail obstacles to better macroeconomic performance and the growth rate of potential output will remain rather low in the near future.

Frait, Jan (2001): “Transitional Economies and Corruption.” *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(5), pages 299–302.

This article summarizes papers presented and discussions held at the recent seminar of the Czech Economic Association. The seminar was devoted to a much discussed issue within transitional economics the impact of corruption on long-term economic development. The seminar addressed the possible implications of recent theoretical and empirical findings related to corruption and transitional economies, including measures directed at reducing corruption, and the specific features and implications of corruption within the banking sector.

Frait, Jan; Komárek, Luboš (2001): "On the Way to European Union: Nominal and Real Convergence in Transition Countries." Czech Journal of Economics and Finance (Finance a úvěr), vol. 51(6), pages 314–30.

The paper provides an introduction to essays published in this volume, which focus on nominal and real convergence in transition countries. The paper is based on the idea that the process of convergence can, to a large extent, be viewed via developments in real exchange rates. Key issues associated with real exchange rate developments in transition countries are defined and the consequent challenges for policy makers are discussed. A trend towards real appreciation has been observed in the data since the outset of transition, though it has slowed in the past two years. Now it appears that the most economically successful transition countries are turning away from the trend via the inflation differential and toward a stronger reliance on nominal exchange rate changes. Policy makers will be challenged by the issue as to what level of real appreciation is sustainable, i.e., compatible with sufficient external competitiveness and macroeconomic stability.

Hájek, Mojmír; Bezděk, Vladimír (2001): "Estimate of Potential Output and Output Gap in the Czech Republic." Politická ekonomie, vol. 49(4), pages 473–91.

The article describes the estimate of potential output and output gap in the Czech economy on the macroeconomic level for the period 1991–1999 and forecasted years 2000 and 2001. Two methods are used. The first is the application of Hodrick-Prescott filter to yearly and quarterly data of real GDP. The second one is Cobb-Douglas production function with technological progress, using yearly data about real GDP, stock of capital and labour.

Hampl, Mojmír (2001): "Approaches to the Theory of Public Goods." Czech Journal of Economics and Finance (Finance a úvěr), vol. 51(2), pages 111–25.

The paper focuses on a comparison of three different approaches that seek to explain the existence of public goods. First the mainstream Samuelson-Musgrave approach, based on the search for an objective nature of so-called pure public goods, is critically evaluated, especially with respect to the methodology it is built upon. Coase's approach, arising from his crucial concept of transaction costs, is then revealed as being consistent with the mainstream Samuelson-Musgrave approach, even though it is not primarily involved with the search for an objective nature of public goods – it rather emphasises the spontaneous occurrence of public goods due to high transaction costs for their provisioning through market forces. Buchanan-Niskanen's public goods concept is lastly described. According to this approach, the existence of public goods can be explained simply as a particular result of a purely subjective majority voting process. That is why efforts to seek out "scientific" economic criteria which distinguish private from public goods are not only useless, they are completely misleading.

Hampl, Mojmír (2001): "Bureaucracy in the Conception of William A. Niskanen." Politická ekonomie, vol. 49(1), pages 47–57.

The paper explains the theory of bureaucracy developed by William A. Niskanen. While sociologist Max Weber's analysis treats the bureaucrats as "eunuchs" or automatic machines creating the public well-being, Niskanen tries to apply standard neo-classical economic models to explain the behaviour bureaucracy as a whole. On this background he concludes that the bureaucracy will concentrate on bargaining process with the sponsor and not on improving the quality of its services. This is a simple explanation why the bureau provides systematically worse products and services to its customers than the standard firm operating on the market.

Holub, Tomáš (2001): "Seignorage and Central Bank Finance." Czech Journal of Economics and Finance (Finance a úvěr), vol. 51(1), pages 9–32.

The author of this paper criticizes the broad, cash-flow based concepts of seignorage that were introduced and emphasized by the economic literature of the 1990s (i.e., fiscal seignorage, total seignorage, etc.), which the author argues are ill justified and confusing. On the other hand, the two classical definitions of seignorage,

ie. monetary and opportunity cost seignorage, are regarded as fully consistent and sufficient for theoretical purposes. The paper discusses the development of the classical concepts of seignorage in the Czech Republic since 1993. It shows that the fast growth of the monetary base in 1993–96 gave way to decline, above all due to reduced minimum reserve requirements. Monetary seignorage thus reached 1.2% of GDP in 1993–99 as a whole. Opportunity cost seignorage reached 1.4% of GDP in the same period. However, it was more than consumed by the central bank's opportunity costs from holding foreign exchange reserves (associated with the existence of a risk premium on foreign exchange markets) and by the government's banking-sector bailouts.

Hrnčíř, Miroslav (2001): "Czech Currency and Monetary Policy in 2000." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(2), pages 66–80.

Monetary policy in the Czech Republic in the year 2000 in the broader framework of macroeconomic development is the topic of this article. The central bank's experience with inflation targeting, and the implementation of the inflation target in 2000 are assessed. The resumption of GDP growth and higher imported fuels costs in 2000 dominated macroeconomic developments in the country. This accentuated the uncertainties for national monetary policy, namely in the course of identifying supply-side changes and identifying the gap between potential and actual product. Arguments as to why the principal instrument of monetary policy, the repo rate, was parked at a stable level throughout 2000 are presented. For 2001, the available indicators seem to signal the likely continuation of the above-mentioned trends from 2000, which, consequently, provide a precondition for maintaining a stable monetary policy setting. The key challenges for balanced development in the medium term are: the ratio between wages and productivity, and trends in public finance.

Izák, Vratislav (2001): "External Factors in Czech Disinflation (Dynamic Analysis)." *Politická ekonomie*, vol. 49(4), pages 493–513.

The paper has examined the impact of both internal and external factors on the net inflation in the Czech Republic in the time horizon 1995:1–2000:12. The framework of the analysis are the extended Phillips curve models. Cross correlograms of stationary data (first differences of year-on-year changes) have revealed by far the decisive role of external factors (import prices, import prices-group 3, nominal effective exchange rate). To reveal the correct temporal linkage between these variables on the one side and the inflation rate on the other side the distributed lag models (finite and polynomial) have been constructed and evaluated. Impulse response functions and variance decompositions for selected VAR models complete the analysis. The main message from this paper is, in the intention of the papers of Ball, that in the small open economies inflation targeting can be dangerous.

Komárek, Luboš (2001): "The State of the Phillips Curve." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(7–8), pages 430–32.

The Czech Economic Association, in co-operation with the Czech National Bank, organised a public seminar on "The State of the Phillips Curve" which featured a lecture by Professor Laurence Ball, in Prague in April 2001. Professor Ball, a professor of economics at John Hopkins University, began with a historical description of the Phillips curve and approach. He then dealt with the existence of the micro-foundation in the Phillips curve approach to invalidate the Lucas critique. Next, Professor Ball described the varying national experiences of the US and several EU countries, basing his explanation for the latter on the principle of hysteresis. Professor Ball concluded the lecture by providing several reasons as to why hysteresis occurs in the labour market.

Kotlán, Viktor (2001): "Nobel Memorial Prize in Economics for the Year 2000." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(5), pages 306–07.

The article summarizes the recent seminar of the Czech Economic Association devoted to the Nobel Prize laureates in economics for 2000, James J. Heckman and Daniel L. McFadden. A paper presented by M. Zajíček concentrated mainly on the work of Mr. McFadden. Economic problems, especially those related to the self-selection bias and its role in appraising the outcome of social programs, are considered.

Kotlán, Viktor (2001): "Psychology and Economics." Czech Journal of Economics and Finance (Finance a úvěr), vol. 51(5), pages 303–05.

This article summarizes a recent seminar of the Czech Economic Association devoted to the relationship between psychology and economics. While economic methodology strives for scientific reasoning, the course of this pursuit often results in the neglect of the behavioral aspects of economic agents. A paper, presented at the seminar, and the discussion afterward showed that psychology may enrich economic thinking about reality.

Lízal, Lubomir; Singer, Miroslav; Švejnar, Jan (2001): "Enterprise Breakups and Performance during the Transition from Plan to Market." The Review of Economics and Statistics, MIT Press, vol. 83(1), pages 92–99.

Using firm-level data, we estimate the effects of the major wave of 1991 breakups of Czechoslovak state-owned enterprises on the subsequent performance of the "master enterprises" and spun-off divisions. We estimate the performance effects of spinoffs by comparing the performance of enterprises that remained intact throughout the 1990–1992 period to the performance of the master enterprises that experienced spinoffs and the newly spun-off subsidiaries. Our estimates suggest that the breakups had a significant immediate effect on the productive efficiency and on the profitability of industrial firms in 1991, and that the effect became much less significant in 1992. The effect is a negative function of the size of the spinoff, being positive for small to slightly above average-sized spinoffs and negative for very large ones. We cannot reject the hypothesis that the estimated effect was identical for the spun-off subsidiaries and the master enterprises that experienced the spinoffs. Our 1991 estimates suggest that the large firms created under the centrally planned system suffered from inefficiencies that were alleviated by the breakups. The 1992 estimates are consistent with increased competition and the appropriation of profits by managers.

Macháček, Martin; Kotlán, Viktor (2001): "EMU and Asymmetric Shocks: A Survey of Adaptation and Insurance Mechanisms." Czech Journal of Economics and Finance (Finance a úvěr), vol. 51(10), pages 514–27.

The authors focus on the ways in which EMU member countries might deal with asymmetric shocks until the convergence of national economic and legal structures gradually eliminates related idiosyncrasies. In a discussion of natural adaptation mechanisms, such as labor market flexibility and relative price adjustments, the authors conclude that a proactive economic policy might be called for. Since monetary policy may not fully consider the regional aspects, fiscal policy would come to the forefront. The operational room of fiscal policy is limited by the EMU's Growth and Stability Pact, the authors contend, as they review the propositions suggested in the literature that may guide the EMU away from „fiscal confederalism" toward fiscal federalism.

Mahadeva, Lavan; Šmídková, Kateřina (2001): "What Is The Optimal Rate Of Disinflation To Be Targeted In The Czech Economy?" Prague Economic Papers, vol. 10(2), pages 145–53.

What is the optimal rate of disinflation to be targeted during transition? This question has attracted more attention under the inflation-targeting regime than under other monetary strategies, because explicit inflation targets are used to anchor expectations. These targets signal what rate of disinflation is targeted by policymakers. Deciding what level of disinflation is least costly in terms of the volatility of important economic variables is not straightforward, since costs depend on monetary transmission in a given economy. In this paper, a small, aggregate, forward-looking model of Czech monetary transmission is used to compare the consequences of different disinflation strategies that are approximated with alternative policy rules. Our results suggest that trajectories with a more linear tendency are superior to trajectories that postpone disinflation or reduce inflation suddenly.

Matoušek, Roman (2001): "Transparency and Credibility of Monetary Policy in Transition Countries: The Case of the Czech Republic." *Zagreb International Review of Economics and Business*, vol. 4(2), pages 91–104.

This paper studies as to what asset price can tell us about the evolving credibility of the monetary policy of the Czech National Bank (CNB). The focus of our analysis is to examine the effect of changes in the two-week repo rate (the official interest rate) on short and long-maturity market interest rates. Argument relies on information asymmetry and the existence of a stationary stochastic equilibrium with full knowledge of authorities reaction function.

Školková, Michaela; Stiller, Vladimír; Syrovátka, Jan (2001): "The Role of Asset Prices in the Monetary Transmission Mechanism." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(9), pages 488–506.

The paper examines the theoretical background of the role asset prices play in the monetary transmission mechanism. The authors firstly consider the determinants of asset prices and their contribution to monetary policy implementation. Secondly, they offer a definition of the key channels of monetary transmission mechanism, particularly the asset prices channel. The authors then concentrate on assets in the Czech Republic including the main determinants of asset prices. Finally, the authors use econometric methods to analyze relations between asset prices and macroeconomics aggregates and between asset prices themselves. The results reveal that most of the relations are weak, nevertheless, there are opportunities for asset prices to be used as subsidiary indicators.

Skořepa, Michal (2001): "On the Differences in Price Levels between the Czech Republic and Germany." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(6), pages 350–63.

According to the results of the International Comparison Project, based on exchange rates and prices recorded in 1996, prices in the Czech Republic (CR) were markedly lower than prices charged for many comparable products and services in the European Union. This observation led some commentators to conclude that there is price tension between the two economies and that the CR's entry into the EU will cause a price shock in the CR unless every effort is made to raise the CR's comparative price level in advance. This line of thinking wrongly assumes that the CR's entry into the EU will necessarily equalize Czech and EU prices. The article, focusing on a comparison with Germany, lists several reasons why such a shock is not a certainty and also cites some of the more important price pressures that are likely to influence Czech price level during the country's accession to the EU.

Šmídková, Kateřina (2001): "Can We Have Both – Real and Nominal – Convergence?" *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 51(6), pages 364–76.

Candidate countries for accession to the EU often view EU convergence criteria as difficult given that the period of faster growth that real convergence necessitates is usually associated with higher inflation. This paper argues that it is important to focus on the mechanism of real convergence in this regard. If economic growth is accelerated by virtue of the closing of a technology gap, the processes of nominal and real convergence can indeed be compatible. In order to analyze this hypothesis, model simulations were run for five accession countries assuming a scenario in which FDI increases exogenously. The model used for simulation is a modified version of the model used in a related research project of Barrell, Holland, Kovacs, Jakab, Šmídková, Sepp, and Cufer (2001). According to simulation results, CPI falls and GDP per capita increases compared to the baseline following the introduction of an FDI shock. Although the results are not identical for all five countries, the hypothesis of compatibility of convergence criteria is generally supported.

Vávra, David; Cincibuch, Martin (2001): "Value of Monetary Income in a Transition Economy." Czech Journal of Economics and Finance (Finance a úvěr), vol. 51(11), pages 574–90.

The authors focus on income from the monopoly rights to issue money accruing to central banks in a transitional environment. The authors introduce a general method to compute the value of this ability and provide a tentative valuation in the Czech case. The range of the estimates demonstrates that a unilateral adoption of the euro would entail a significant loss in terms of monetary income. On the other hand, EMU membership is found to be beneficial.

Arlt, Josef; Radkovský, Štěpán (2000): "The Importance of Modelling and Forecasting of Time Series Volatility for the Control of Economic Processes." *Politická ekonomie*, vol. 48(1), pages 38–61.

It can be observed that the volatility of high frequency time series (daily and higher frequency) has in certain time periods different level. The classical time series linear modelling methodology is based on condition of constant volatility. There are two conceptions of solution of the problem of the classical linear model. The first conception is based on idea that the problem is in the type of model of time series. Therefore R. Engle developed the class of ARCH models. The second conception is based on idea that the assumption of normality in models is not real in practise. In transmission of regulative intervention from one time series to another, the level of their volatility plays very important role. It is empirically analyzed the problem of intervention transmission from REPO interest rate to PRIBOR 1T, 1M, 3M and 1R rates. The GARCH models of volatility enables to construct the confidence intervals for conditional means and to define the effective intervention to the development of time series. The non effective intervention to PRIBOR 1T series does not have chance to be transmitted to another time series. Only the effective intervention can be transmitted. The realization of transmission depends on many factors among them, the expectations of changes of REPO interest rate play very important role.

Bezděk, Vladimír (2000): "Public Finance Yesterday, Today and Tomorrow." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 50(3), pages 126–29.

Public finance represents an increasingly important issue in the political and economic debates in the Czech Republic, comprising both practical and theoretical matters, many of which (namely, tax revenue development, contingent liabilities, structural budget deficits, and fiscal federalism) are developed in detail in this issue of *Finance a úvěr*. There can be no doubt that public finances in the Czech Republic are under considerable duress. Recent fiscal policy has created structural budget deficits the past couple of years and, moreover, a portion of fiscal policy has been increasingly pursued outside official budgets. Finally, public finances as a whole are undergoing structural changes as public administration reforms are implemented. There is a clear need in the Czech Republic for a broader professional discussion and an expanded debate of all aspects of these issues.

Bezděk, Vladimír; Stiller, Vladimír (2000): "Forecasting the Main Tax Revenues in the Czech Economy." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 50(2), pages 66–77.

This article deals with the forecasting of the main tax revenues in the Czech economy. The authors analyze the relationship between taxes (value added, excise, corporate income, personal income, and social-security contributions) and selected macroeconomic variables (especially, GDP and wage growth). Several linear regression models are presented. They tend to be viable and suitable for the short-term estimation of tax revenues conditional to no structural changes in the fiscal framework. The authors, in emphasizing the difficulties associated with the predictability of budget resources, shed light upon the fiscal processes in the Czech economy.

Čihák, Martin; Holub, Tomáš (2000): "Monetary Conditions Indicators." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 50(12), pages 654–72.

This article provides an overview of foreign-language (non-Czech) literature on monetary conditions indices. The authors also discuss the issues involved in the construction of a monetary conditions index for the Czech Republic. They argue that if a monetary conditions index is to have any use for practical monetary policy, one must first distinguish two components of monetary policy stance: the monetary policy stance vis-à-vis the monetary policy target, and the monetary policy target itself. They conclude that MCI can be useful for measuring the monetary stance vis-à-vis the target, but better still is a frequent publication of inflation forecasts and the methodology behind such forecasts on the part of the central bank.

Cincibuch, Martin; Vávra, David (2000): "Road to EMU: Do We Need a Flexible Exchange Rate?" Czech Journal of Economics and Finance (Finance a úvěr), vol. 50(6), pages 361–84.

The authors consider the current exchange-rate regime in the Czech Republic as the Czech economy prepares for entry into the EU and the EMU. The macroeconomic impacts of a single-currency regime are classified according to traditional OCA theory. Using quantitative measures, the authors find the degree of macroeconomic convergence between the Czech and German (EU) economies sufficient enough to preclude major obstacles to the implementation of a fixed-currency regime in the Czech Republic. Also examined are the transitional specifics of the Czech economy. The paper analyzes the real appreciation of the Czech currency and its competitiveness and finds that the development of cost factors exerts depreciationary pressures on the exchange rate. Conversely, a fixed regime might alleviate problems related to the influx foreign capital and consequent nominal appreciation – an idiosyncrasy of the Czech economy. However, once labor market rigidities are removed, a fixed regime offers the Czech economy a basis of sustainable competitive advantage, growth, and convergence to the EU.

Dědek, Oldřich (2000): "Currency Turbulence in 1997 in the Czech Republic – Part One." Politická ekonomie, vol. 48(5), pages 605–21.

The Czech economy experienced a standard shake-up triggered by a gradual build-up of external imbalance that ended up with a speculative attack. As a result of the many institutional bottlenecks, the supply side of the economy was unable to keep pace with the rapid expansion in domestic demand. The mounting external imbalance was also linked with considerable internal imbalances. The contagion came in May 1997 from South-East Asia. Then followed a sharp weakening of the CZK. The CNB opted for a strategy of liquidity squeeze. Escalation of the crisis led to the adaption of managed floating of the CZK finally. The first signals of a calming of the situation emerged at the start of June. It became possible to launch a strategy to bring interest rates down. This process lasted until around the end of August. The price paid for eliminating the external imbalance was economic recession.

Dědek, Oldřich (2000): "Currency Turbulence in 1997 in the Czech Republic – Part Two." Politická ekonomie, vol. 48(6), pages 739–63.

The Czech economy experienced a standard shake-up triggered by a gradual build-up of external imbalance that ended up with a speculative attack. As a result of the many institutional bottlenecks, the supply side of the economy was unable to keep pace with the rapid expansion in domestic demand. The mounting external imbalance was also linked with considerable internal imbalances. The contagion came in May 1997 from South-East Asia. Then followed a sharp weakening of the CZK. The CNB opted for a strategy of liquidity squeeze. Escalation of the crisis led to the adaption of managed floating of the CZK finally. The first signals of a calming of the situation emerged at the start of June. It became possible to launch a strategy to bring interest rates down. This process lasted until around the end of August. The price paid for eliminating the external imbalance was economic recession.

Frait, Jan; Komárek, Luboš; Kulhánek, Lumír (2000): "An Analysis of Inflation in the Czech Republic Using the P* Model." Eastern European Economics, vol. 38(4), pages 54–72.

The paper presents a version of the P* model of inflation dynamics for a small open economy and applies it to the Czech economy time series from the period of 1991–1999. The paper is organised as follows. Section 2 presents a brief discussion of the monetary policy indicators issue. Section 3 describes the logics of the P* model. Section 4 explains the extension of the basic model to the case of a small open economy. Section 5 applies the model to the Czech economy data and presents the estimates of the Czech inflation dynamics determination. The results of the estimates suggest that the dynamics of the Czech inflation evolves in line with a P* model logic: the inflation in the current period changes to close the price gap, i.e. the gap between actual and equilibrium price level. The foreign component of the price gap seems to be more important than domestic component which supports the hypothesis that the equilibrium price level in the Czech Republic is to a large extent determined by the monetary policy in the EU via the explicit or implicit peg of the Czech currency exchange rate to EUR. The overall results show that the inflation in the Czech Republic is primarily a monetary phenomenon.

HAMPL, MOJMÍR (2000): "Methodological Problems of Economics as a Nominalistic Science." *Politická ekonomie*, vol. 48(1), pages 25–37.

This article focuses on a description of a substantial methodological change in economics that has been being in progress for a previous couple of decades. To explain this change the article exploits the bases of K. R. Popper's distinction between nominalism and essentialism in science. The article comes to a conclusion that the methodological essence of economics in recent years has been shifting from the essentialist shape to the nominalistic one. The passage from essentialism to nominalism is closely connected with the development and the extension of quantitative methods, statistics and advanced mathematics in economics. Another characteristic of this passage leans on the increasing ability of economics to invent and offer hypotheses testable by Popper's falsification method. Main purpose of the article is to describe and analyse some of the problems connected with mentioned methodological turn in economics. That is why problems like data-mining or biased tests are deeply analysed in this paper and methods of avoiding this problems are proposed. The last part of the paper comes to the conclusion that thanks to described methodological turn in economics this science is neither only inductive-based nor just deductive-based but the methodology of contemporary economics is rather the compromise of both. This compromise creates a new methodological paradigm for economic research.

HOLUB, TOMÁŠ (2000): "Price Convergence to the European Union: A Problem of Relative Prices." *Politická ekonomie*, vol. 48(5), pages 660–669.

The article analyses the process of price convergence of the Czech economy to the EU. The authors stress, that the problem consists primarily in the convergence of relative prices in the Czech Republic, not in the convergence of average price levels. The authors define a „coefficient of relative price differences“ to measure the scale of the relative price convergence problem. They conclude that this coefficient is still much larger in the Czech Republic than even in the least developed countries of the EU. If prices are downward sticky, relative price convergence can come about more easily at a higher inflation rate than is prevailing in advanced EU economies. Using the extreme assumption of downward price rigidity, the authors estimate the "natural" inflation rate in the Czech Republic to be 3–6% on average over the next ten years.

IZÁK, VRATISLAV (2000): "Czech Disinflation and Gross Domestic Product." *Politická ekonomie*, vol. 48(5), pages 623–46.

The first part of the paper characterizes the main features of the Czech macroeconomic development in the time period 1995:I–1999:III. Cross-correlograms of net inflation, adjusted inflation and producer price index on the one side and explanatory variables: wage gap, broad money, nominal rate of exchange and index of world prices of raw materials and foodstuffs on the other side show the correlations with different time lags. In the second part the dynamic model for an open economy with government sector has been constructed and several simulation exercises imitating Czech macroeconomic development have been made. The role of the slope of the short term Phillips curve (3 different coefficients) and that of expectations formation including direct inflation targeting has been analysed. The impact of favourable supply shocks and the response of extinguishing, neutral and accommodating aggregate demand policies have concluded the paper.

IZÁK, VRATISLAV (2000): "Disinflation, Supply Shocks and Monetary Policy." *Prague Economic Papers*, vol. 9(1), pages 25–46.

This paper reviews the main features of the Czech macroeconomic development in the last years with the accent on disinflation and real GDP. The adjustment path of the Czech economy is clear: The decrease in nominal GDP growth has caused a deceleration of inflation on the one side and a drop of growth rates of real GDP and later even a decline in the level of real GDP on the other side. Further the econometric investigation of relations between wages and labour productivity and net inflation, producer prices and gap has been made. As the main factors influencing the disinflation in the last quarters the index of raw materials and foodstuffs has been revealed. The analysis of the impact of real exchange rate on net exports concludes the paper.

Janáček, Kamil; Čihák, Martin; Frýdmanová, Marie; Holub, Tomáš; Zamrazilová, Eva (2000): "Czech Economy on a way back to growth." Prague Economic Papers, vol. 9(2).

The paper contains an analysis of the current trends in the Czech economy, and a short-term outlook for 2000. The authors claim that the economy is going through a gradual turn from recession to stagnation and to a slight recovery. The main factors of the turn toward revival are exports, followed by private household consumption, while government consumption contributed only slightly to the increase of domestic demand. The authors see the main potential risk for the year 2000 in the need to stabilise economic growth and achieve its further acceleration. The success will mainly depend on a fast removal of financial barriers which the majority of Czech firms is now facing. Further inflow of foreign capital, growing competition pressures in the financial sector, the growth of exports, and a gradual increase of domestic demand are likely to help to overcome these barriers

Janáčková, Stanislava (2000): "Price Convergence and the Readiness of the Czech Economy for Accession to the European Union." Eastern European Economics, vol. 38(4), pages 73–91.

In Czech economic strategy for EU accession, the difference of price levels is often cited as an important topic for macroeconomic policy. However, the key task is the convergence of Czech Republic's economic level (GDP per head) toward EU average. Convergence of the price level will be a side-effect accompanying the real convergence. At the end of 1998, Czech Republic's economic level was just over 60% of EU average, while the relative price level was estimated at roughly 43%. Both real and price level convergence will require productivity increase in the CR, faster than that achieved by EU. Price level convergence not underpinned by productivity increase could not be sustained, as it would undermine the competitiveness of Czech exports. Macroeconomic policy should strive to create a favourable framework for the growth of productivity, rather than trying to „pre-programme“ the price level convergence. The bulk of the present difference in price levels is in non-tradeable goods. In tradeables, some price divergence exists as well, often due to differences in quality that are hard to measure. Convergence of the price level toward EU average will proceed through changes of relative prices in the Czech Republic, and in the price level relation between the tradeable and non-tradeable sectors.

Jílek, Josef (2000): "Derivatives in the Czech Republic and Abroad: Present and Future." Eastern European Economics, vol. 38(3), pages 26–63.

Derivatives, a phenomenon of the financial and commodity markets of the 1980s and 1990s, allow fast, easy, and affordable management of market risks faced by financial institutions, businesses and individuals. This article analyzes the latest development trends on the international and Czech derivatives market. It also describes present accounting practices and the approach of regulators.

Kotlán, Viktor (2000): "Financial Indicators and the Czech Economy: Macroeconomic Stabilization and Monetary Policy in Transition Economies." Czech Journal of Economics and Finance (Finance a úvěr), vol. 50(4), pages 243–45.

The article summarizes papers presented at two seminars organized by the Czech Economic Association in November 1999 held in Ostrava and Jindřichův Hradec, respectively. The first seminar, Financial Indicators and the Czech Economy, attracted papers aimed at both presenting the theory and testing the explanatory power of financial indicators, performance in the Czech economy. The second seminar, Macroeconomic Stabilization and Monetary Policy in Transition Economies, brought together participants interested in monetary policy transition issues. Topics such as price level convergence, Taylor rule, Monetary Conditions Index, inflation expectations, and others were addressed.

Kotlán, Viktor (2000): "Young Economists on the Methodology of Economics." Czech Journal of Economics and Finance (Finance a úvěr), vol. 50(12), pages 699–702.

The Czech Economic Association has once again awarded young economists for contributions made to economic research. Each awarded presented a lecture that dealt with economic methodology. This article summarizes the lectures, each of which addressed a specific methodological topic: evolution, definition and the role of the mainstream in economics, Methodenstrait, and real business cycle methodology, among others. The seminar ended with a fruitful discussion, also summarized here.

Kotlán, Viktor; Macháček, Martin (2000): "Is EMU an Endangered Specie? Regional Impacts of Single Monetary Policy." Czech Journal of Economics and Finance (Finance a úvěr), vol. 50(7–8), pages 386–405.

The authors of this paper argue that European Monetary Union (EMU) member countries are likely to respond differently to the single monetary policy of the European Central Bank. Disparities are inevitable, they maintain, given differences in monetary policy transmission due mainly to the so-called credit channel and its different strength in individual countries. The authors develop their argument on two tracks: First, a regional cycles hypothesis is applied to EMU member states and literature is surveyed to illustrate how monetary policy shocks are very likely to bring about different reactions in the development of real economic activity of different EMU member countries. Second, theory and empirical research regarding the so-called credit channel of monetary policy and its strength in the EMU countries is presented. The authors link the two issues and argue that the different regional impacts of single monetary policy in the EMU are caused, to a large extent, by the differing economic structures of EMU member countries, thus supporting the credit-channel explanation. The paper concludes by asserting that the economic structure of the Eurosystem will converge gradually, with the speed of convergence greatly dependent on the degree of unification of EMU jurisdiction. In the meantime, fiscal policy in the EU will be constrained by the Growth and Stability Pact and the EMU will thus have to stay patient not to go the way of dodo bird.

Křovák, Jiří; Filáček, Jan (2000): "Czech Economy in 2000 and 2001." Prague Economic Papers, vol. 9(2).

We predict that GDP will grow 1.5% in 2000 after falling 0.2% in 1999. Sluggish growth in 2000 will be driven by domestic demand, namely fixed investment. Interest rates set by the CNB are now in a "parking zone". The two-week repo rate remains at 5.25%. We do not expect any significant (upward) changes during the course of this year. We expect average annual inflation (CPI) to increase to 3.8% in 2000. Unemployment will rise to 10.8% (at yearend) and employment will decline by 2%. Real wages will grow by a modest 1.6%. We predict that the trade gap will widen to CZK 85 billion and the current account deficit will comprise some 2.4% of GDP in 2000. The CZK against the euro will be more or less nominally stable.

Procházka, Petr (2000): "The Integration of Czech Banking into the European Single Market." Czech Journal of Economics and Finance (Finance a úvěr), vol. 50(6), pages 326–47.

This article analyses the progress of the integration of the Czech banking sector into the European Single Market. Different stages of the integration effort are assessed together with their main factors. The introduction of the euro in the Czech Republic as a legal tender subsequent to the achievement of Maastricht criteria is herein defined as the final stage of such integration. Among the integration factors addressed in the paper are: macroeconomic conditions, the degree of liberalization of capital movements, institutional conditions, harmonization of banking legislation, and outstanding microeconomic and institutional preconditions. In each of these areas the conditions that need to be met towards the Czech Republic's accession to the EU are described, along with the different levels and stages of preparedness and the situation in the negotiation process as of March 2000, including further convergence requirements towards realizing Czech EU membership.

Šmídková, Kateřina (2000): "Alternative Monetary Policy Rules in the Model of the Czech Economy." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 50(4), pages 224–42.

Since koruna turbulence in 1997, there has been considerable dialogue concerning suitable strategy for the Czech monetary policy. This paper provides a model framework for such discussion. Three alternative monetary strategies are approximated by different policy rules. Several specific features of the Czech economy (such as its significant openness, administered price deregulation, and nominal convergence) are incorporated in the author's model. Major shocks come from external prices and price corrections. Similarly, policy rules mirror strategies of monetary policy that are relevant to the Czech experience. For example, the standard inflation-targeting rule is modified by an imported equilibrium interest rate. Alternative definitions of aggressiveness regarding the exchange-rate rule correspond to changes in the width of the band. Model simulations can be used for a comparison of the efficiency of monetary rules in ensuring convergence to low inflation and their costs in terms of output, interest rates, and trade balance volatility.

Šmídková, Kateřina (2000): "Comparison of Monetary Policy Rules Using a Czech Economy Model." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 50(5), pages 258–69.

Three alternative policy rules are contrasted in a model framework in this paper. Such simulation and their results provide a background for policy debate on the properties of alternative strategies of Czech monetary policy. The specific features of an economic transition period are reflected in an extended set of measures when comparing the policy rules. The paper presents the results of these simulations, including tests of sensitivity to calibration, and summarizes the conclusions. First, any policy rules that combine several targets are inferior to inflation and exchange-rate rules since they are less efficient in ensuring nominal convergence, and more costly in terms of output, interest-rate and external-balance volatility. Second, exchange-rate rules are less efficient and less costly in terms of output volatility. Inflation policy rules are more efficient and less costly in terms of interest-rate volatility. This result illustrates that it is very difficult to hit upon a single superior strategy. The final choice depends on preferences. Third, exchange-rate and inflation policy rules produce gradual real appreciation. Under exchange-rate rules, real appreciation is due to the inflation differential. Under inflation rules, it is due to gradual nominal appreciation. This result, it is argued, supports the author's assertion that it is not possible for a central bank to fix any real variable with its strategy.

Šmídková, Kateřina; Hrnčíř, Miroslav (2000): "The Czech Experience with Inflation Targeting in Transition." *Prague Economic Papers*, vol. 9(3), pages 217–229.

This paper argues that inflation targeting is a strategy that can be under certain conditions adopted by central banks in countries in transition even though their typical goal is to disinflate instead of stabilising low inflation. On the one hand, according to the Czech experience, inflation targeting offers several benefits, such as increasing control over expectations and short-term flexibility of monetary strategy that are attractive for economy in transition. On the other hand, constraints imposed by period of transition as well as by openness of economy are present no matter which monetary strategy is chosen by the central bank. Implied costs should not be attributed to a particular monetary strategy. Inflation targeting has made various factors constraining monetary policy more visible and, as a result, requirements on the quality of decisions as well as on communication strategy have increased.

Šmídková, Kateřina; Hrnčíř, Miroslav (2000): "Transition to the Strategy of Inflation Targeting." *Eastern European Economics*, vol. 38(6), pages 13–42.

This paper argues that inflation targeting is a strategy that can be under certain conditions adopted by central banks in countries in transition even though their typical goal is to disinflate instead of stabilising low inflation. On one hand, according to the Czech experience, inflation targeting offers several benefits, such as increasing control over expectations and short-term flexibility of monetary strategy that are attractive for economy in transition. On the other hand, constraints imposed by period of transition as well as by openness of economy are present no matter which monetary strategy is chosen by the central bank. Implied costs should not be attributed to a particular monetary strategy. Inflation targeting has made various factors constraining monetary policy more visible and, as a result, requirements on the quality of decisions as well as on communication strategy have increased.

Stavrev, Emil (2000): "Monetary and Fiscal Policies' Efficiency and the Determination of a Nominal Equilibrium Exchange Rate." *Czech Journal of Economics and Finance (Finance a úvěr)*, vol. 50(9), pages 464–77.

The author of this paper constructs a continuous time macro-econometric model of the Czech economy. The model is assembled as a system of twelve non-linear differential equations. The model is put into use to determine the nominal equilibrium exchange rate of the Czech koruna in a macro-economic framework. The paper also investigates the effectiveness of monetary and fiscal policies in the presence of a fixed exchange-rate regime and massive capital inflows. The search for an equilibrium point is outlined and stability and sensitivity analyses are provided, along with in-sample static and dynamic predictions with the approximate discrete analogue.

Czech National Bank
Economic Research Department
Na Příkopě 28, 115 03 Praha 1
Czech Republic
<http://www.cnb.cz>
e-mail: research@cnb.cz