Earl L. Wright: Insights, analysis, conclusions

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The Forum visited Austria plus four of the 10 new members of the European Union: Slovakia, Czech Republic, Slovenia and Hungary. Moving from 15 to 25 members is a huge jump for the EU, resulting in a population of 450 million. In time this population will be able to flow freely across borders.

Free trade zones and a huge consumer base are among the advantages of enlargement. The economic growth of the new EU members has been stronger in the past two-three years than that of the 15 older EU members. The education base of the EU-10 is sufficiently strong to create a competitive workforce with the 15 original members.

Personal income is still higher in the original 15 EU countries, two-three times that of the 10 new members.

Significant issues

There appear to be significant issues with regard to governance and property rights in the four new EU countries we visited. Property rights are weakest in Slovenia.

Home ownership is low relative to the United States in all of the countries we visited. I think this will increase significantly as the capital and financial markets improve and mortgages become available to those who want to buy a home. The heavy savings rate will support the desire for home ownership in all these countries. The free flow of capital in the EU will allow a mortgage marketplace to be developed similar to what we saw being created in Hungary.

The capital markets, however, will not be enhanced by the stock markets. The stock markets are not sophisticated enough and they are too small to be much of a resource for private capital investment.

The banking community, particularly in Vienna, will probably be a primary source of financing for endeavors in these four EU countries, whether for government borrowing or for private enterprise borrowing.

The ability of the capital markets to function will depend upon a more sophisticated level of laws that will allow the execution of property rights transfer. There also needs to be a means by which actions can be taken against those that default on debt or fail to meet the requirements under which they obtained the capital.

In the EU-10, 35-40 percent of everyone's salary goes to support the pension system, which includes healthcare costs as well. It is an onerous burden on future generations, particularly as the population base in these countries is declining. They are all looking at privatizing part of their pension system, which would create opportunities for financial institutions to manage those assets.

In Slovakia, an unusual system is being created which may generate some real problems if copied by the other countries. It will affect any company that may decide to manage the privatized assets of pension funds.
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The Slovakian situation dictates that if there is a deviation below 70 percent of the performance within the standard group investments, the fund manager has to make up that difference from his own resources. That is a burdensome condition which, if placed on everybody else, will subject the investment return of privatization to mediocrity at best, with investments in nothing other than high quality bonds and with a modest amount in equities under any and all conditions.

Opportunities

Financial institutions will benefit from the growth and financing the growth of the new EU countries. I believe the Viennese banks that will participate in the management of some of the defined contribution private pension funds, particularly in Slovakia and possibly in Hungary and the Czech Republic, will be positively impacted.

I also believe that there will be a consolidation of the financial institutions, especially in Vienna.

The Slovakian, Hungarian, and Czech Republic stock exchanges are very small, but some of the privatization monies going into these exchanges may increase their value. Other than that, I do not know how these stock exchanges will have a significant benefit because there is not enough size nor enough financial sophistication to use them as part of the capital markets for growth.

Because Hungary, Slovakia, Czech Republic and Austria are right in the middle of Europe, they have significant manufacturing and distribution capabilities. In the near future, this part of Europe has exceptional growth potential as it works to catch up with the rest of Europe.

The financial institutions which will be providing funding for the new EU countries may represent good opportunities for investors who do their due diligence.