

PUBLIC FUNDS IN THEORY OF FINANCIAL STRUCTURE A COMPANY IN CZECH REPUBLIC

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Abstract

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Mutually beneficial co-existence of the private and state sectors can be seen as proven in theory. The proof is the concept of a two-sector economy of A. Wagner (1835–1917), while, in Wagner's view, the importance of the state sector should grow (Wagner's law). State finance is understood in this context as a tool used to achieve social justice, and in general as a socially stabilizing element.

In conditions of real Czech economy, the relationship between the state and private sectors is shown in the form of subsidies for businesses enterprises; although at first sight the available data do not demonstrate the key role of public finance. Another form of limited understanding of the importance of public funds is the concept of financial structure of a company understood by contemporary theory of finance of firm (in Czech context) as a set of sources for financing entrepreneurial activities – public funds are virtually not mentioned here.

The aim of the paper is to contribute to correct this shift in understanding of the importance of public finance and to bring it nearer both to the original theoretical concept (A. Wagner) and to reality, both in quantitative and qualitative terms.

Main focus of this paper is to the Czech Republic circumstances. For the comparison are here presented available data from other countries and global data as well.

Czech Republic, state and private sector, public funds, financial structure of a company, moral hazard

1 INTRODUCTION

1.1 The aim of the paper

The aim of the paper, to contribute to correct shift in understanding of the importance of public finance and to bring it nearer both to the original theoretical concept (A. Wagner) and to reality, both in quantitative and qualitative terms, is possible to divided into the following sub-objectives:

- a) to bring to mind mutually beneficial coexistence of the private and state sectors (subchapters 1.2.1, 3.1, 3.2),
- b) to point out the absence of public funds in the corporate financial structure (subchapters 1.2.1, 1.2.2),
- c) to suggest an „objectivised “ financial structure including public funds (subchapters 3.3),
- d) to prove the importance of public finance for business also at a quantitative level (subchapters 3.4).

1.2 Brief review of the current state in the area of the paper's aim

1.2.1 Financial imbalance in the co-existence of the private and state sectors

The relationships between the public and private (market) sectors are regarded in the contemporary financial theory of the public sector (OCHRANA, PAVEL, VÍTEK *et al.*, 2010, pp. 13–14) as non-conflicting or trouble-free in principle.

The term used in this context is a mixed economy and it „expresses the co-existence of the profit-making and non-profit sectors. ... it is observed that they live alongside each other, complement each other, support each other and need each other.“ (STRECKOVÁ, MALÝ *et al.*, 1998, p. 11). This concept is further extended by (OCHRANA, PAVEL, VÍTEK *et al.*, 2010, p. 16) by another element of a subsystem „non-profit sector“.

The above mentioned „mutual support“ of both the sectors is, however, reduced to a one-way

support of business activities by public finance. This financial imbalance tends to be standard because „Support of businesses ... takes place in all the developed countries. ... The tools used, however, vary from country to country. Nevertheless, most such tools require financing by means of public finance ...“(OCHRANA, PAVEL, VÍTEK *et al.*, 2010, p. 209).

The imbalance in question may reach such an extent that we can speak about abuse of public finance, which can be illustrated by the following example from banking: „ ... this measure enables private banks to spread costs related to financial crisis over time, but is **apparent abuse of public finance**.“ (DVOŘÁK, 2008, p. 318).

1. 2. 2 *Information imbalance in the co-existence of private and state sectors (absence of public funds in the theory of corporation finance)*

An analysis of references dealing with the theory of corporation finance ((e.g. KRAUSEOVÁ, 2002, pp. 19–27), (VALACH, 2003, pp. 175–176)) leads to a conclusion that as far as the structure of sources used for financing business activities is concerned, the outcome of cooperation between both sectors is a clear information imbalance, which is manifested by virtually absolute absence of public funds in the theory of corporation finance.

The only rational conclusion drawn from such a state of theory of corporation finance is that public funds are so insignificant for financing the profit-making sector that they can be disregarded.

2 MATERIALS AND METHODS

2.1 Materials (Data files characteristics)

Books

From the point of view of influence and audience of sources, books are a predominant information source, especially academic textbooks, monographs and statistical yearbooks.

Journal articles

In accord with the focus of the paper on efficient communications means in an academic discussion in local context, this source is of limited importance.

Conference papers

The author considers conference papers (besides books) the most efficient tool used to shift the perception of the issue in question in the desired direction in the scientific community.

Internet

The main reason for using this information source is its ability provide data de facto I real time.

2.2 Methods used

The methodological focus of the paper lies in literary research, description, comparison, and analytic-synthetic methods.

In order to describe more precisely the purpose and the importance of the particular methodological

components of the paper, the following must be mentioned:

- Re literary research (including Internet resources): it is of crucial importance in the stage of acquiring the input data from available data files.
- Re description: it is mainly used while collecting the input data.
- Re comparison: serves, above all, to confront opinions of authors or schools.
- Re analysis: Analytic procedures are related to comparative procedures. They are used to discover connections and relations (if they exist) among sources used for financing business activities, including public funds.
- Re synthesis: Synthetic procedures are used mainly in order to phrase the findings of the paper.

3 RESULTS

3. 1 Causes of the financial imbalance in the coexistence of the private and state sectors – the mission of the state sector

A. Convention (pragmatic or normative level) – mission of the public finance

The imbalance of financial flows between the state and profit-making sectors is so apparent that it may even evoke notions of an inferior role of public finance.

The status of public finance may be perceived as superior from the point of view of a system – as its mission is preventing and dealing with market (and other) failures (STRECKOVÁ, MALÝ *et al.*, 1998, p. 29).

The principle of market regulation itself is generally considered indispensable (Jackson and Brown, 2003, p. 47). At the same time, the potential of public finance is indeed exceptional, as it exceeds the corporation level, because, as is stated by STRECKOVÁ, MALÝ *et al.* (STRECKOVÁ, MALÝ *et al.*, 1998, p. 78), public finance can “ensure functioning of the non-profit and, above all, public sector and contribute to achieving stability and efficiency of the national economy.”

Partial result No. 1:

Pragmatically speaking, the potential of public finance seems to be strategically more important compared to corporation finance. If public finance has such amounts of available sources that it is able to handle market failures, the financial imbalance in question is, in fact, an expression of its dominant strategic position and not of its alleged weakness.

B Conceptual reasons (theoretic level, force of economic laws)

Besides pragmatic causes, there are also conceptual, theoretic or philosophic roots of the financial imbalance.

It turns out useful to start with a thesis saying that public finance is, per se, able to cover both „behaviour of an individual in the *private sphere* of their activities.“ (BUCHANAN, 1998, p. 6), and effects of the „fiscal institutions on the behavior of individuals and groups in the private sector of the economy.“ (BUCHANAN, 1998, p. 5).

This potential of public finance can be more clearly shown by model approaches at even macroeconomic level. (STRECKOVÁ, MALÝ *et al.*, 1998, p. 113).

Of the three known model approaches, we attach the most importance to Wagner's law. Reference sources give a lot of definitions of the law (e.g. (KUBÁTOVÁ, 2011, p. 41), (PEKOVÁ, 2008, pp. 227–228) or (HILLMAN, 2009, p. 744). Because of the reference to the unique source (WAGNER, 1893) we prefer the formulation quoted in the last mentioned source, which states (indirect quotation): „... the size of government as measured by public spending in creases proportionately more than the growth of national income (WAGNER, 1893)“.

Partial result No. 2:

Even the theory proves the superior position of public finance as the crucial cause of the financial imbalance in the co-existence of the profit-making and non-profit sectors.

The paper contains data that allow check the validity of the Wagner law. Scientific evidence (correlation, regression) here do not carry – for our purposes it is sufficient to compare the percentage trends. The point is that public finance may be perceived as an important source for private sector.

3.2 Causes of information imbalance in the coexistence of the private and state sectors

Subchapter 1.2.2 stated that presentation of public funds in financial structures of profit-making businesses is virtually non-existing. The thesis will be illustrated by one of the most qualified sources: „**Subsidy** ■ financial means given from → *public budgets* to lower levels of public administration (authorities or state bodies), which use them according to fixed rules (Special-purpose subsidies) or freely (General subsidies). ...“ (HINDLS, HOLMAN, HRONOVÁ *et al.*, 2003, p. 91).

The source does not mention at all the possibility that public subsidies could be awarded to businesses in the profit-making sector.

The question is why the absence of public funds in financial structures of profit-making enterprises is a rule rather than an exception.

If we put aside bad faith, there are at least two more reasons:

- a) Predominant focus of sources dealing with corporation finance on the tactical and operational level of financial management processes.
- b) Implicit perception of budgetary means as sources resulting from activities of profit-making

sector businesses, because, as it is stated in footnote 2 of OCHRANA, PAVEL, VÍTEK *et al.* (OCHRANA, PAVEL, VÍTEK *et al.*, 2010, p. 17) „It is typical of the public sector thatone sort of public revenue is tax revenue obligatorily returned according to the law.“

Partial result No. 3:

The author of the paper tends to come to a rather heretical conclusion (from the point of view of corporation finances). Public finance is in a strategically stronger position compared to corporation finance. The dominance is so strong that public finance may afford to disregard imprecise or incomplete attitudes of corporation finance.

3.3 Objectivised financial structure (entry of public finance)

Partial result No. 4:

In this paper we suggest emphasizing explicit statement of the share that public funds have in the financial structure of a company in such a way that element of financial structure “subsidy (alternatively financial support) from public funds“ (MAREK *et al.*, 2011, pp. 427) will be replaced by the following Tab. I.

The result (Tab. I) will very likely not represent the final solution to the problem. Nevertheless, the solution can be described in Czech conditions as the most complex so far. And from this point of view is this result of the analyzes important.

3.4 Demonstration of the importance of public finance for the business sector

The importance of public funds for the business sector will be demonstrated by the volumes of public funds that the business sector gains.

Verification of Wagner's law is possible, but (as mentioned above) it is more or less side-effect.

The first meaningful data are connected with transformation of the Czech national economy from the model of command economy to the market economy in the 1998. Other available data are connected with privatization in Czech Republic, which was a part of our economic transformation (see Tab. II).

The data in last line of the Tab. II shows the general significance of the public subsidy. The data indicate slightly increasing trend of the total public subsidy relative to GNP in the Czech Republic in the reporting period.

Accurate final totals of public funds that the private sector has drawn so far are not known yet.

However, unofficial estimates, which cover even obviously criminal activities of various lobbies, are available. The estimated extent varies („approximately half a trillion CZK“, „almost 600 billion CZK“, „hundreds of billions CZK“), according to the sources, in the following order –

I: Public funds in the financial structure of a company

I. Sources created more or less legally		
a) General grants (subsidy)		
1	direct subsidy	(OCHRANA, PAVEL, VÍTEK <i>et al.</i> , 2010, p. 209)
2	„direct ... public subsidy to businesses“	(ZEMPLINGEROVÁ, 2006, pp. 204–213)
3	„indirect public subsidy to businesses“	(ZEMPLINGEROVÁ, 2006, pp. 204–213)
4	tax relief	(OCHRANA, PAVEL, VÍTEK <i>et al.</i> , 2010, p. 209)
5	supported bank products	(OCHRANA, PAVEL, VÍTEK <i>et al.</i> , 2010, p. 209)
6	services provided free of charge	(OCHRANA, PAVEL, VÍTEK <i>et al.</i> , 2010, p. 209)
7	tax holidays	
8	investment incentives	(KUBÁTOVÁ, 2011, p. 49)
9	„state dumping“ (subvention according to WTO)	(PŘENOSILOVÁ, DVOŘÁK, 1997, p. 17)
10	transfers in the form of non-special-purpose subsidies	(PEKOVÁ, 2008, p. 215)
11	assumption of loss incurred (not defined more precisely)	(DVOŘÁK, 2008, p. 319)
12	explicit promise of loss coverage of a private enterprise	(DVOŘÁK, 2008, p. 276)
13	implicit promise of loss coverage of a private enterprise	(DVOŘÁK, 2008, p. 276)
b) Specific examples of subsidies		
14	„bail out“ – supplying missing liquidity (so that the business can meet its obligations)	(DVOŘÁK, 2008, p. 275)
15	recapitalization – a new concept meaning a massive supply of liquidity related to bank losses due to current (2008 and further) financial crises, de facto „direct ... public subsidy to businesses“	(ZEMPLINGEROVÁ, 2006, pp. 204–213)
16	defaulted private debt – transferred to a public debt	(DVOŘÁK, 2008, p. 273)
17	privatization debt – as a consequence of direct sale of a privatized property on credit	(DVOŘÁK, 2008, p. 153)
18	transfers in the form of special-purpose subsidies	(PEKOVÁ, 2008, p. 215)
19	subvention (strictly special-purpose subsidies)	(PEKOVÁ, 2008, p. 215)
20	gifts	(DVOŘÁK, 2008, p. 278)
II. Sources created more or less illegally		
a) Sources of general character		
21	socialization – „costs of unsuccessful credit transactions ... transferred to the system of public finance“	(DVOŘÁK, 2008, p. 276)
22	profit resulting from the status of a preferred partner	(KISLINGEROVÁ <i>et al.</i> , 2011, p. 204)
23	unnecessary high expenses (at the expense of a state institution)	(KISLINGEROVÁ <i>et al.</i> , 2011, p. 204)
b) Sources of a specific character		
24	„not paying taxes and social and health insurance“	(NAHODIL, 2009, p. 305)
25	„obtaining additional “profit” from unpaid taxes or insurance“	(NAHODIL, 2009, p. 305)
26	„fiscal evasion“, tax evasion	(NAHODIL, 2009, p. 305)
27	„additional financial means“ for finishing a project resulting from deliberately underestimated project costs (before its acceptance)	(TETŘEVOVÁ, 2008, p. 94)
28	„remaining financial means“, from overestimated project costs (if they are not purpose-related)	(TETŘEVOVÁ, 2008, p. 94)
29	„appropriation of someone else's property or sources and their legalization“	(NAHODIL, 2009, p. 305)

Source: Adapted from (DVOŘÁK, 2008), (KISLINGEROVÁ *et al.*, 2011), (KUBÁTOVÁ, 2011), (NAHODIL, 2009), (OCHRANA, PAVEL, VÍTEK *et al.*), (PEKOVÁ, 2008), (PŘENOSILOVÁ, DVOŘÁK, 1997), (TETŘEVOVÁ, 2008), (ZEMPLINGEROVÁ, 2006)

BUREŠ (2001), DVOŘÁK (2008, p. 153), KUBÁTOVÁ (2011, p. 51).

If we look at the above mentioned “subsidies”, which the business sector has acquired from public finance, we obtain Tab. III.

Result of the comparison in Tab. III is an evident. The total of public funds that the private sector has drawn so far is fully comparable with total external debt of the Czech Republic. It is a compelling evidence of the public funds in quantitative terms.

II: Comparison of direct and indirect subsidies with the GNP (CR, billions of CZK, %)

Year		1997	1998	1999	2000	2001	2002	2003
HDP (GNP)	CZK billion	1 669	1 880	1 955	2 030	2 241	2 408	2 550
HDP (GNP)	%	100	112.6	117.1	121.6	134.3	144.3	152.8
Public subsidy according to ÚHOS*	CZK billion	33.7	40.6	51	14.6	49.9	101.5	71.1
Indirect public subsidy (transformation institutions)	CZK billion	95.2	116.6	140.7	145.4	n.a.	n.a.	n.a.
Total public subsidy	CZK billion	128.9	157.2	191.7	160	n.a.	n.a.	n.a.
Total public subsidy	%	100	122.0	152.9	124.1	n.a.	n.a.	n.a.
Total public subsidy relative to GNP	%	7.7	8.4	9.8	7.9	n.a.	n.a.	n.a.

* Remark: Úřad pro ochranu hospodářské soutěže (government controller of competition – antimonopoly office).

Source: Adapted from Tab. XII.1 *Direct and indirect public subsidies to businesses (in billions of CZK)* [source: (ZEMPLINGEROVÁ, 2006, pp. 204–213), (OCHRANA, PAVEL, VÍTEK *et al.*, 2010, p. 209), Statistical Yearbook of the Czech Republic 1997, 1999, 2000, 2001, 2002] and author calculations

III: Comparison of the transformation losses and external debt of the Czech Republic

transformation losses/external debt	value
all the transformation losses (estimate 1)	500–600 billion CZK
all the transformation losses (estimate 2)	hundreds of billions CZK
total of public funds that the private sector has drawn so far (2009 – estimate 3)	1 500 billion CZK
total external debt of the Czech Republic (as at year-end 2011 – accurate figure)	1 789 billion CZK
total external debt of the Czech Republic (to the I. quarter 2012 – accurate figure)	1 906 billion CZK

Source: Adapted from BUREŠ (2001), DVOŘÁK (2008), KUBÁTOVÁ (2011), Statistical Yearbook of the Czech republic 2011 and http://ekonomika.idnes.cz/cesko-dluzi-v-zahranici-1-9-bilionu-korun-f0e-/ekonomika.aspx?c=A120629_102259_ekonomika_neh [19. 8. 2012, 12:12]

IV: Capital expenditure private and public – comparison with GDP (2004–2008)

Year	2004	2005	2006	2007	2008
GDP current prices					
CZK milion	2 814 800	2 983 900	3 222 400	3 535 500	3 689 000
%	100	106.0	114.5	125.6	131.1
business investment (private)					
share in GDP %	21.0	20.0	119.7	20.5	19.1
CZK milion	591 108	596 780	634 813	724 778	704 599
%	100	101.0	107.4	122.6	119.2
capital expenditure (public)					
share in GDP %	5.7	5.7	5.9	5.4	6.0
CZK milion	159 718	168 853	191 210	190 481	223 229
%	100	105.7	119.7	119.3	139.8
share in business investment %	27.0	28.3	31.1	26.3	31.7

Source: Statistical Yearbook of the Czech Republic 2009 and 2011

Latest available data (from time horizon 2004–2008) relate to the capital expenditure. Its analysis is presented in Tab. IV and Tab. V.

Credibility of the data source are (especially in this case) beyond dispute – Statistical Yearbook of the Czech Republic is probably the most relevant source of the primary data.

Only the pure public capital expenditures are approximately one third of private sector investment. Even this comparison itself shows the importance of the public resources. In this case data do not confirm absolutely conclusively Wagner law.

However, so far we do not take into account subsidies and other current transfers. To this modification is devoted Tab. V.

Tab. V shows, that public subsidies and other current transfers shifting meaning of the public resources to significantly higher values.

In this paper our priority is the situation in Czech Republic. However, even in this case will be beneficial become familiar with available data from other countries. In first step we will analyze for the selected countries the share of social spending to GNP (see Tab. VI).

V: *Capital expenditure private and public with subsidies and other current transfers – comparison with GDP (2004–2008)*

	2004	2005	2006	2007	2008
GDP current prices					
CZK milion	2 814 800	2 983 900	3 222 400	3 535 500	3 689 000
%	100	106.0	114.5	125.6	131.1
business investment (private)					
share in GDP %	21.0	20.0	119.7	20.5	19.1
CZK milion	591 108	596 780	634 813	724 778	704 599
%	100	101.0	107.4	122.6	119.2
capital expenditure and subsidies and other current transfers (public)					
share in GDP %	32.9	34.0	33.8	31.7	32.0
CZK milion	927 303	1 015 305	1 090 217	1 121 696	1 179 494
%	100	109.5	117.6	121	127.2
share in business investment %	156.9	170.1	171.7	154.8	167.4

Source: Statistical Yearbook of the Czech Republic 2009 and 2011 and author calculations

VI: *The Share of social spending to GNP in the 20th century*

Country	1910	1930	1980	1990	1995
Japan	0.18 %	0.21 %	10 %	12 %	12 %
United States	0.56 %	0.56 %	11 %	12 %	14 %
Greece	0	0.07 %	9 %	14 %	14 %
Portugal	0	0	10 %	13 %	15 %
Italy	0	0.08 %	17 %	21 %	24 %
Germany	0.59 %	4.82 %	20 %	20 %	25 %
France	0.81 %	1.05 %	23 %	24 %	27 %
Sweden	1.03 %	2.59 %	30 %	32 %	33 %

Source: Adapted from Tab. X.2 The share of social spending to GNP in the 20th century (HILLMAN, 2009, p. 745)

VII: *Sources of financing of non-profit sector, 1995 (average from 19 countries)*

source of financing	share in %
public sector	42 %
fees and sales	47 %
charity	11 %

Source: Adapted from Diagram No. 8 Zdroje příjmů neziskového sektoru, 1995 (průměr z 19 zemí) (SALAMON, L. M., ANHEIER, H. K. *et al.*, 1999, p. 36).

In this case (mostly historical data) data confirm validity of Wagner's law. But more important is fact, that currently shares of social spending to GNP are undoubtedly high. It confirms the importance public resources also in this area and in international context. We can even declare, that source HILLMAN (2009) works with global data.

For the second, we will use the occasion to analyze importance of the public finance for funding of non-profit sector on the whole. We use data from a unique source, which also operates in fact in the global framework. This source SALAMON, L. M., ANHEIER, H. K. *et al.* (1999) distinguishes in principle three sources of financing (see Tab. VII).

Also in this case, at the international level, show data very visible importance of public resources.

Those overall figures are, however, the average number.

Selected country-specific data are presented in Tab. VIII. Especially interesting are for us data from Central and Eastern Europe countries. Source SALAMON, L. M., ANHEIER, H. K. *et al.* (1999) distinguishes according two groups of countries. Criterion for this division is decisive source of financing – either fees and sales or public sector (see Tab. VIII).

Latest available data (from time horizon 1920–2005) from Central and Eastern Europe countries and Great Britain are connected to the trends of the public spending in % of GDP. Its analysis is presented in Tab. IX.

Partial result No. 5:

The importance of public funds for stabilization of the private sector is indisputable. This partial conclusion is supported not only by data from Czech Republic, but also by data for other countries even in global scale.

What can be discussed, though, is the total amount of public funds which support the profit-making sector at a given moment. And what seems to be even a bigger problem is to identify why public funds have to be used. It is clear that there are both

VIII: Sources of financing of non-profit sector, 1995 (country – specific data)

source of financing			
	public sector	fees and sales	charity
country / territory			
all countries	42 %	47 %	11 %
country with fees and sales in a dominant position			
Japan	34 %	62 %	3 %
USA	31 %	57 %	13 %
Hungary	27 %	35 %	18 %
Slovakia	21 %	56 %	23 %
Mexiko	9 %	85 %	6 %
country with public sector in a dominant position			
Ireland	78 %	15 %	7 %
Germany	64 %	32 %	4 %
Austria	50 %	44 %	6 %
Czech Republic	43 %	40 %	18 %

Source: Adapted from Diagram No. 8 Zdroje příjmů neziskového sektoru v jednotlivých zemích, 1995 (průměr z 19 zemí) (SALAMON, L. M., ANHEIER, H. K. *et al.*, 1999, p. 38)

IX: Volume of public spending in % of GDP (horizontal analysis)

Year	1920	1937	1960	1980	2005
Spain	9.3	18.4	18.8	32.2	40.1
	100.0%	197.9%	202.2%	346.2%	431.2%
Holland	13.5	19.0	33.7	55.2	48.1
	100.0%	140.7%	249.6%	408.9%	356.3%
Austria	14.7	20.6	35.7	48.1	50.1
	100.0%	140.1%	242.9%	327.2%	340.1%
Switzerland	17.0	24.1	17.2	32.8	36.1
	100.0%	141.8%	101.2%	192.9%	212.4%
Germany	25.0	34.1	32.4	47.9	47.1
	100.0%	136.4%	129.6%	191.6%	188.4%
Great Britain	26.2	30.0	32.2	43.0	44.5
	100.0%	114.5%	122.9%	164.1%	169.9%
France	27.6	29.0	34.6	46.1	54.5
	100.0%	105.1%	125.4%	167.0%	197.5%
Italy	30.1	31.1	30.1	42.1	49.5
	100.0%	103.3%	100.0%	139.9%	162.8%

Source: Adapted from Tab. IV: **Objem veřejných výdajů jako procento procento HDP**, (KOHOUT, P., KREJDL, A. and PAVEL, J, 2006, p. 53) and author calculations

more or less objective reasons (global financial crisis) and subjective reasons (economic criminality).

4 DISCUSSION

4.1 The Coexistence of the private and state sectors – financial imbalance (mission of public finance and Wagner's law)

The discussion must not disregard the issue of market failure and factual validity of Wagner's law in real in current conditions of the national (Czech Republic) economy.

Market failure itself wouldn't have to be perceived as fatal, if there weren't the possibility of the failure of higher managerial level, failure of the top decisive sphere, the government. „Among the main reasons leading to the fact that government interventions do not meet their intended goals are the following:

.....
4. Even if all the previous restrictions didn't exist, one would remain. It is a restriction resulting from the core of political process ... Long-term implementation of an internally logical and consistent policy is in essence impossible. *Democracy is a method which, using a way that suits everyone, reaches*

a decision that doesn't suit anyone (STRECKOVÁ, MALÝ *et al.*, 1998, p. 48).

The validity of Wagner's law in the national economy is related to the existence of „Banking safeguarded by state banks...” (STRECKOVÁ, MALÝ *et al.*, 1998, p. 113). Except for one case, the situation in the Czech Republic is the following „Currently, commercial banks have the position of a private entity with solely foreign capital.” (KUBÁTOVÁ, 2011, p. 51), which calls the validity of Wagner's law in conditions of Czech national economy into question.

There are, for that matter, significant, theoretically founded doubts about unconditional validity of that law. *This theory ... is generally accepted even though it is difficult to give evidence supporting the veracity of the law...* (PEKOVÁ, 2008, pp. 227–228).

At an empirical level, such doubts are quite distinct. „Subsidies in the Czech Republic plummeted in 2004 (from 3.9%, respectively. 2.9% in 2002 and 2003 to 0.6–0.7% in the following years).“ (OCHRANA, PAVEL, VÍTEK *et al.*, 2010, p. 209).

The issue of market (and other) failures can be considered resolved in terms of this paper.

The validity of Wagner's law is questioned by conditions in the Czech Republic. A well-founded assumption claims that the fluctuation of the validity is mainly due to, „... state interventions in the social area.” (PEKOVÁ, 2008, pp. 227–228). This fact however, does not change importance of the other outcomes of the paper.

4.2 Absence of public funds in the theory of corporation finance – information imbalance

With current state of things, a theoretical shift is expected from the theory of corporation finance. And it is up to the willingness of corporate financiers to put things right.

4.3 Objectivised financial structure – with explicit statement of public funds

The theory of corporation finance shows only limited effort to include input of public funds in the financial structure of a company to a greater extent.

Such a state does not correspond to reality because it only reacts to standard situations when profit-making sector works as a „money-printing machine“ and intervention of public funds is not logically necessary.

4.4 The importance of public funds for the financial structure of a profit-making company

One of interesting issues is the share of „debt privatization “of the whole fiscal impact of our transitive privatization on public finance.

According to Dvořák (DVOŘÁK, 2008, p. 153) it is true that „Czech public finance ... participates noticeably in transformation costs, ...“, nevertheless „now we can only speculate if direct sale of privatised property on credit, ...“, were or still are of crucial importance for all the transformation losses.

One, so far isolated source, claims that losses of public finance due to privatisation will not be that significant. So-called political necessity to finance privatised businesses resulted in the following situations in which „Banks were under political pressure to support the transformation process by means of liberal credit policy.“, however, the percentage of privatisation loans was relatively low” (KOUBA, VYCHODIL a ROBERTS, J., 2005) – see following Tab. X.

It turns out that an overwhelming part of aggregate subsidies from public funds is related to other (problematic) bank activities, which showed in the total amount of classified loans. „It is important to point out that in the developed world bankers and banking industry have become symbols of economic trouble and main determinants of the financial crisis. There is a growing effort ... to refuse ... compensate for the effects of incompetent and wrong decisions of bankers on financial situation ...“ (KUBÁTOVÁ, 2011, p. 53).

4.5 Moral hazard

The phenomenon of moral hazard has not appeared yet in the text. Yet, it is unavoidable to disregard it in a discussion. According to Dvořák (DVOŘÁK, 2008, p. 275) the concept of „Moral hazard ... Was originally used in insurance relationships to label empirically observed distorted behaviour of an insure in terms of risk underestimation caused by the fact that the risk is covered by the insurance.“ (highlighted by FK). The current concept of moral hazard keeps this basic principle.

It might seem that the concept of socialisation has appeared in order to conceal asocial roots of moral hazard: „... Routinely, **significantly high costs of unsuccessful credit transactions are socialised, i.e. transferred to the system of public finance.**“ (DVOŘÁK, 2008, p. 276). In accordance with the logic, the concept “recapitalisation” has appeared

X: Privatisation loans, all the transformation losses and external debt of the Czech Republic

year/period	loans in total	percentage of privatisation loans	
in percent	in total		
1999	869.6 billion CZK	2.3 %	20,00 billion CZK
1991–1999	n.a.	2.3–4.6 %	n.a.

Source: Adapted from (KOUBA, VYCHODIL and ROBERTS, J., 2005)

in connection with handing the current global financial crisis.

Doubts about the objectivity of the last quoted source are eliminated by the next viewpoint: **„Covering losses stemming from unsound loans by the state is ...one of the most harmful forms of debt burden transfer“** (DVOŘÁK, 2008, p. 276). Furthermore, the source Dvořák (DVOŘÁK, 2008, p. 330) warns that relying excessively on public funds is related to threats of an apocalyptic nature: **„ ... if the financial crisis broke out to the full, no financial institution wouldn't be able to cover all the losses incurred“** (highlighted by FK).

So using public funds has its limits. Managing the way they are used is described by Strecková, Malý *et al.* (STRECKOVÁ, MALÝ *et al.*, 1998, p.107), who come up with their own solution to the problem: **„Public expenditures are actually determined by political choice of the government.“**

Rather than demonize **„problematic public finance“** it will be sufficient if the government behaves responsibly.

5 CONCLUSIONS

The most important points of the paper (results of research) are following:

a) Coexistence of private and state sectors

The paper shows that **despite the existence of financial and information imbalance** the public sector has a strategically stronger position, which allows it, if need be, to stabilize the financial system.

Certain developmental phases in the Czech Republic cast **doubts about validity of Wagner's**

law. There may be two causes of such, from the global point of view non-standard, condition:

- absence of banking ensured by state banks
- rate of competence of state interventions in the social area.

b) Absence of public funds in the theory of corporation finance

It results from lesser attention that the theory of corporation finance pays to public funds. This fact can be easily eliminated.

c) Objectivised financial structure (public finance entry)

The range of public funds, which can be part of the financial structure of a company, may be surprisingly high.

d) Demonstration of the importance of public finance for the business sector

The crucial importance of public finance for **handling not only exceptional situations** (economic transformation, global financial crisis, etc.) is obvious as the data available shows. The same has been proved by existing estimates of demands for public funds (from 500 to 1,500 billion CZK).

e) Moral hazard

The crucial phenomenon is the real unenforceability of the law, which leads to breaking all the rules that should regulate the way public funds are used. Due to that even traditional sources of financing business activities suffer, so the real losses incurred because of moral hazard will probably be higher than is publicly estimated.

SUMMARY

The objective of the article is to contribute to the discussion on the real importance of public finance for the for-profit (private) sector in the Czech Republic.

The motivation for writing this article was the lack of emphasis given to the importance of public finance for the for-profit sector, as represented by corporate finance, in the generally available theoretical publications. At the same time, contemporary Czech theory of corporate finance (in the form of the theory of corporate financial structure) virtually ignores public finance as a resource for corporate financing (financial and information asymmetry). This is in stark contrast with the actual importance for the domestic private sector of public resources, without which, for example, the banking sector of the Czech Republic would not be able to exist.

The article's thesis in favour of the importance of public resources for corporate finance draws mainly on a detailed analysis of theoretical sources (monographs, articles in peer-reviewed journals and conference papers). In this context, it should be noted that summaries of the literature, comparative studies and analytical/synthetic approaches turned out to be the most important of all the methods used.

The conclusions of the article clarify in particular the:

- a) causes of financial asymmetry in the co-existence of the private and public sectors (both at the pragmatic level and in terms of convention, as well as at the conceptual or theoretical level);
- b) causes of information asymmetry in the co-existence of the private and public sectors; with an emphasis here on knowledge from theoretical sources; in addition
- c) they define the objectified position of public finance in the financial structure of a for-profit business by making use of unique detailed information from sources which, in isolation, do not in themselves conclusively prove the importance of public finance for the for-profit sector, this is in turn supported

d) by numerical data illustrating the importance of public finance for the for-profit sector.

In this way the article seeks to contribute to the discussion on the importance of public finance for the for-profit sector, and to objectify the perception of the position of this source for financing business activities.

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