

Competitiveness of CEI Countries or ... Dual Track Economies?

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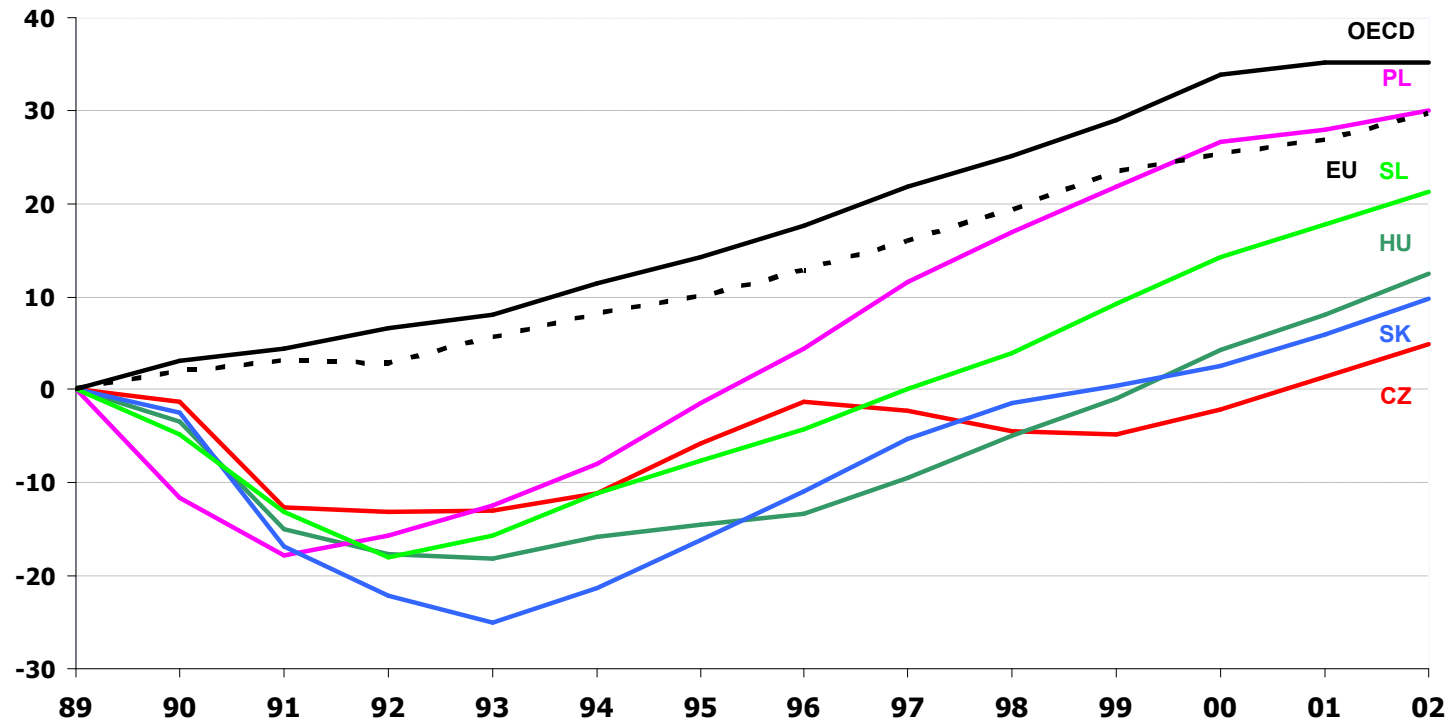
What Is Competitiveness?

- Classical Approach:
 - **Relative price advantage or Cost advantage**

- Current Interpretation
 - **Everything = any aspect of market performance**
 - both at the level of the firm and
 - at the level of a country
 - **Product quality,**
 - **Ability to innovate,**
 - **Capacity to adjust rapidly to changing market conditions**
 - **Corporate and public governance**
 - **Availability of infrastructure**
 - **and many other indicators.....**
 - **=> a global indicator for 'competitiveness' of an economy.**

The Big Fall

Real GDP Growth in the Region, %



Why Dual Track Economy?

- Top ranked in FDI attractiveness
- Slowly growing economy (by CEECs standards)
- Fiscal problems
- Doing business
- EU accession changes the picture
- Will Euro (or “Constitution”) be the fixed points to move the Earth?

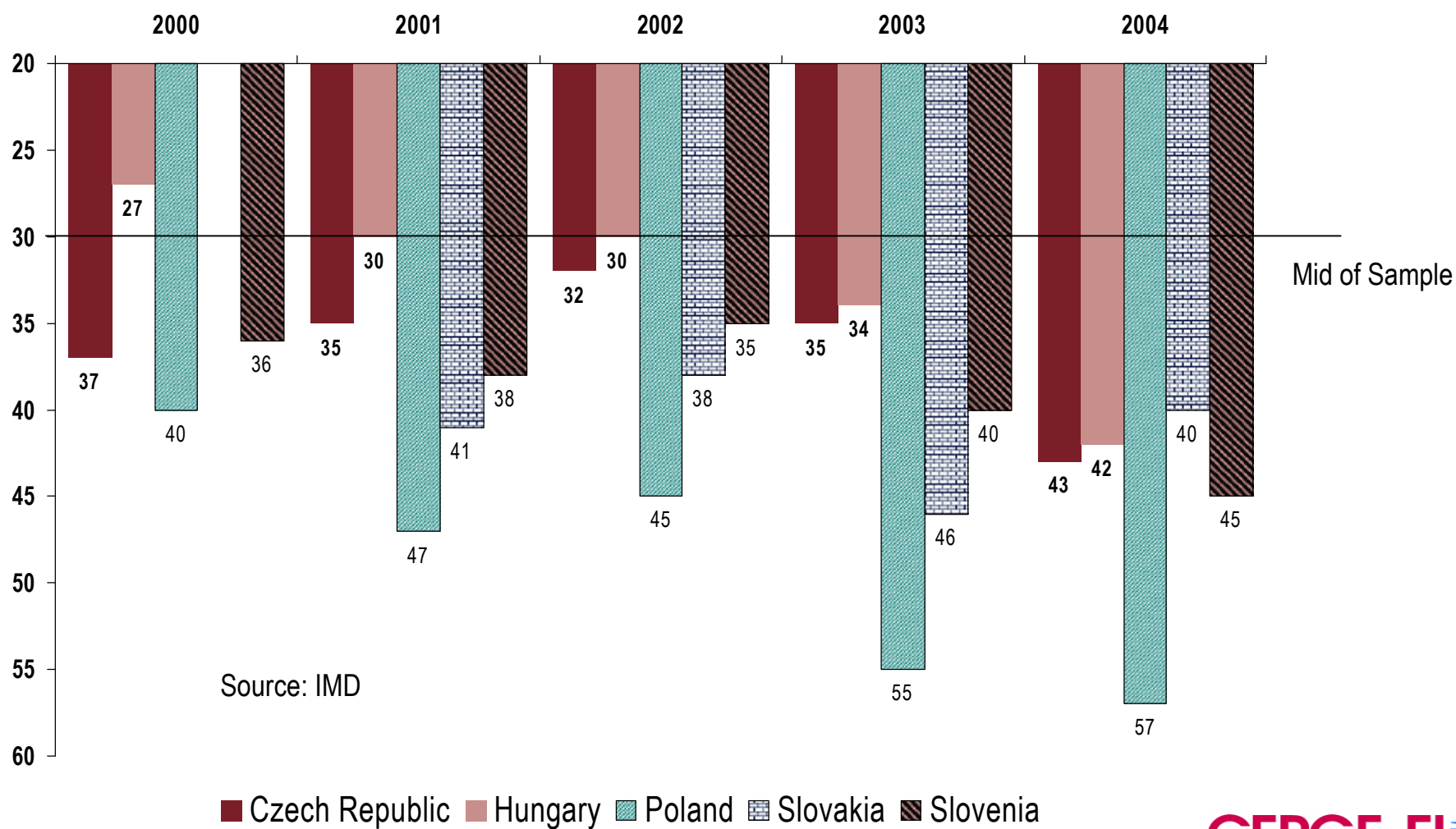
Classical Approach

- Economy-wide unit labor costs (ULCs, PPP adjusted)
 - Highest Slovenia (60%), Poland (45%) of Austria (WIIW)
 - Were relatively stable in most new EU countries after 2000
 - Hungary deteriorated
 - Czech Republic, Slovakia, and Estonia less
 - Improvement for Polish industries
 - Slovakia, Lithuania, Estonia, and the Czech Republic hurt due to rapid wage growth
 - Czech Republic and Hungary continued in labor shedding (improvement of productivity)

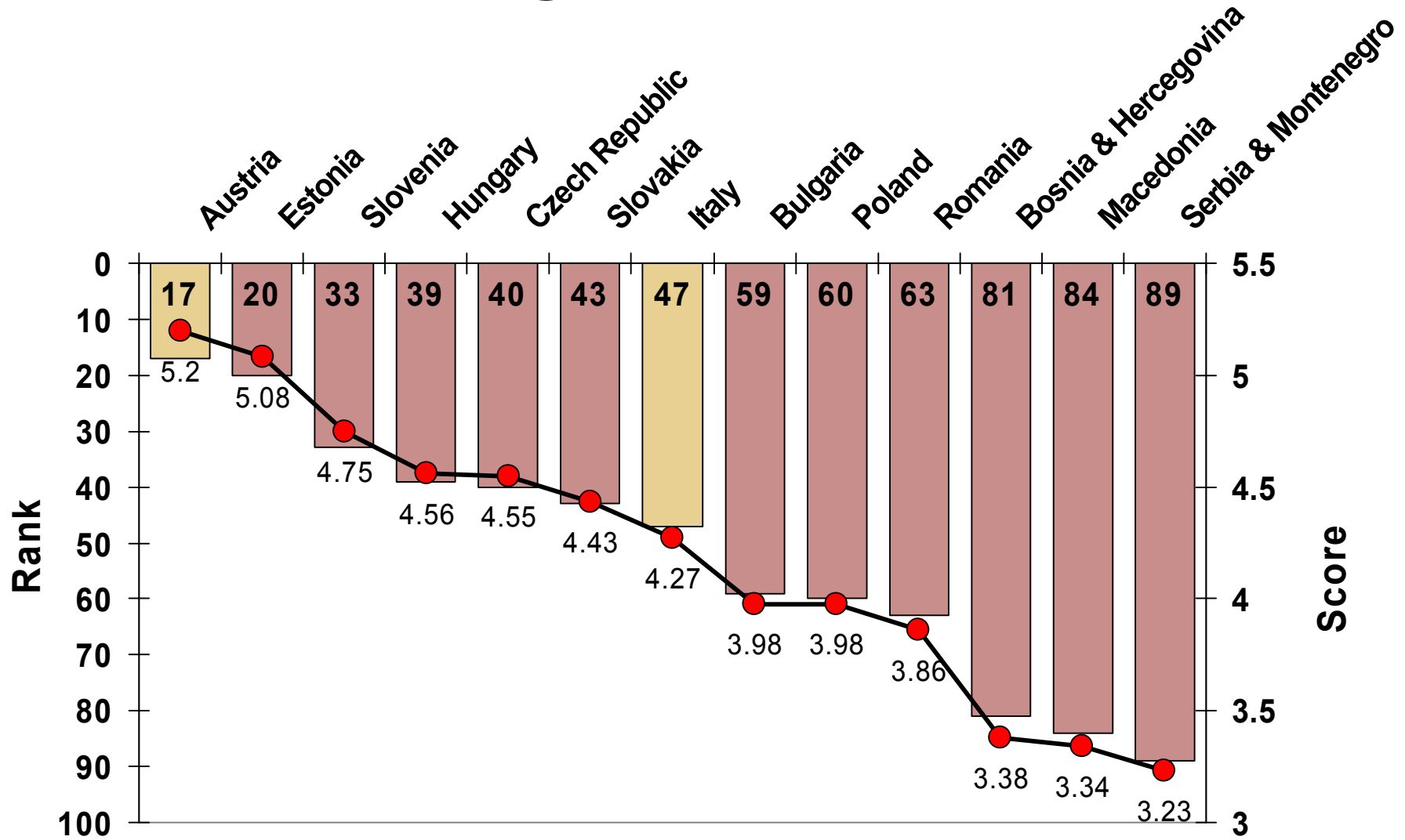
Competitiveness Ranking (IMD)

- 60 countries in total
- Mid of Sample = Rank 30
- Scoreboard Ranking (No. of criteria = 241)
 - **Economic Performance (83)**
 - **Government Efficiency (77)**
 - **Business Efficiency (69)**
 - **Infrastructure (94)**
- Criteria
 - **Hard Data (129)**
 - **Survey (112)**

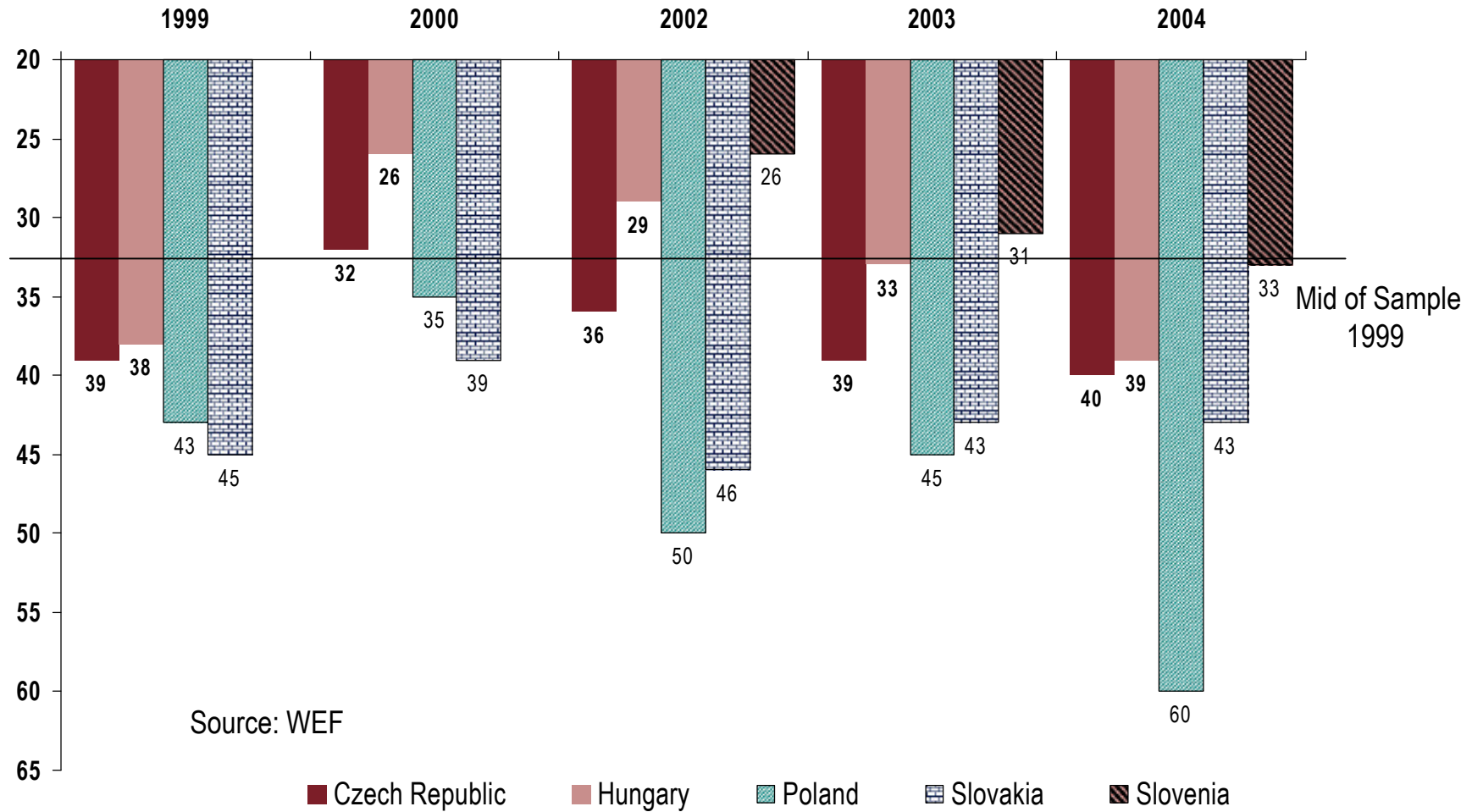
CEECs Ranking - IMD



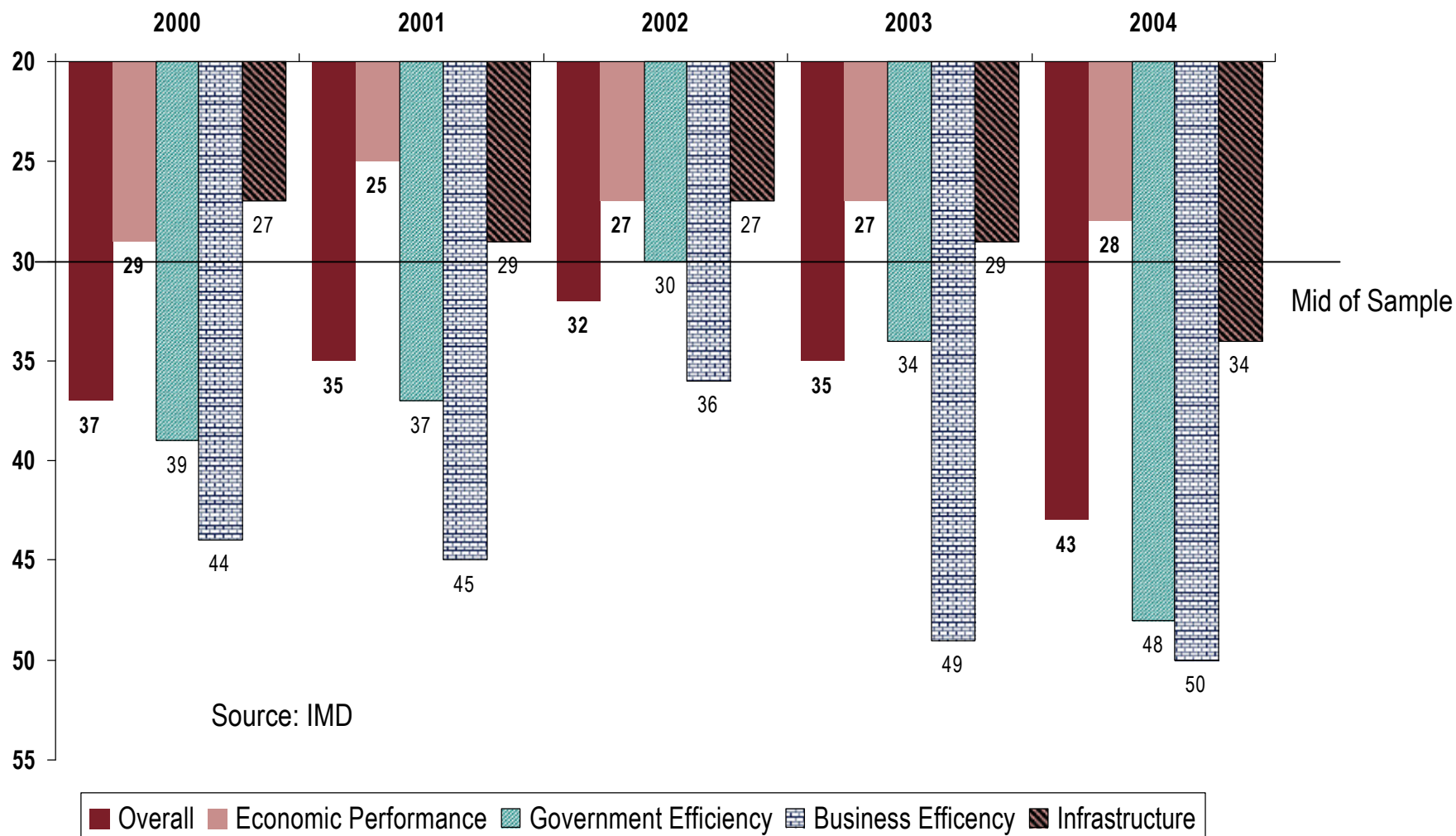
CEECs Ranking 2004 - WEF



CEECs Ranking - WEF



Czech Republic Ranking



Competitiveness Ranking (IMD)

- Scoreboard Ranking

- **Economic Performance (28)**

- Domestic Economy (40)
 - International Trade (33)
 - International Investment (7)
 - Employment (45)
 - Prices (22)

- **Government Efficiency (48)**

- Public Finance (51)
 - Fiscal Policy (40)
 - Institutional Framework (42)
 - Business legislation (51)
 - Societal Framework (30)

- **Business Efficiency (50)**

- Productivity (34)
 - Labor Market (19)
 - Finance (50)
 - Management Practices (55)
 - Attitudes and Values (50)

- **Infrastructure (34)**

- Basic Infrastructure (22)
 - Technological Infrastructure (35)
 - Scientific Infrastructure (43)
 - Health and Environment (39)
 - Education (38)

Competitiveness Hampered:

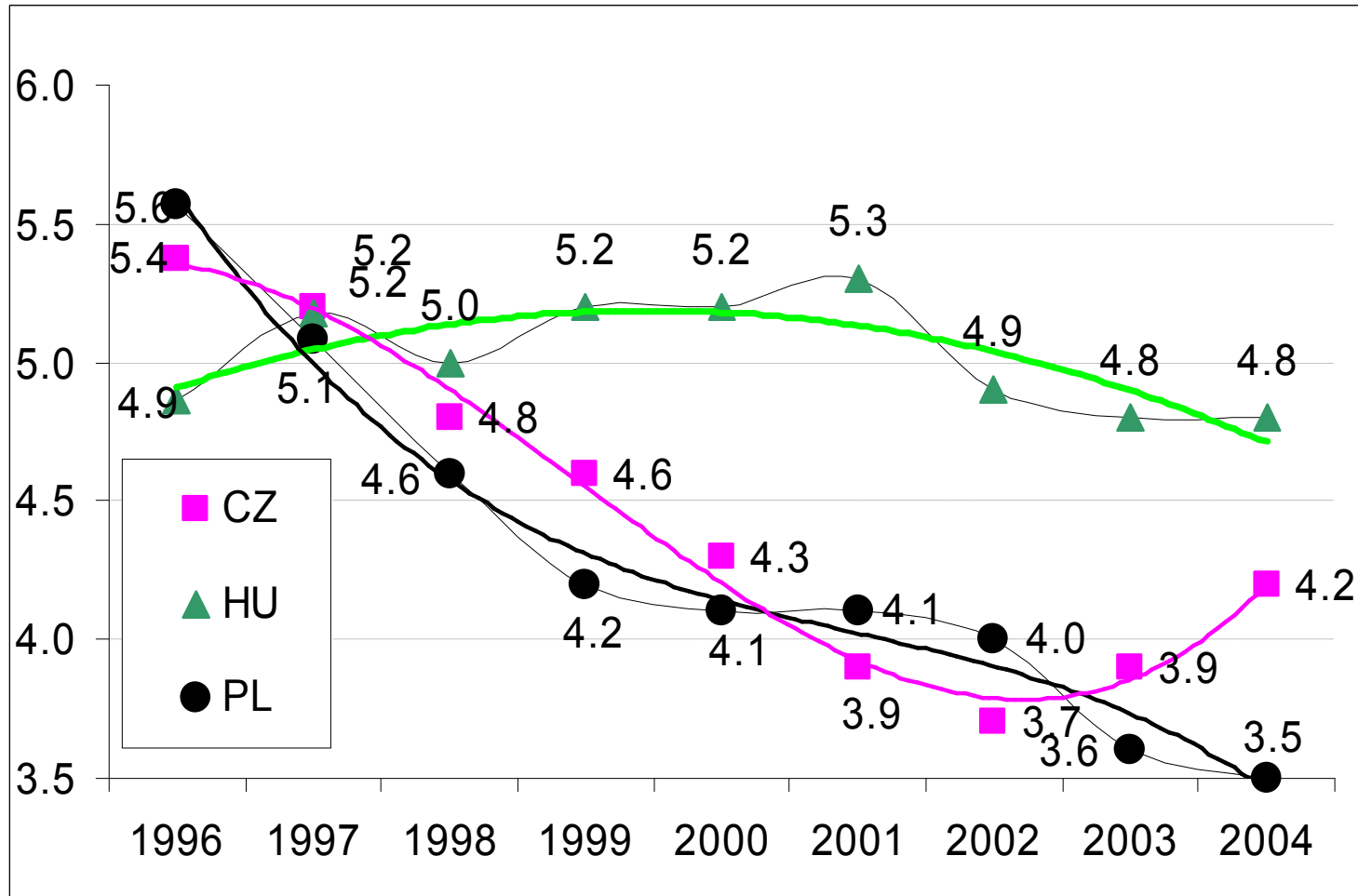
- Problems in Plain Language
 - Small Share of Labor with High Education, Low Flexibility
 - Wrong Labor Skill Structure for Modern Economy
 - Red Tape and Regulation, Transparency
 - High Taxes, especially on Labor
 - Generous Welfare
 - Wrong Incentive Security Scheme
 - Fiscal Deficits
 - Unsustainable Social Security (Demography)
 - Banking and Stock Market

Private Shares on GDP

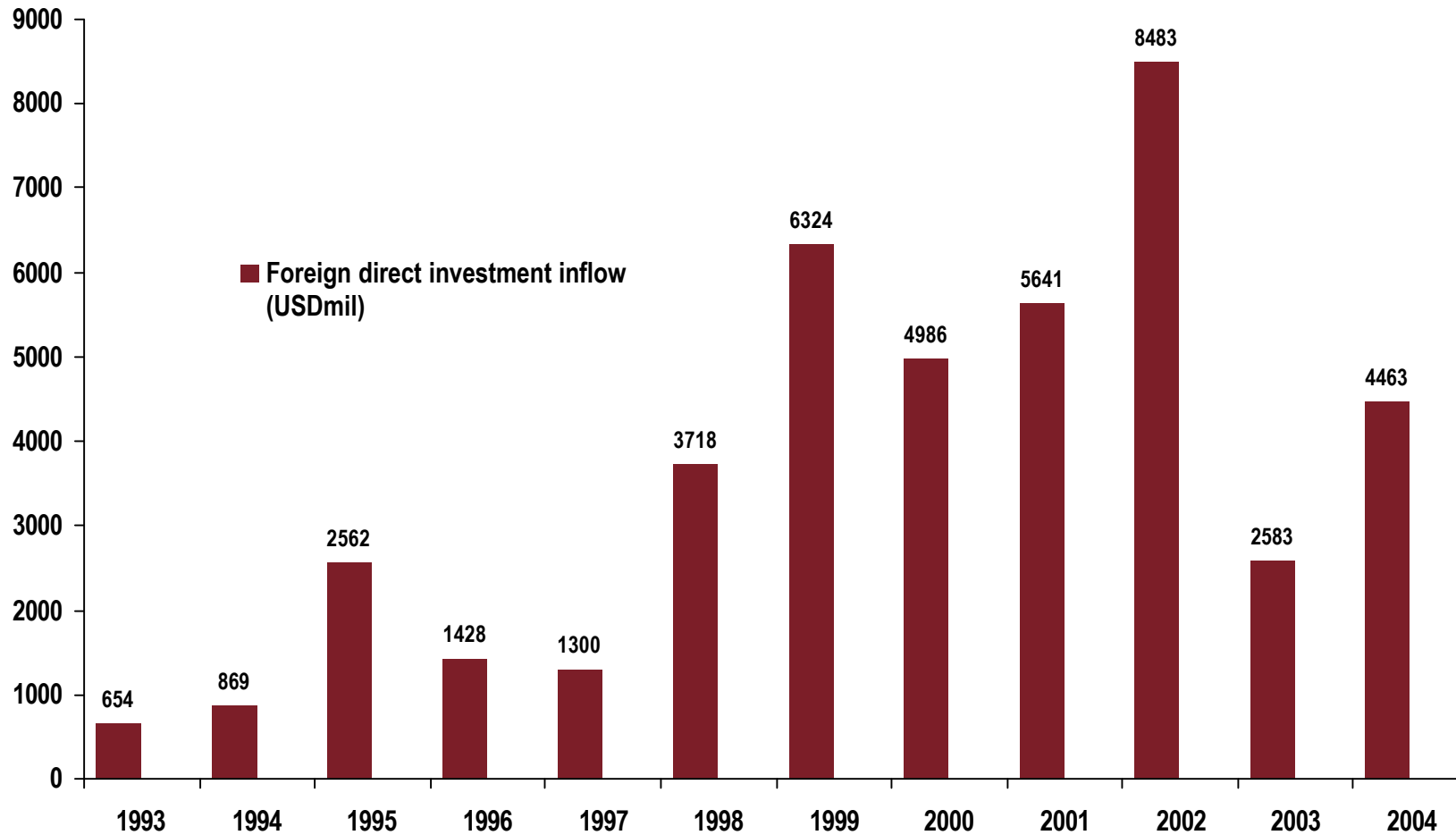
	1990	1994	1995	1996	1997	1998	1999	2000
Czech Republic	5	65	70	75	75	75	80	80
Hungary	20	55	60	70	75	80	80	80
Poland	25	55	60	60	65	65	65	70
Slovak Republic	5	55	60	70	75	75	75	75
Slovenia	10	30	45	45	50	55	55	55

Source: EBRD (2001).

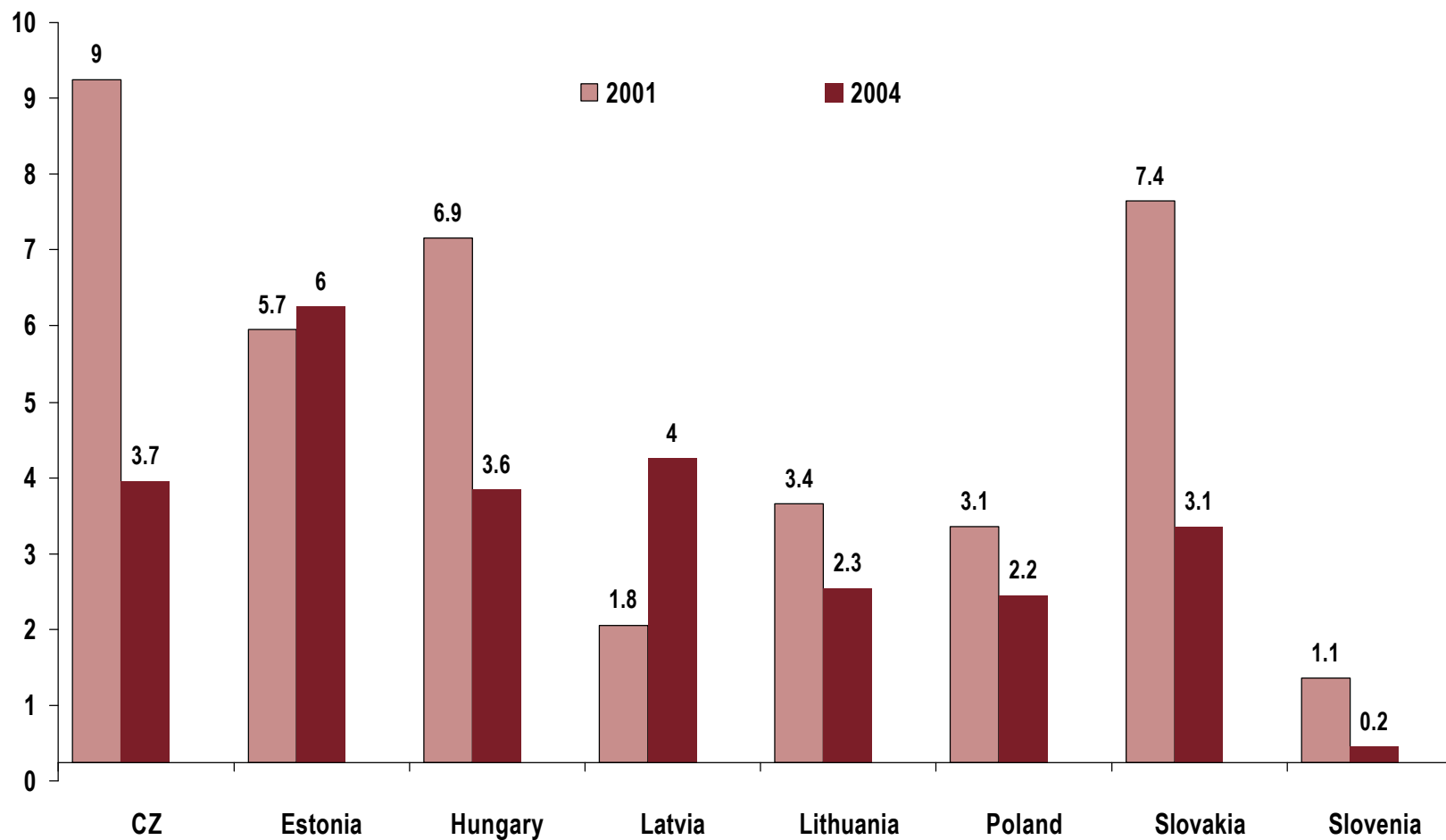
Corruption Perception Index



Foreign Direct Investment Inflow



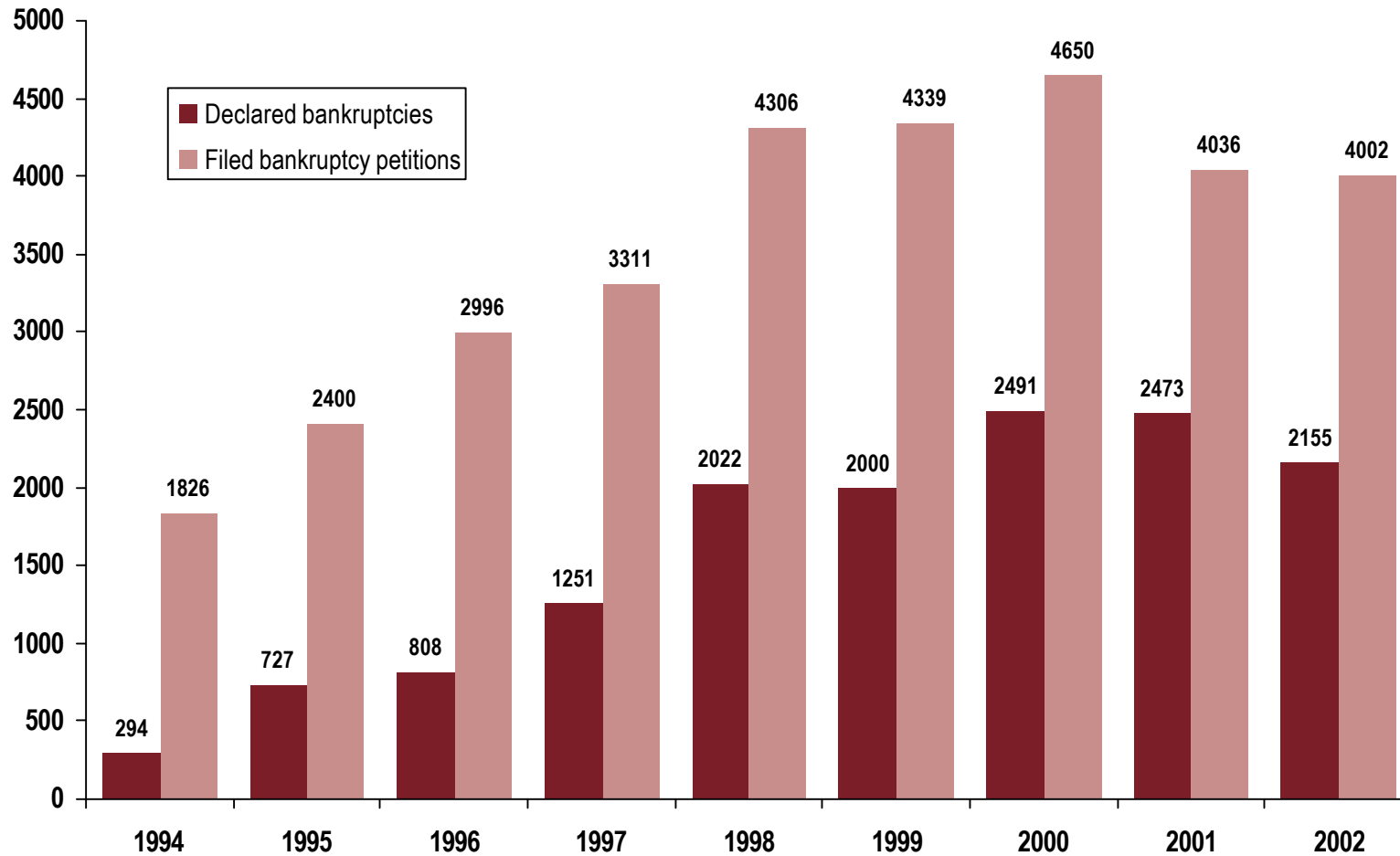
FDI, % GDP



Business Environment

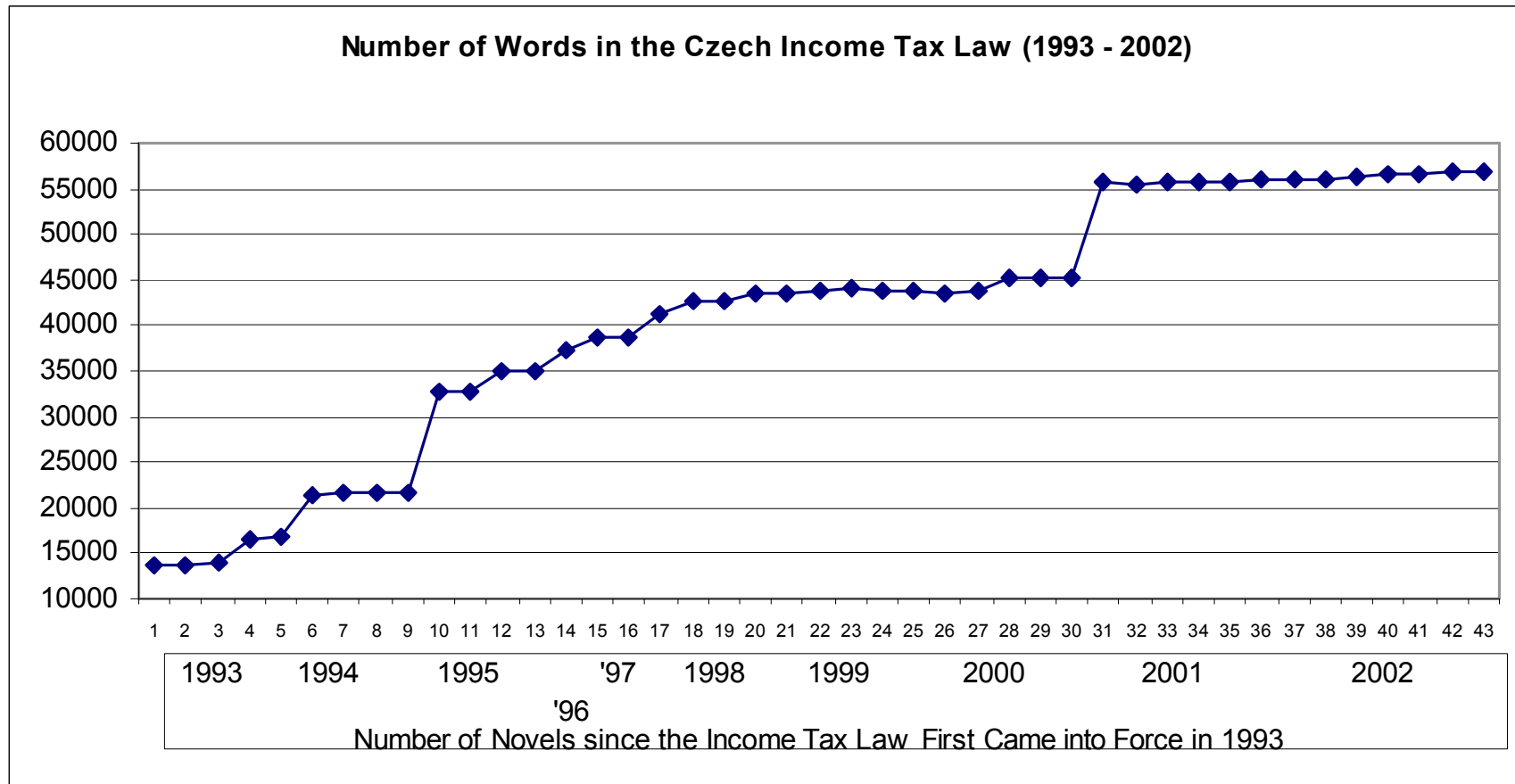
- Early Czech transition has been characterized with problems in
 - ensuring the rule of law,
 - extensive credit fraud,
 - an ineffective judicatory system,
 - insider dealing,
 - insufficient use of public tenders, and
 - a general spread of corruption in public administration and commercial courts
- Is the Czech Republic is comparable to other Central European economies?
 - Yes... but others imply legal enforcement and bankruptcy procedures are weaker

Bankruptcies in the Czech Republic

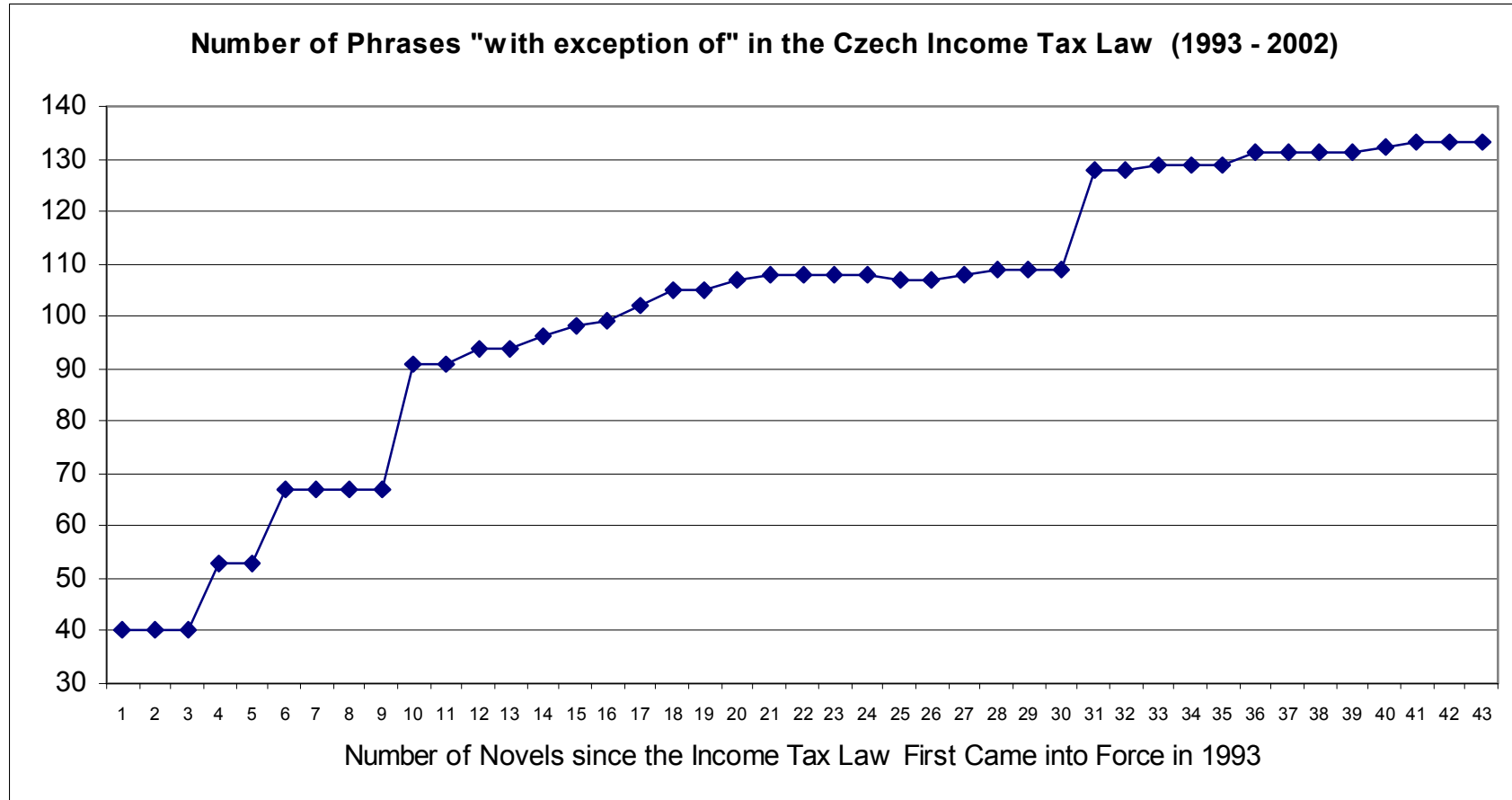


Source: Ministry of Justice, Ministry of Industry and Trade

Too Simple Laws?



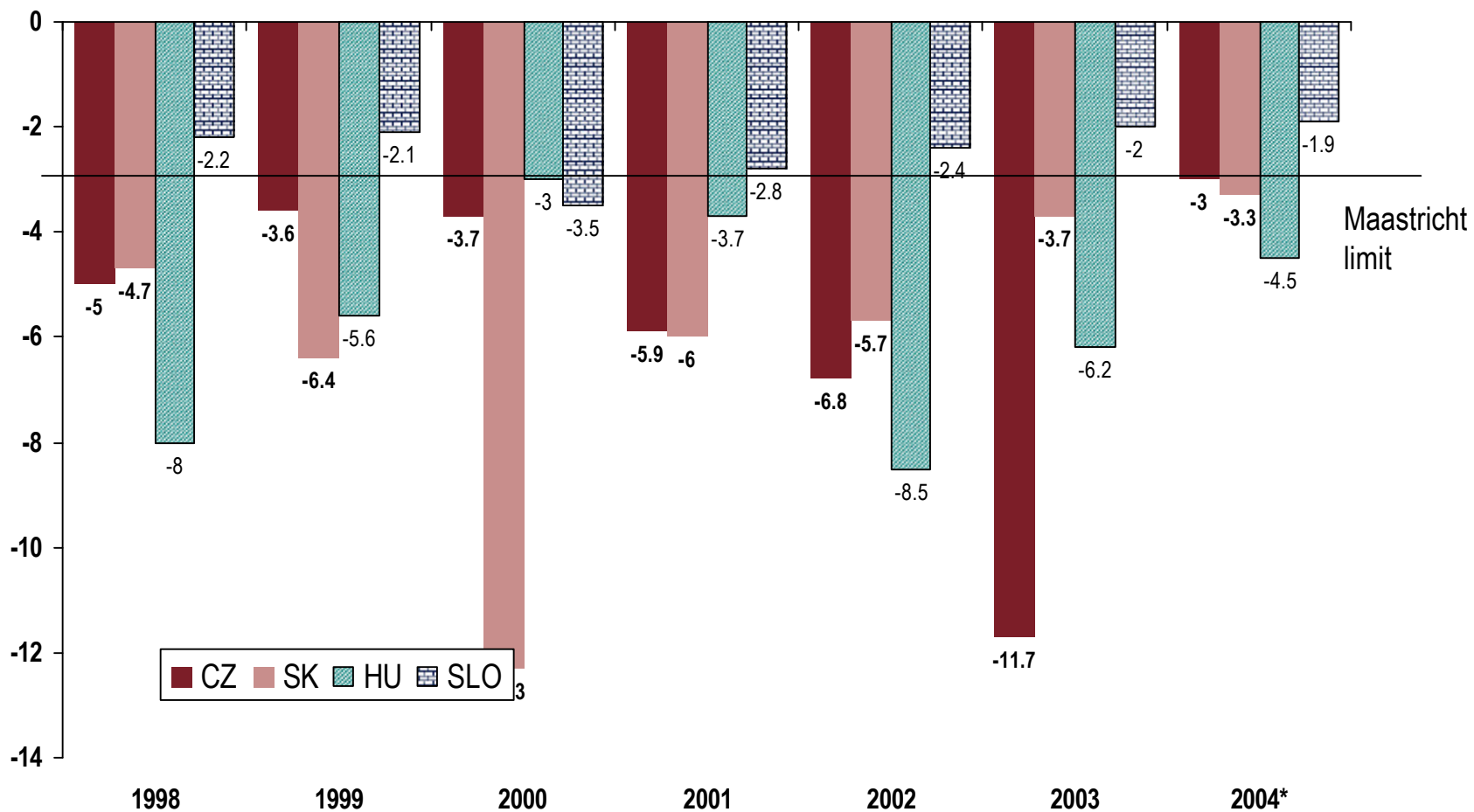
Use Exceptions to Improve...



Deregulate ... Or Unregulated Market?

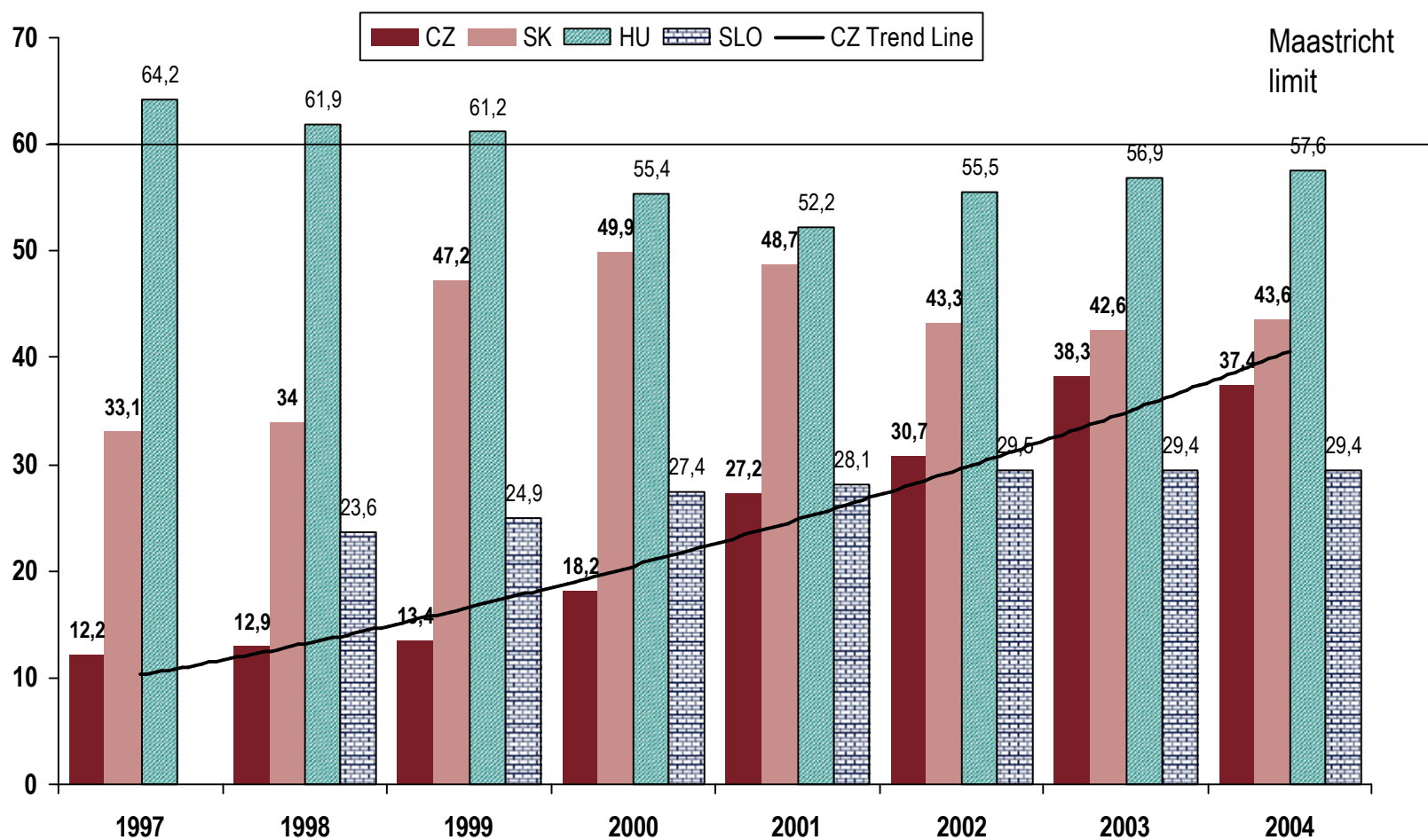
- The voucher privatization drove the design of the Czech equity markets
 - **It was very rapid establishment**
 - **about 1,700 companies within two years**
- The regulation of the market lagged
 - **insider trading,**
 - **price manipulation,**
 - **fraud in the investment funds industry, and**
 - **abuses of minority shareholder rights**
- Erosion of investors' confidence

Public Fiscal Deficits, %GDP



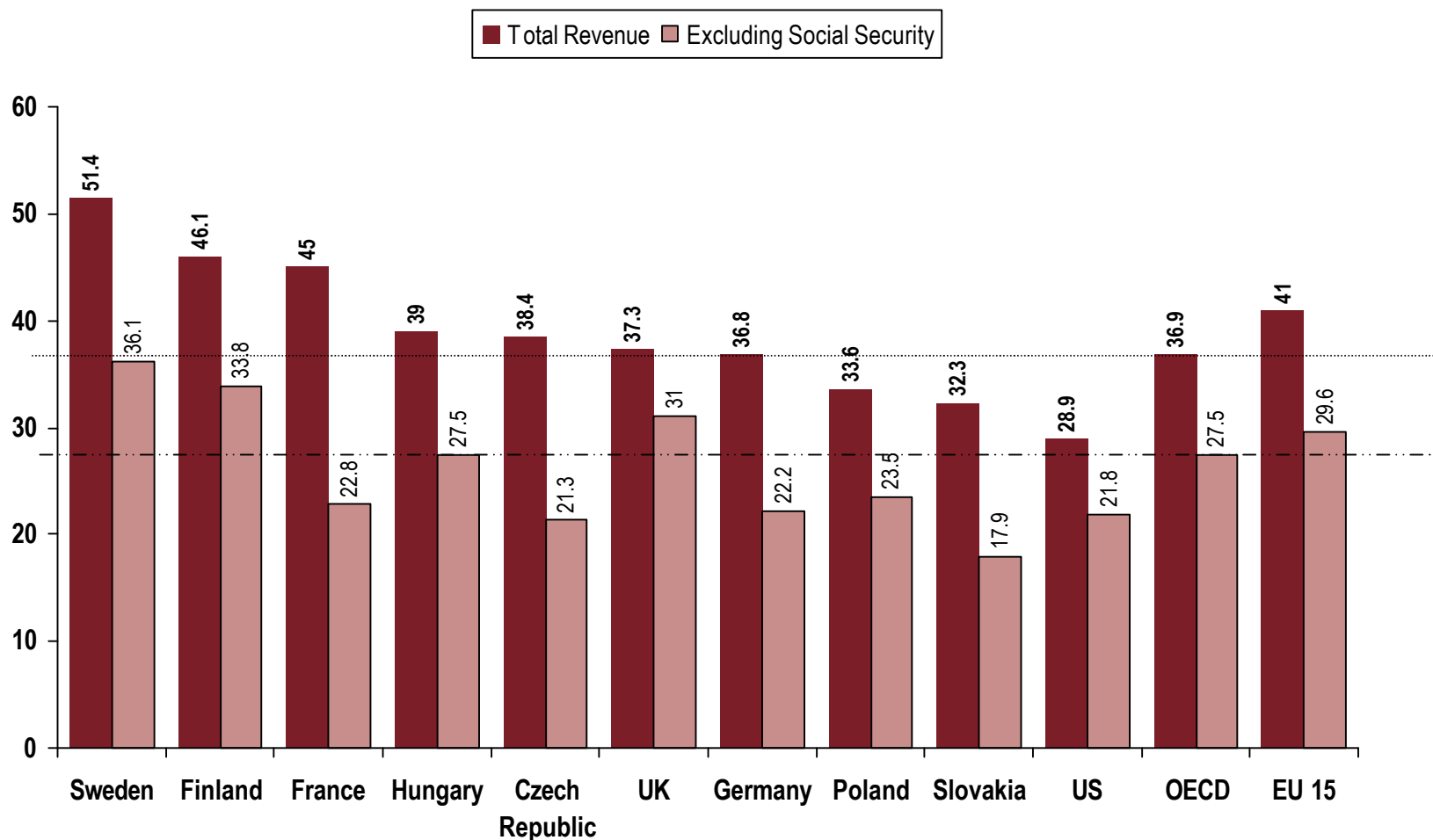
Source: Eurostat

General Governmental Debt, %GDP



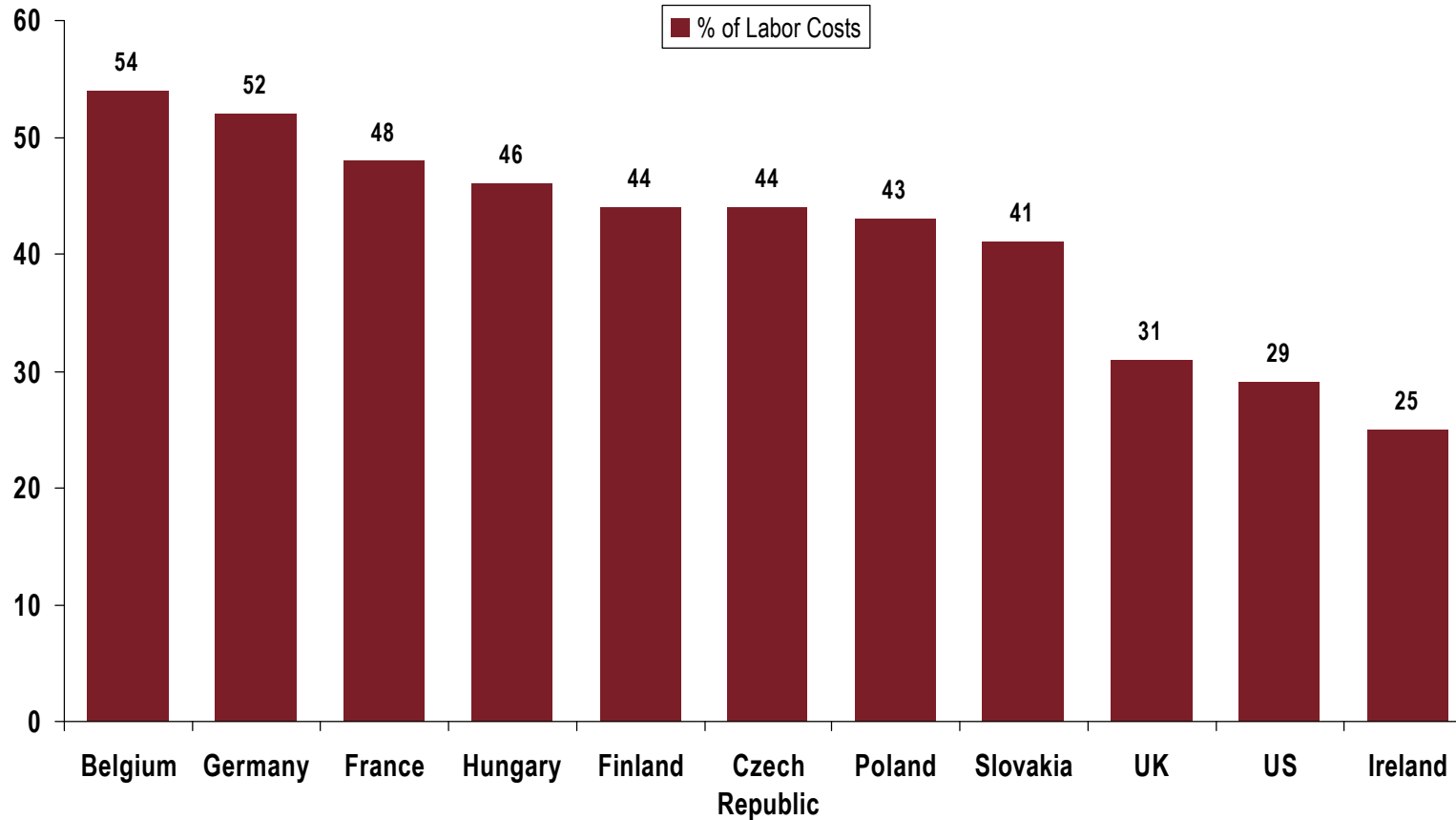
Source: Eurostat

Tax Revenue as % of GDP, 2001, OECD



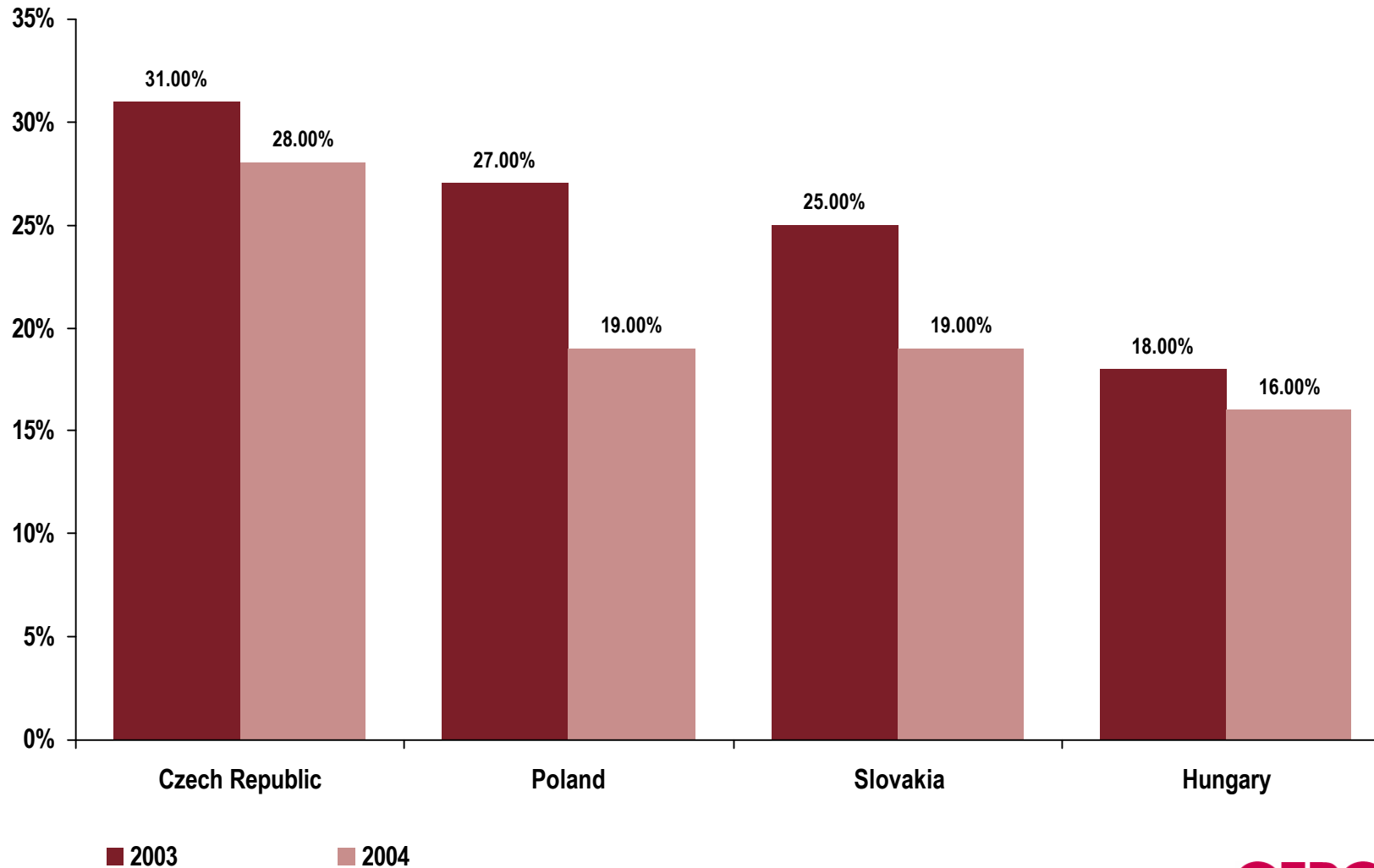
Source: OECD

Income Tax and Social Security Contributions, 2003

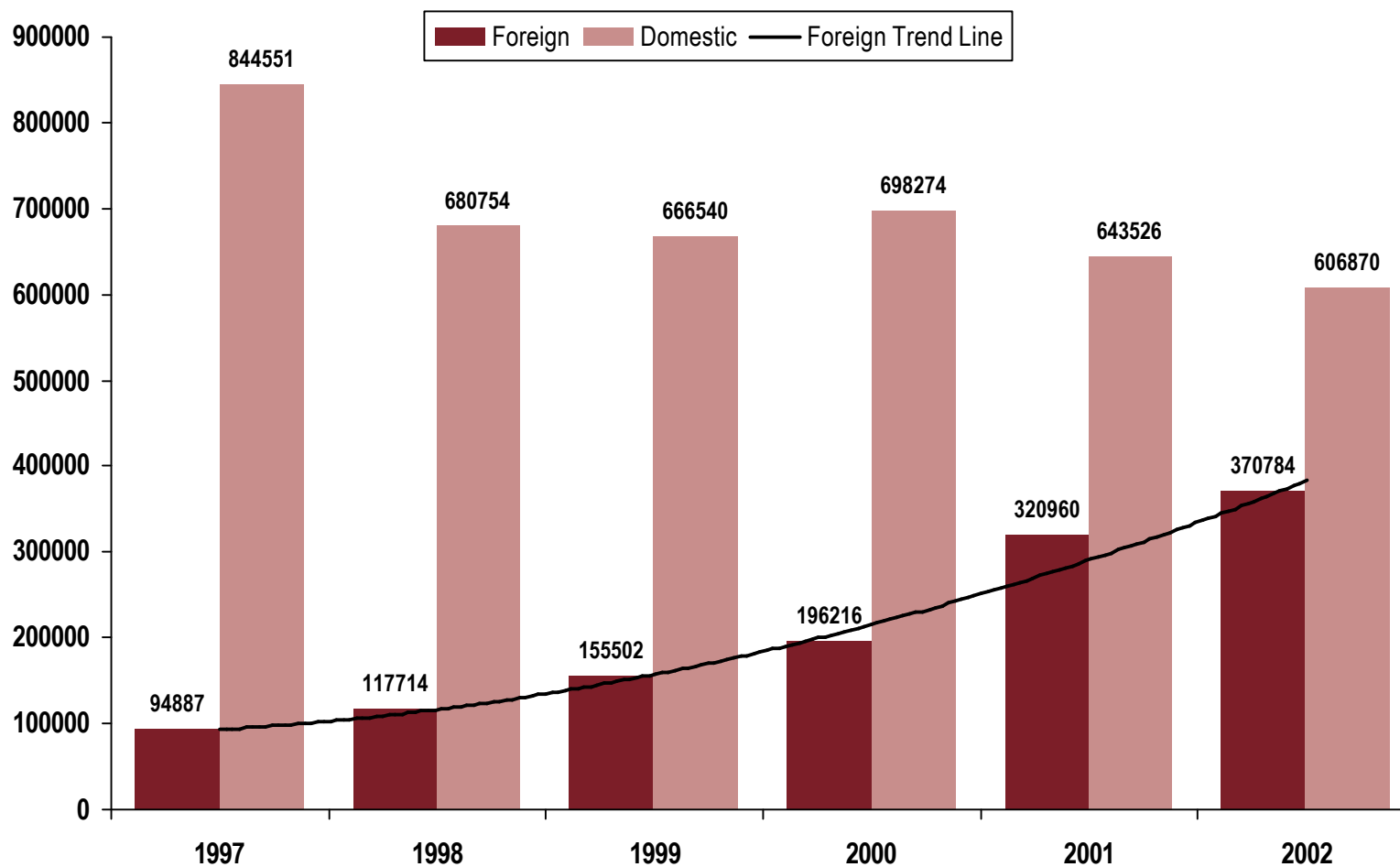


Source: OECD

Changes in Corporate Income Tax Rate



Value Added Creation, mil. CZK



Source: CZSO

Value Added Creation

- In 2002 the annual value added per employee was
 - **CZK 683 000 in firms under foreign control,**
 - **CZK 408 000 in domestic firms.**
- => foreign firms have productivity higher by 2/3.
- Increasing value added in companies under foreign control is due to
 - **acquisitions**
 - **higher productivity**

Doing Business (2003/4)

Country Country	Starting a Business			Hiring and Firing Workers				Enforcing Contracts			Closing a Business		
	# of Procedures	Duration (days)	Cost (% GNI per capita)	Flexibility of Hiring Ind.	Conditions of Employment Ind.	Flexibility of Firing Ind.	Employment Laws Ind.	# of Procedures	Duration (days)	Cost (% GNI per capita)	Procedural Complexity Ind.	Actual Time (in years)	Actual Cost (% of estate)
Czech R	10	88	11.7	17	63	27	36	16	270	18.5	64.6	9.2	38
Czech R	10	40	10.8	17	63	27	36	22	300	9.6	64.6	9.2	18
France	9	49	1.4	63	61	26	50	21	210	3.8	79.2	2.4	18
France	7	8	1.1	63	61	26	50	21	75	11.7	79.2	1.9	8
Germany	9	45	5.9	63	46	45	51	26	154	6.0	61.1	1.2	8
Germany	9	45	5.9	63	46	45	51	26	184	10.5	61.1	1.2	8
Hungary	5	65	64.3	46	92	23	54	17	365	5.4	56.9	2.0	38
Hungary	6	52	22.9	46	92	23	54	21	365	8.1	56.9	2.0	28
Poland	10	31	21.2	33	92	39	55	18	1,000	11.2	65.3	1.5	18
Poland	10	31	21.2	33	92	39	55	41	1,000	8.7	65.3	1.4	18
Slovak R	10	98	10.2	34	89	60	61	26	420	13.3	40.3	4.8	18
Slovak R	9	52	5.7	34	89	60	61	27	565	15.0	40.3	4.7	18
Slovenia	10	61	15.5	53	84	41	59	22	1,003	3.6	65.3	3.7	18
Slovenia	10	61	12.3	53	84	41	59	25	1,003	16.3	65.3	3.6	18
United K.	6	18	1.0	33	42	9	28	12	101	0.5	36.2	1.0	8
United K.	6	18	0.9	33	42	9	28	14	288	15.7	36.2	1.0	6
United States	5	4	0.6	33	29	5	22	17	365	0.4	45.8	3.0	4
United States	5	5	0.6	33	29	5	22	17	250	7.5	45.8	3.0	8

Educating Future Labor...

- Educational attainment of the 25-64 year-old (2002)
 - Slovak Republic 11.0
 - Czech Republic 11.9
 - Poland 12.1
 - Hungary 14.2
 - OECD country mean 23.0
 - Germany 23.4
 - France 24.0
 - United Kingdom 26.9
 - Finland 32.6
 - United States 38.1

Educating Future Labor...

- Percentage of 20 to 24-year-olds in education (2002)
 - Slovak Republic 22.1
 - Czech Republic 25.7
 - United Kingdom 30.8
 - United States 33.9
 - OECD country mean 37.5
 - Hungary 37.7
 - Germany 38.0
 - France 53.2
 - Poland 53.8
 - Finland 56.1

After EU Entry...

- Effects on Czech Republic, Slovakia, Hungary, Slovenia
 - **No visible change in unemployment**
 - **No visible change in inflation**
 - Note: CZ had major VAT legislative change
- Analysis of trade for CZ:
 - **Visible increase in the percentage of the total EU trade turnover**
 - **Visible increase in the percentage of the total EU share on imports**
 - **No significant change in the percentage of exports to EU**

Dual Track Economy - Summary

- Slowly growing economy
 - with a potential well above 5%

- Breaking hard but which break is the main one?
 - Inadequate social security system
 - Relatively high taxes and overall state influence
 - Future of human capital is gloomy
 - Business environment

- Top ranked in FDI attractiveness
 - but walking like John Silver
 - as foreign firms seem to be superior
 - not much hi-tech (requiring highly skilled labor), just assembly lines
 - and education does not seem ready to provide skilled labor in the future