

### Transition and Current Trends: CEE Region and Czech Republic – An Economic Overview

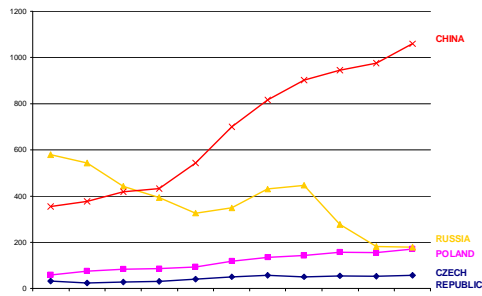
Lubomír Lízal  
CERGE-EI

April, 2006

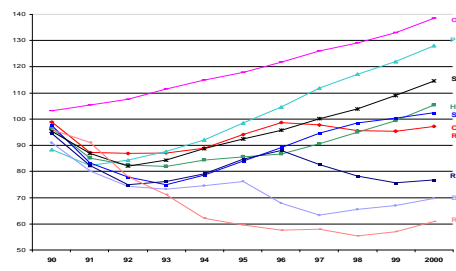
### Starting Comparison

Indicator	TRANSITION ECONOMIES						COMPARATORS			
	CEE EU	Russia	Other NIS Mongolia	China	Vietnam	Low income	India	Middle-income	OECD	
Population, 1989 (millions)	122	149	139	1,102	64	1,002	850	1,105	773	
GNP per capita, 1990	4,110	2,268	2,141	404	188	320	380	2,220	20,170	
At PPP	6,440	4,647	4,660	1,000	..	1,086	1,090	4,289	15,615	
Growth rate before transition	1.9	1.5	2.3	4.9	..	3.4	5.6	2.9	3	
Urban population as share of total population, 1991	61	74	58	18	19	28	27	62	77	
Investment share of GDP, 1989	34	34	31	35	16	21	24	25	22	
Industry share of GDP, 1989	51	50	40	48	23	28	29	36	31	
Energy use (kilograms of oil equivalent per dollar of GDP)	0.81	0.91	0.71	0.38	..	0.14	0.21	0.41	0.31	
Gini coefficient, 1989	26	24	24	30	36	46	34	45	33	
Life expectancy at birth, 1989 (years)	71	69	70	70	66	56	60	68	77	
Literacy rate, 1991	3	2	2	31	12	41	52	17	<5	

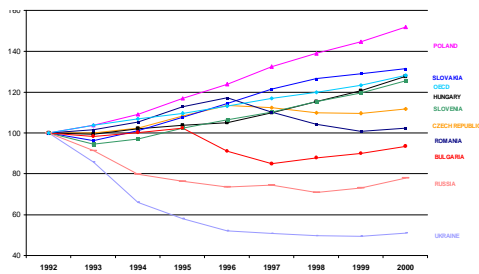
### Nominal GDP, World Economic Power (Billions of US\$ using Annual Average Exchange Rates)



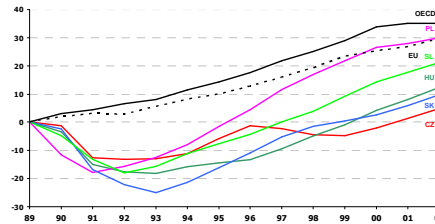
### Real GDP Index (1989=100)



### Real GDP Index (1992=100)



### The Big Fall Real GDP Growth in the Region, %



### Private Sector Share of GDP

	1990	1994	1995	1996	1997	1998	1999	2000
Czech Republic	5	65	70	75	75	75	80	80
Croatia	10	40	45	50	55	55	60	60
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
Estonia	10	55	65	70	70	70	75	75
Latvia	10	55	60	60	60	60	65	65
Lithuania	10	50	55	65	70	70	70	70
Albania	5	50	60	75	75	75	75	75
Bulgaria	10	40	45	45	50	50	60	70
Romania	15	35	40	60	60	60	60	60
Russia	5	50	55	60	70	70	70	70
Ukraine	10	30	35	40	50	55	55	60

7

### External Debt as % of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Czech Republic	20.3	33.1	23.7	24.7	26.0	31.8	36.0	40.6	43.1	42.3
Hungary	64.4	67.7	58.1	63.7	68.7	70.4	61.1	51.9	56.9	59.9
Poland	83.7	69.9	56.4	54.9	47.1	38.0	35.2	36.0	36.2	38.3
Slovak Republic	13.0	24.5	24.1	26.6	32.0	30.9	38.8	48.5	55.9	53.1
Slovenia	11.2	14.7	13.9	14.8	15.7	15.8	21.2	22.9	25.3	27.4
Bulgaria	52.5	159.2	160.4	127.7	116.8	77.4	97.7	95.8	83.7	80.5
Romania	3.0	7.4	16.5	16.1	18.3	24.1	29.5	30.1	24.0	27.1
Albania	na	na	130.1	78.9	52.4	27.6	27.3	33.1	28.7	26.5
Russia	148.5	106.6	90.7	60.7	43.6	36.6	31.5	29.8	58.6	87.1
Ukraine	na	na	0.6	11.8	19.1	22.0	20.6	23.5	28.0	37.3
Kazakhstan	na	na	24.5	33.4	28.0	21.0	21.3	28.6	37.3	50.1

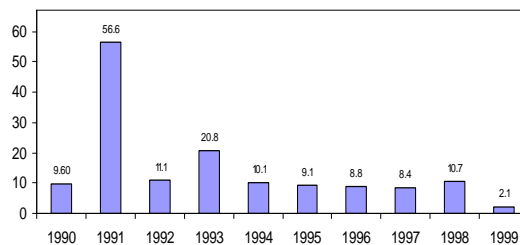
8

### CPI, %

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Czech Republic	9.6	56.6	11.1	20.8	10.0	9.1	8.8	8.5	10.7	2.1	3.9
Hungary	33.4	32.2	21.6	21.1	21.2	28.3	23.6	18.3	14.3	10.1	9.5
Poland	555.4	76.7	45.3	37.6	29.5	27.8	19.9	14.9	11.8	7.3	9.9
Slovak Republic	18.4	58.3	9.1	25.1	11.7	7.2	5.4	6.4	5.6	14.0	12.1
Slovenia	104.6	247.1	92.9	22.8	21.0	13.5	9.9	8.4	8.0	6.1	8.6
Bulgaria	26.3	334.0	82.0	73.0	96.3	62.0	123.0	1082.0	22.2	0.7	7.0
Romania	37.7	222.8	199.2	295.5	137.0	32.3	38.8	154.0	59.1	45.8	45.0
Russia	5.6	161.0	2506.0	840.0	204.4	128.6	47.8	14.7	27.6	86.1	20.7
Ukraine	4.2	161.0	2730.0	10155.0	401.0	181.7	39.7	15.9	10.6	22.7	28.0
China	3.1	3.5	6.3	14.6	24.2	16.9	8.3	2.8	-0.8	-1.4	0.7
Vietnam	36.4	82.7	37.7	8.4	9.3	16.8	5.6	3.1	8.7	5.4	na
South Africa	14.4	15.2	13.9	9.7	9.0	8.6	7.4	8.5	7.0	6.5	5.5
United States	5.4	4.2	3.0	3.0	2.6	2.8	2.9	2.3	1.6	2.2	3.2
EU15	5.5	5.2	4.4	3.6	2.9	2.7	2.4	1.9	1.5	1.4	1.9

9

### Inflation



10

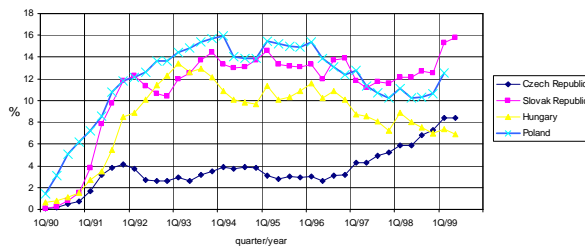
### Unemployment

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Czech Republic	0.7	4.1	2.6	3.5	3.2	2.9	3.5	5.2	7.5	9.4	8.8
Croatia	9.3	13.2	13.2	14.8	14.5	14.5	10.0	9.9	11.4	13.6	20.8
Hungary	1.9	7.4	12.3	12.1	10.4	10.4	10.5	8.7	9.1	7.1	6.6
Poland	6.3	11.8	13.6	16.4	16.0	14.9	13.2	10.5	10.4	13.0	14.0
Slovak Republic	1.5	11.8	10.3	12.2	13.7	13.1	11.1	11.6	11.9	19.2	17.4
Slovenia	4.7	7.3	8.3	9.1	9.0	7.4	7.3	7.4	7.9	7.5	11.7
Estonia	na	na	na	6.5	7.6	9.7	10.0	9.7	9.6	12.3	4.9
Latvia	na	0.6	3.9	8.7	16.7	18.1	19.4	14.8	13.8	14.4	7.9
Albania	9.5	8.3	27.9	29.0	19.6	16.9	12.4	14.9	17.7	18.0	17.1
Bulgaria	1.5	11.1	15.3	16.4	12.8	11.1	12.5	13.7	12.2	16.0	18.0
Romania	na	3.0	8.2	10.4	10.9	9.5	6.6	8.8	10.3	11.5	10.1
Russia	0.0	0.0	4.8	5.3	7.1	8.3	9.2	10.9	12.4	11.7	9.9
Ukraine	0.0	0.0	0.3	0.4	0.4	0.5	1.1	2.3	3.7	4.3	4.3
European Union	7.5	8.2	9.2	10.7	11.1	10.5	10.6	10.3	9.5	8.8	8.0

11

### Unemployment

Unemployment in Central Europe



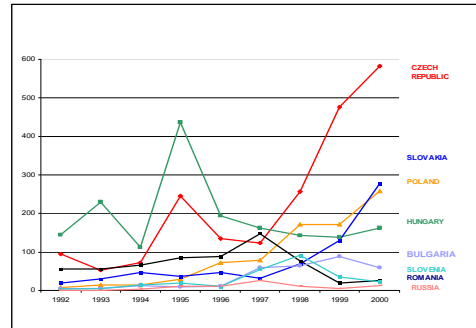
12

## Income Inequality

	Late 1980s		Early 1990s		Late 1990s	
	Year	Gini	Year	Gini	Year	Gini
Czech Republic	1989	18.3	1993	18.7	1997	25.9
Hungary	1987	21.0	1993	22.6	1998	25.3
Poland	1987	25.6	1993	28.4	1998	32.7
Slovak Republic	1989	17.6	1993	18.5	1996	26.3
Slovenia	1987	21.5	1993	25.1	1998	32.1
Bulgaria	1989	23.3	1993	34.3	1997	34.1
Romania	1989	23.3	1994	28.6	1997	42.2
Russia	1988	23.8	1993	43.0	1998	48.0
Ukraine	1988	23.3	1995	47.4	1997	na

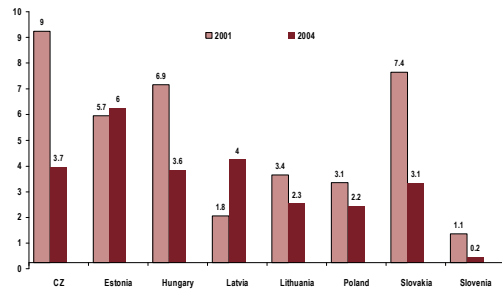
13

## Foreign Direct Investment Per Capita



14

## FDI, % GDP



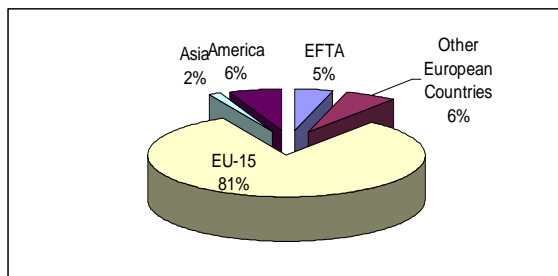
15

## Foreign Direct Investment Inflow - CZ



16

## Source Countries, FDI Inward Flows in 2000, %



17

## What Is Competitiveness?

- Classical Approach:
  - Relative price advantage or Cost advantage
- Current Interpretation
  - A Bit of Everything = any aspect of market performance affecting current and future productivity, growth and sustainability
    - both at the level of the firm (Internal to firm) and
      - Product quality,
      - Ability to innovate,
      - Capacity to adjust rapidly to changing market conditions....
    - at the level of a country (External to firm)
      - Public governance
      - Availability of infrastructure
      - and many other indicators....
  - => a global indicator for 'competitiveness' of an economy.

18

### 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?

19

### 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)

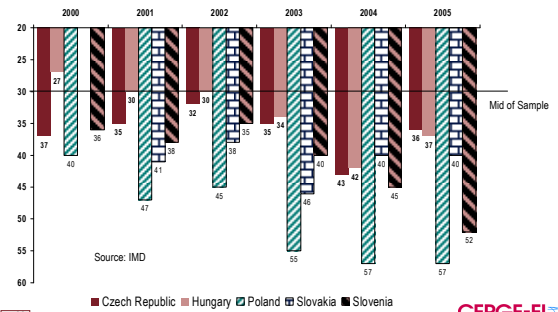
20

### Hard Data?

- Can we document soft measures?
  - Is there any link between perception and real world?
  - Do soft measures give an early warning?

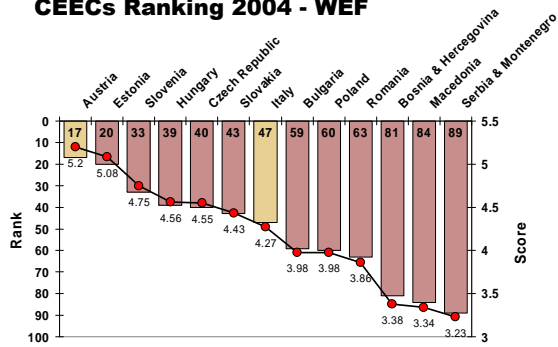
21

### CEECs Ranking - IMD



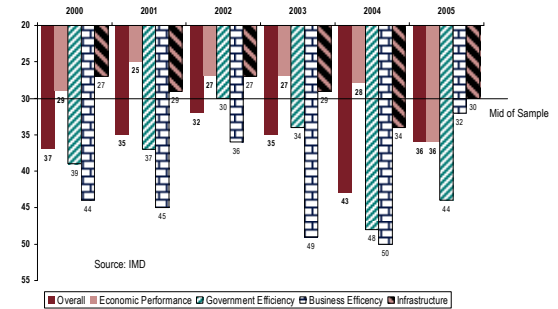
22

### CEECs Ranking 2004 - WEF



23

### Czech Republic Ranking



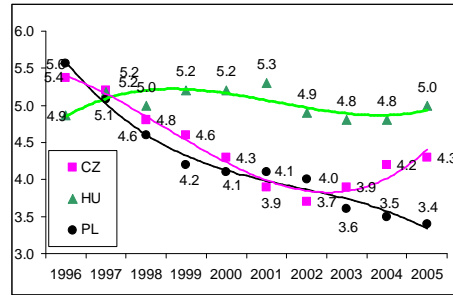
24

### 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

25

### Corruption Perception Index



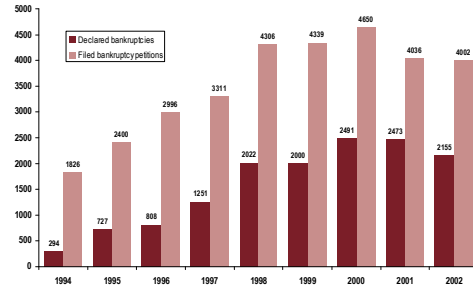
25

### Business Environment

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

27

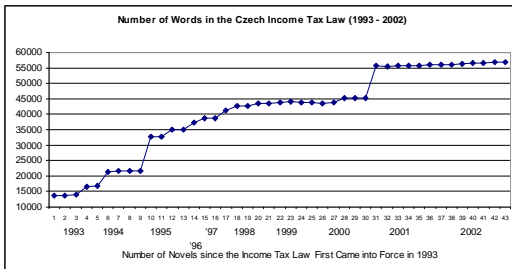
### Bankruptcies in the Czech Republic



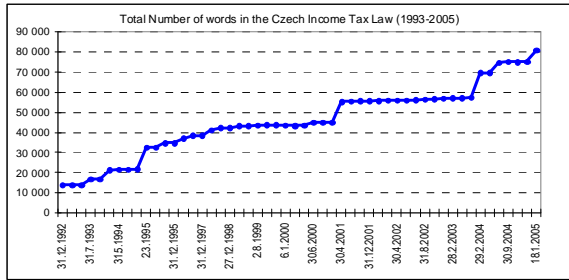
Source: Ministry of Justice, Ministry of Industry and Trade

28

### Too Simple Laws?

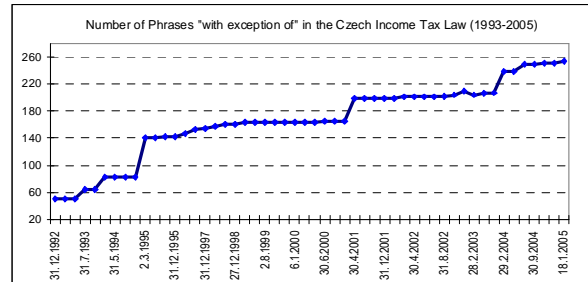


### Too Simple Laws?



31

### Use Exceptions to Improve...



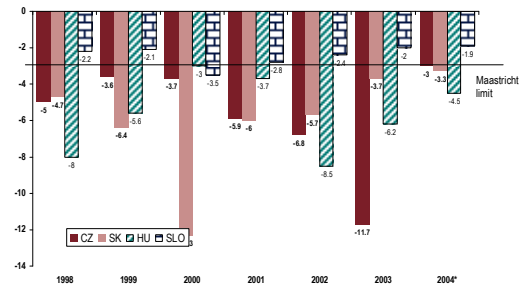
32

### 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

33

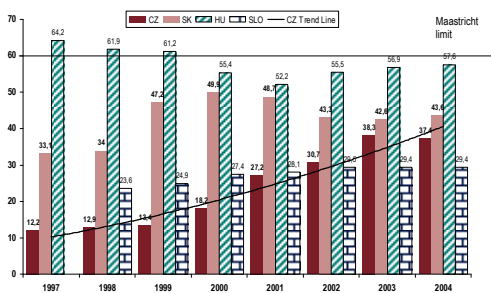
### Public Fiscal Deficits, %GDP



Source: Eurostat

34

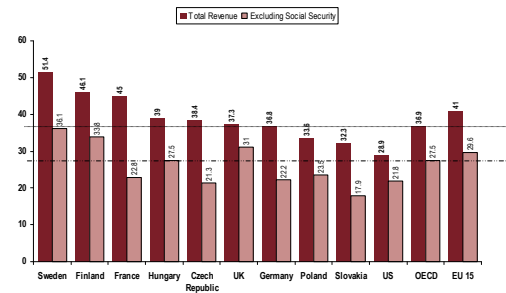
### General Governmental Debt, %GDP



Source: Eurostat

35

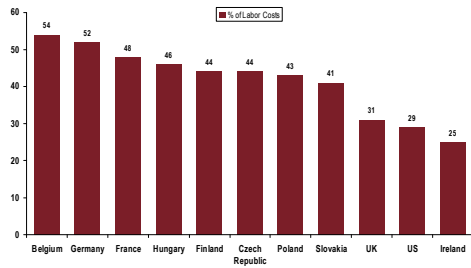
### Tax Revenue as % of GDP, 2001, OECD



Source: OECD

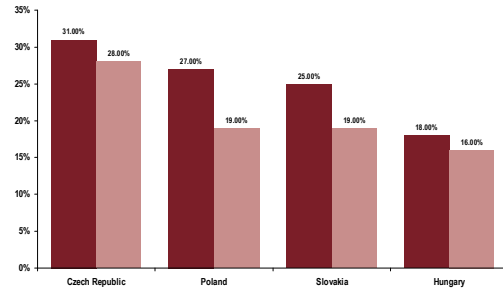
36

### Income Tax and Social Security Contributions, 2003



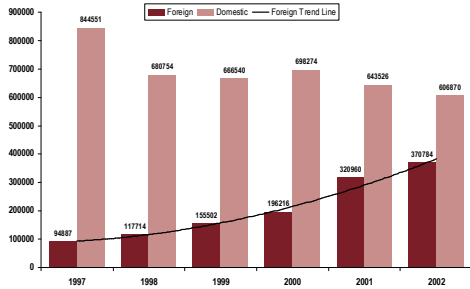
Source: OECD

### Changes in Corporate Income Tax Rate



38

### 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

40

### Doing Business (2003/4)

Country	Starting a Business				Hiring and Firing Workers				Enforcing Contracts				Closing a Business	
	# of Procedures	Duration (days)	Cost (% of capex)	Flexibility of Hiring Ind.	Conditions of Employment Ind.	Flexibility of Firing Ind.	Employment Laws Ind.	# of Procedures	Duration (days)	Cost (% of capex)	Procedural Complexity Ind.	Actual Time (in years)	Actual Cost (% of estate)	
Czech R	10	88	11.7	17	63	27	36	16	270	16.5	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	88	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	6	
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	4	

41

### Doing Business (2003/5)

Country	Starting a Business			Enforcing Contracts			Closing a Business		
	# of Procedures	Duration (days)	Cost (% of capex)	# of Procedures	Duration (days)	Cost (% of debt)	Actual Time (in years)	Actual Cost (% of estate)	
Czech R	10	55	10.0	22	300	9.6	9.2	38	
Czech R	10	40	9.5	21	290	9.1	9.2	14	
France	9	42	1.2	21	75	11.7	2.4	18	
France	7	8	1.2	21	75	11.7	1.9	9	
Germany	9	45	5.9	26	184	10.5	1.2	8	
Germany	9	24	4.7	26	175	10.5	1.2	8	
Hungary	6	52	40.4	21	365	8.0	2.0	38	
Hungary	6	38	22.4	21	365	8.1	2.0	14	
Poland	10	31	22.2	41	980	8.7	1.4	22	
Poland	10	31	21.1	41	1,000	8.7	1.5	18	
Slovak R	10	103	9.4	27	655	15.0	4.8	18	
Slovak R	9	25	5.1	27	565	15.0	4.8	18	
Slovenia	10	61	13.7	25	1,003	16.2	3.7	18	
Slovenia	9	60	10.1	25	913	15.2	3.6	14	
United K.	6	18	0.9	14	288	15.6	1.0	8	
United K.	6	18	0.7	14	288	17.2	1.0	6	
United States	5	5	0.5	17	250	7.5	3.0	4	
United States	5	5	0.5	17	250	7.5	2.0	7	

42

### 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

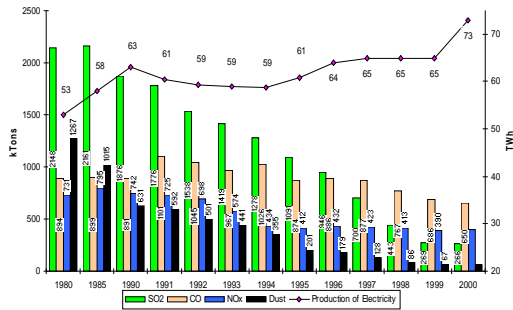
43

### 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

44

### Pollution



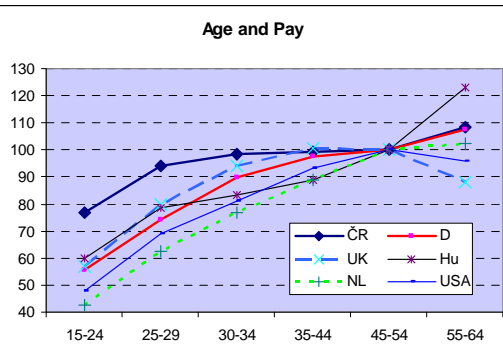
45

### 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

46

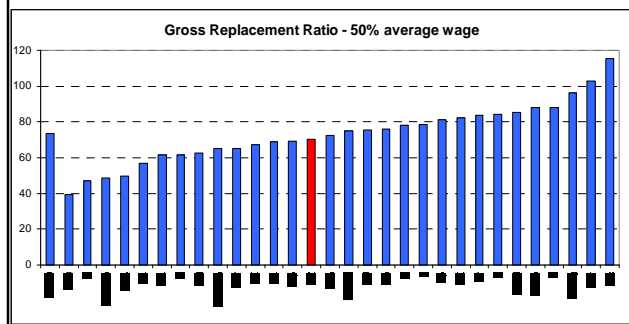
### Age and Pay



47

Source: OECD Labor Force Statistics

### Gross Replacement Ratio

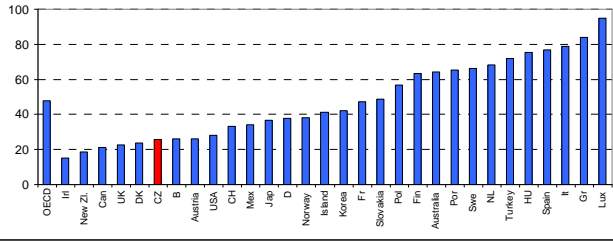


48

Zdroj: OECD

### Gross Replacement Ratio

Replacement Ratio - 200% of average wage



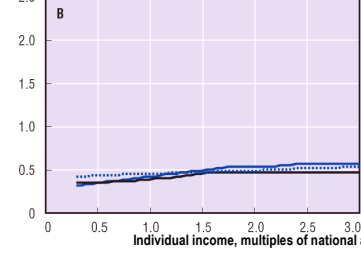
49

Zdroj: OECD

### Pension vs. Pay

— Austrálie ..... CR  
— UK

Gross relative pension



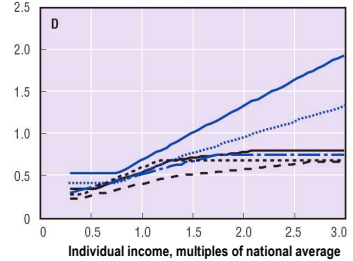
50

Source: Pensions at a Glance, OECD

### Pension vs. Pay

— Portugalsko ..... Francie — Norsko  
— Jap. .... Švýcarsko - - - - USA

Gross relative pension



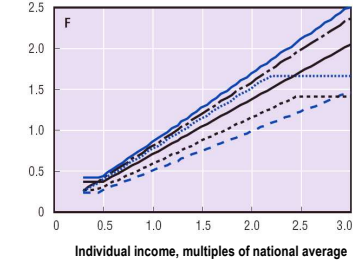
51

Source: Pensions at a Glance, OECD

### Pension vs. Pay

— Recko ..... Maďarsko — Holandsko  
— Itálie - - - - Polsko - - - - Slovenská Rep.

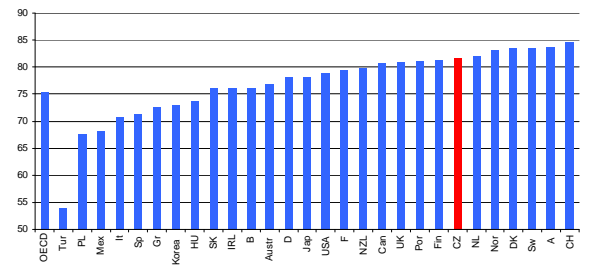
Gross relative pension



52

Zdroj: Pensions at a Glance, OECD

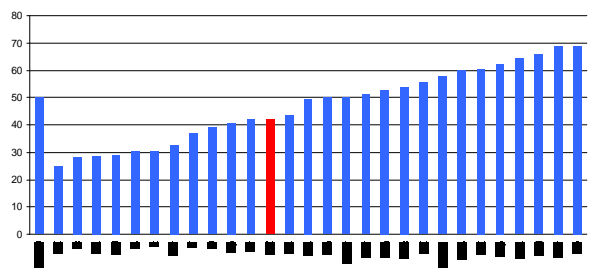
### Participation, 25-54 yrs.



53

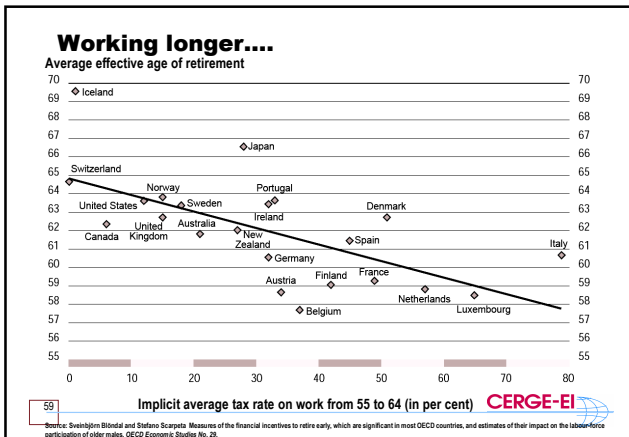
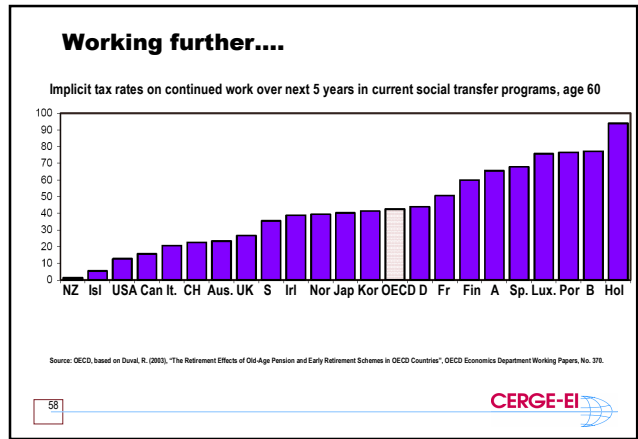
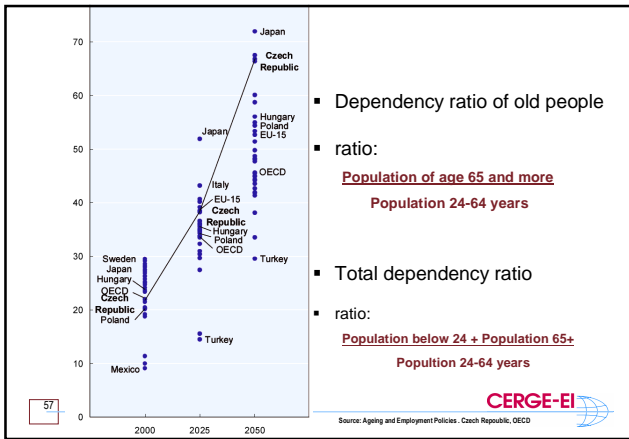
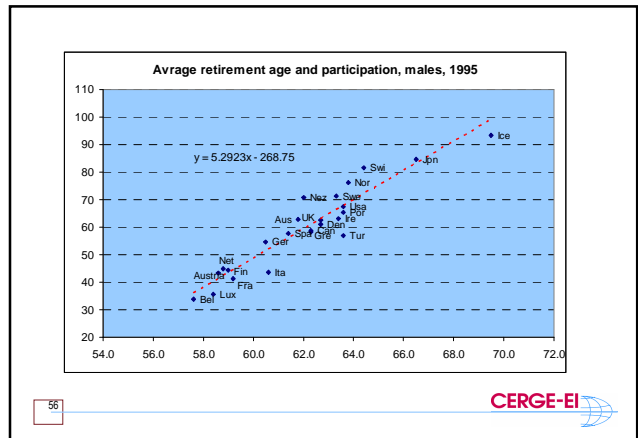
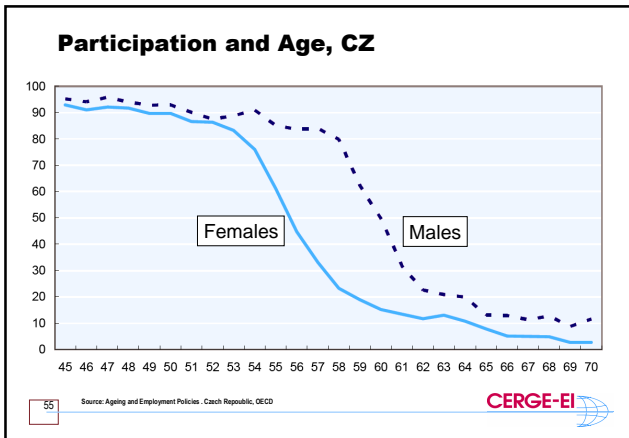
Source: OECD

### Participation, 55-60 yrs



54

Source: OECD



### Dual Track Economy - Summary

- Growing economy despite governmental efforts
  - with a LT 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
  - 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

60

CERGE-EI

**Thank you**