



Weekly Briefing

**Czech Republic economy briefing:
In the Middle-Income Trap:
Limits and Potential of the Czech Economy**
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In the Middle-Income Trap: Limits and Potential of the Czech Economy

Summary

An overwhelming majority of enterprises are sceptical of the economic prospects of the Czech Republic, being concerned about the imminent risk of overall economic decline. Representatives of the national business, therefore, appeal to the government and state authorities to cope with the rising problems. The economic efficiency is obstructed by a handful of factors including the existing legal framework and the absence of a political strategy. The briefing analyses the findings of the recent research conducted by the Czech Chamber of Commerce and a survey carried out among businesses. They show that a transition to a new economic model is the main challenge today.

Introduction

The longer-term economic performance of the Czech Republic arouses doubts. An increasing number of people and social groups become aware of what is usually called a middle-income trap.¹ Even though the living standard has risen for nearly the entire post-communist period, the present economic model has met its limits. Representatives of the Czech business have recently put forward several important findings and analyses which identify the crucial problems and risks. They formulate concrete priorities and possible measures which can contribute to the due shift at the political level.

Scepticism prevails

The Czech Chamber of Commerce, Confederation of Industry of the Czech Republic and Confederation of Employers' and Entrepreneurs' Unions of the Czech Republic conducted a survey among Czech businesses in August.² The results indicate widespread sceptic attitudes

¹ *Ekonomická situace Česka je špatná, míní 57 procent lidí. Nejvíce od roku 2014* (2023, September 15). iDNES.cz. https://www.idnes.cz/zpravy/domaci/ekonomickou-situaci-v-cr-vnima-jako-spatnou-57-procent.A230915_133001_domaci_maku

² Bidrmanová, M. (2023, September 1). *Jsmo skanzen. Míříme ke kolapsu. České firmy vystavily státu vysvědčení.* Seznam Zprávy. <https://www.seznamzpravy.cz/clanek/ekonomika-firmy-jsme-skanzen-mirime-ke-kolapsu-ceske-firmy-vystavily-statu-vysvedceni-236237>

regarding the prospects of economic development. Only 7 per cent of enterprises are optimistic about the future in contrast to 60 per cent declaring the opposite stance—33 per cent hold a neutral position. It is worth analysing the reasons behind this mood. The most frequent reasons for the negative stance are as follows: (a) the imminent risk of overall economic decline and collapse (17.0 per cent); (b) the risk of stagnation and lagging behind (10.7 per cent); (c) political mismanagement (9.3 per cent); (d) the loss of competitive ability and low level of labour productivity (7.9 per cent); (e) the absence of a long-term strategic vision (6.5 per cent); (f) the risk of economic recession (5.9 per cent), which coincides with the first point in essence; (g) the excessive and inappropriate interventions from the EU (5.0 per cent); (h) the lack of labour force (4.7 per cent); (i) the excessive bureaucratic and administrative burden (4.3 per cent). At the same time, almost half of the enterprises (42 per cent) admit that they do their business as usual without the need to change their business plans and portfolios despite the abovementioned difficulties and risks. A mere 3 per cent of subjects would consider the termination of their economic activities in the case of a negative scenario.

From a businessmen's point of view, it is the state that bears the largest share of responsibility. One of the chief problems is the legal framework which often undermines, rather than stimulates, economic development and progress. The recent survey identifies a wide array of obstacles that are to be eliminated to move forward. Let's mention at least the most important ones: (a) protracted processes for requesting permission for the construction, business and other kinds of activities (55 per cent); (b) the absence of a strategic vision on the part of the state and its long-term implementation (45 per cent); (c) complicated legislation which is often not coherent with the state strategic documents (43 per cent); (d) impacts of the EU Green Deal and related aspects of the green transformation (38 per cent); (e) frequent changes of the legal regulation (27 per cent); (f) excessive regulation of the business environment (27 per cent); (g) the lack of a qualified labour force (26 per cent); (h) the absence of an agreement on the definition of "public interest" between the state and local authorities (24 per cent); (i) high expenses needed for the realisation of business projects (20 per cent).

Strategic investment

All these obstacles pose a threat to strategic investment which is one of the essential conditions for a successful and sustainable economic development in the next decades. The business circles share a broad consensus on the crucial areas in terms of investment. An emphasis should be put on the following priorities: (a) education (50.0 per cent); (b) energy

(47.0 per cent); (c) transportation (46.9 per cent); (d) research, development and innovation (43.7 per cent); (e) technical and digital infrastructure (35.8 per cent); (f) digital technologies (29.4 per cent); (g) agriculture and food industry (26.4 per cent); (h) health care and social services (24.9 per cent); (i) housing (24.2 per cent). For a long period, the Czech enterprises have warned against a discrepancy between the educational curricula, skills and orientation of graduates on one hand and the needs of business on the other. It is reaffirmed by the survey according to which the state should invest especially in the quality of education, reform of the curricula, expansion of technical subjects and connections between schools and companies.

Both large and small enterprises are concerned about the developments in the energy market. The green transformation as well as decoupling from the resources of raw materials in Russia together with the risk of further politicisation of the energy cooperation and trade entailing possible disruption, trade wars, rise in prices and the lack of resources and important components are all perceived as a serious risk. The Czech Republic can hardly carry out the green transition without a large share of domestic nuclear energy. Not by coincidence, the representatives of business highlight the priority of the construction of nuclear facilities along with the development of sources of renewable energy and the enhancement of the transmission and distribution grid with a stable and reliable connection to the adjacent countries. The economic potential of the country is diminished by the absence of a complete motorway network, the relatively low quality of the existing roadways and the lack of high-speed railways. Insufficient infrastructure connectivity with other countries has negative impacts on economic efficiency.

Strategic planning

Strategic planning requires longer-term horizons going beyond the four-year election term. The business representatives believe that the basic precondition is cooperation between the state and political actors, enterprises as well as trade unions. The statement issued by the Czech Chamber of Commerce and other organisations on September 1 declares that the economic model introduced after the fall of the Communist regime has exhausted itself and another transformation is to be carried out.³ Such a transformation should be primarily based on new technologies, improvement of the market environment and enhancement of the

³ *V Česku se zformovalo nové podnikatelské hnutí, které chce odvrátit černý scénář tuzemské ekonomiky. Vládu podněcuje k odvaze řešit dlouho zanedbávané problémy* (2023, September 1). Hospodářská komora České republiky. https://www.komora.cz/press_release/v-cesku-se-zformovalo-nove-podnikatelske-hnuti-ktere-chce-odvratit-cerny-scenar-tuzemske-ekonomiky-vladu-podnecuje-k-odvaze-resit-dlouho-zanedbavane-problemy/

industrial and trade capabilities. The new technologies include digitalisation, research and development, implementation of artificial intelligence, automatisisation as well as the expansion of the Internet and network infrastructure. The improvement of the market environment involves stabilisation and growth of the domestic market in conjunction with the mitigation of inflation and inflationary pressures, healthy development of the labour market, increase in efficiency of state administration and last but not least certain deregulation of the market. The enhancement of the industrial and trade capabilities, in turn, requires the introduction of green technologies, expansion of the service sector, increase in purchasing power as well as access to additional labour force.⁴

A recent analysis of the Czech Chamber of Commerce observes disturbing facts.⁵ The country has lost comparative advantages and got into a middle-income trap. Even though the Czech Republic remains the leader in economic convergence towards the EU average among the Visegrad countries in terms of GDP per capita, after the 2008 global economic crisis the trend has been rather stagnating, amounting to 91 per cent of the EU average in 2022. The Czech post-communist economic model has been based on opening up, inflow of foreign investment and cheap labour force. However, the growth potential of the cheap labour force is about to exhaust itself more so that the national economy suffers from the lack of labour force. Another problem is that the economy generates very low added value. The parameter belongs to the lowest in the EU which corroborates the position of the Czech Republic as the subcontractor with a low share of final products on the overall production. The low added value is accompanied by insufficient growth of labour productivity in relation to the growth of salaries. The latter has been increasing more than labour productivity, which creates strong inflationary pressures. Not by coincidence, the country has been experiencing one of the highest inflation rates in the EU.

⁴ *Strategické investice státu. Závěrečná zpráva* (2023, September 1). Hospodářská komora České republiky. <https://www.komora.cz/wp-content/uploads/2023/09/Zaverecna-zprava-vyzkumu-ke-strategickym-investicim.pptx>

⁵ Zdeněk Zajíček: *Česko se ocitlo v „pasti středních příjmů“*. *Zpomali růst mezd i životní úroveň* (2023, August 20). Hospodářská komora České republiky. https://www.komora.cz/wp-content/uploads/2023/08/Konkurenceschopnost_analyza_HK.pdf

Conclusion

The Czech Republic has seemingly got into a middle-income trap. Therefore, a transition to a model based on added-value production is needed in order to remain internationally competitive. It will require strategic investment and planning, focus on research and development, modern education to generate a qualified and flexible labour force as well as thought-out support for start-ups and the private sector not to undermine the potential of the market economy with all its subjects. The transformation should be accompanied by a restrictive fiscal policy unless the expenditures are aimed at investment items. However, there is a lack of political will for such steps at the moment.