



Slovak Competitiveness: Fundamentals, Indicators and Challenges

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Competitiveness:

What can the concept refer to?

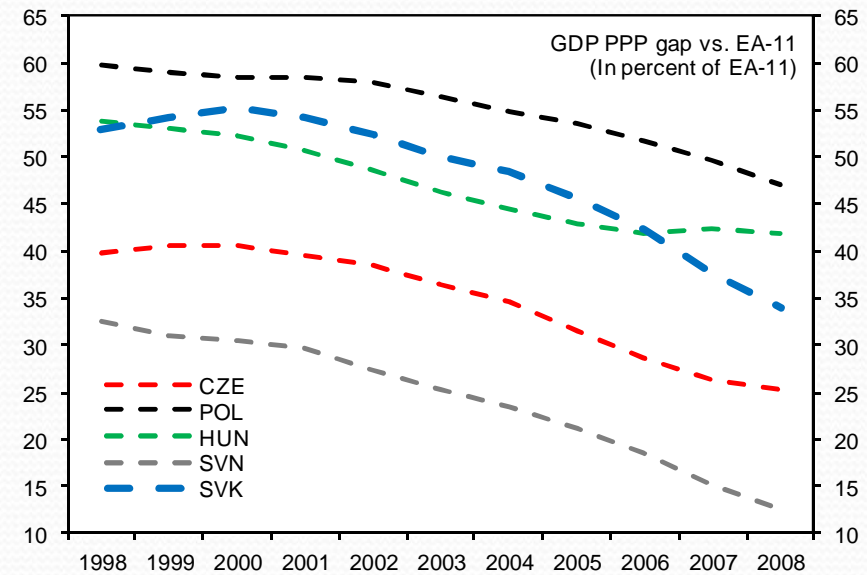
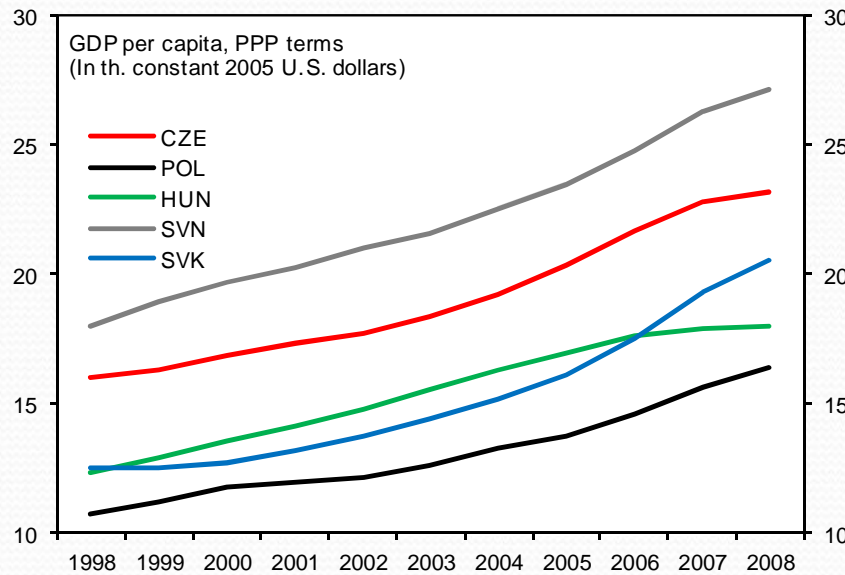
1. Long term: fundamentals of output per capita and long-run growth

- For example, European Competitiveness Report 2010: “productivity growth is the key driver of competitiveness in the long run”
- Fundamentals: inputs of capital and labor, education, quality of the business environment

2. Short term: indicators of short-run exchange rate misalignment

□ GDP and Growth Fundamentals

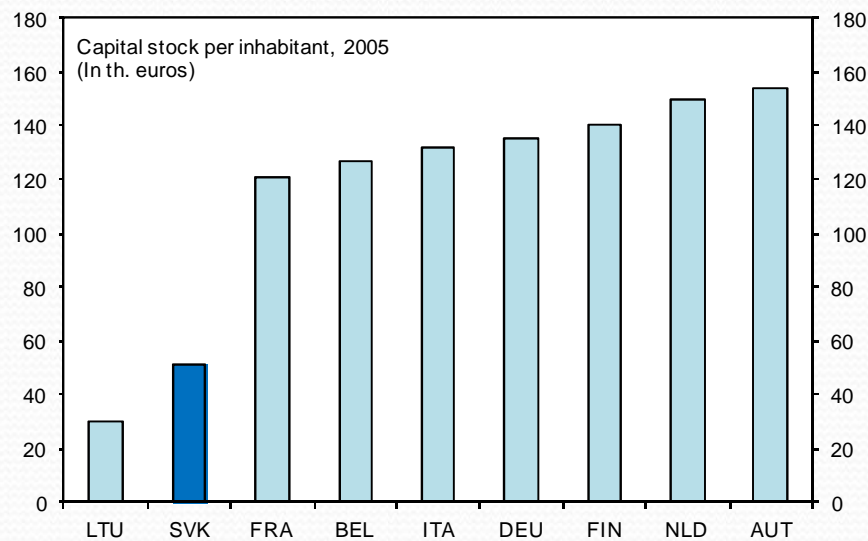
GDP per capita is below EU average and below other countries in the region.
But Slovakia has been converging fast.



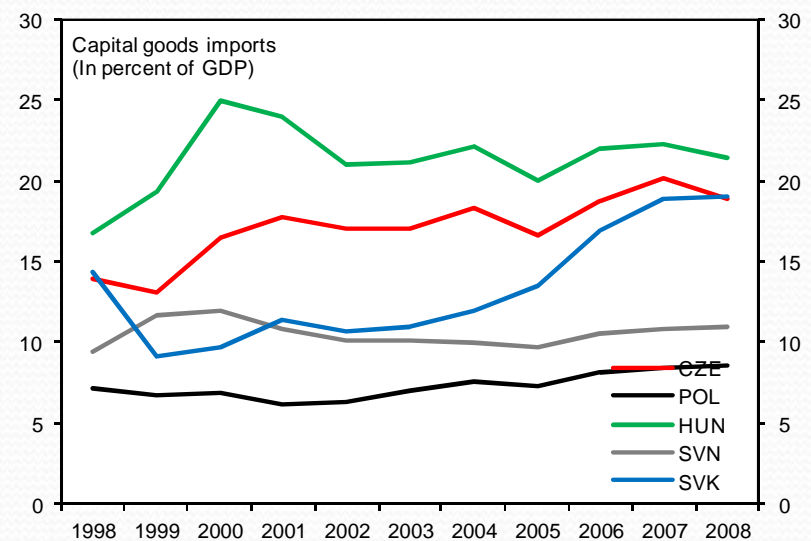
Sources: World Bank Development indicators and IMF staff calculations

Reasons for Still Relatively Low Level of GDP Per Capita

1. Capital stock: relatively low but growing

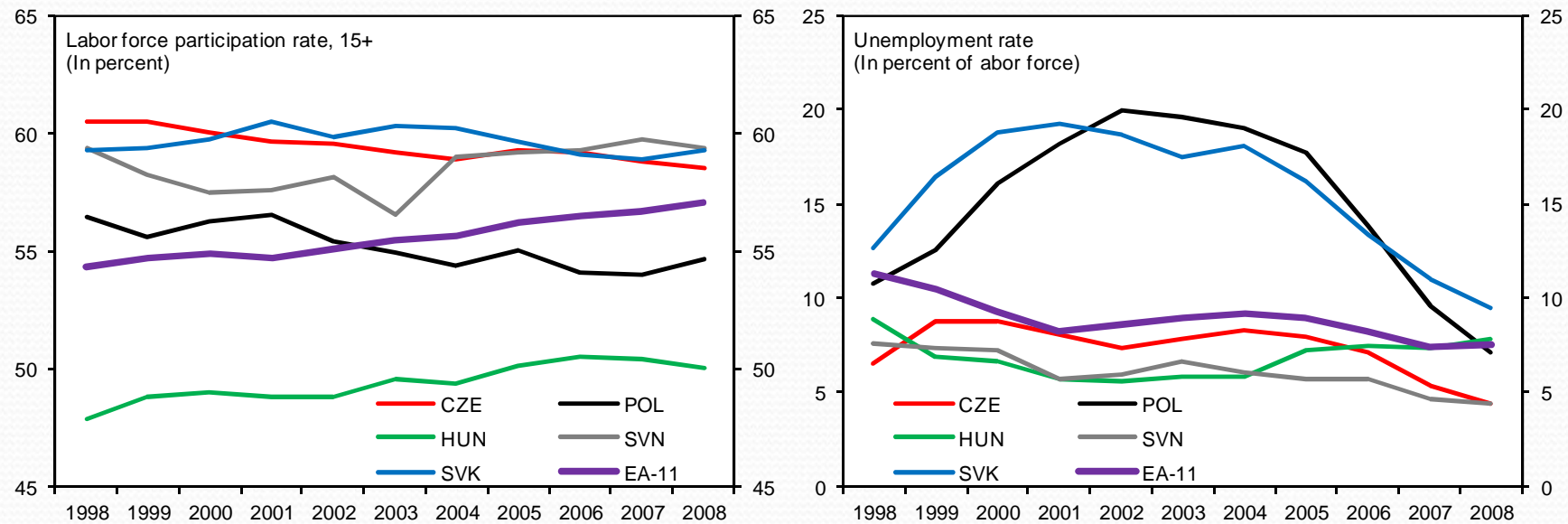


Source: Eurostat



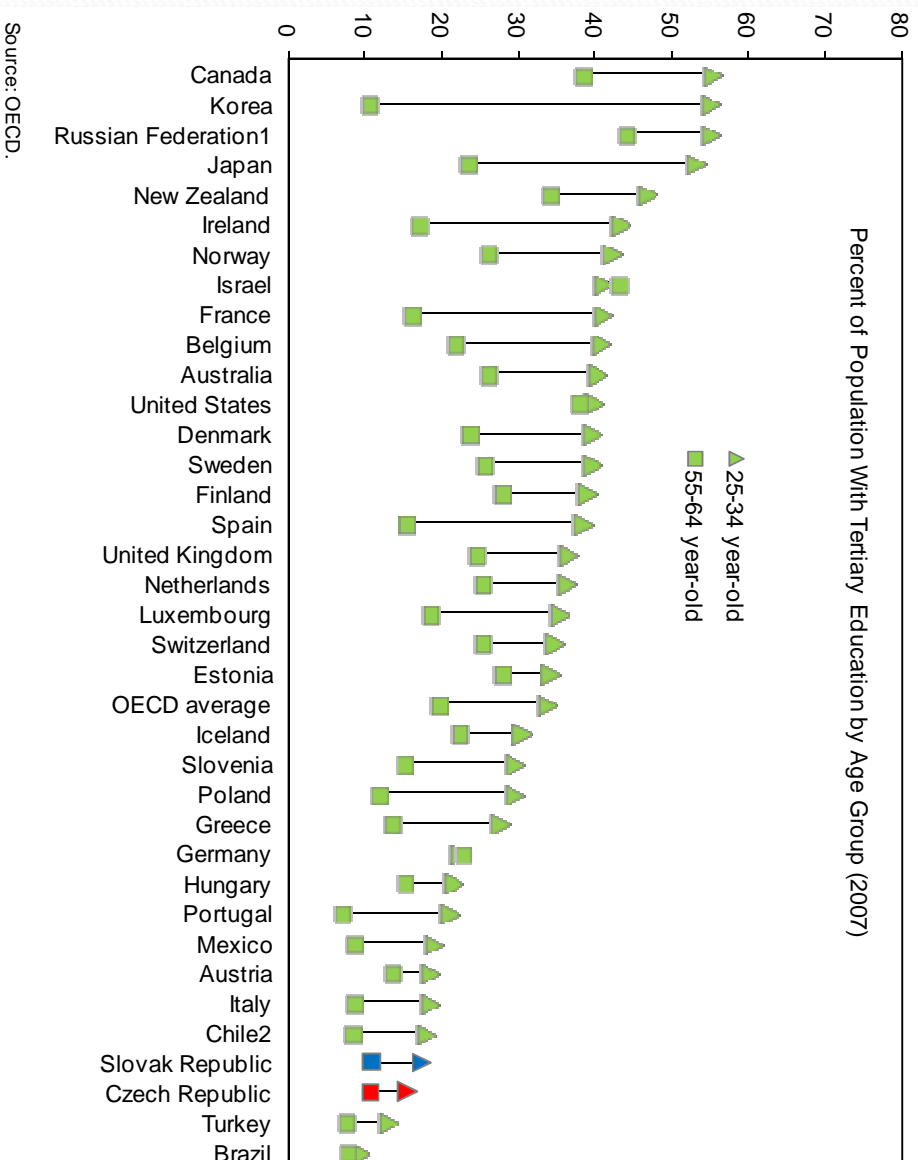
Sources: World Bank; and IMF staff calculations

2. Labor force: high participation rate, but unemployment rate needs to come down.

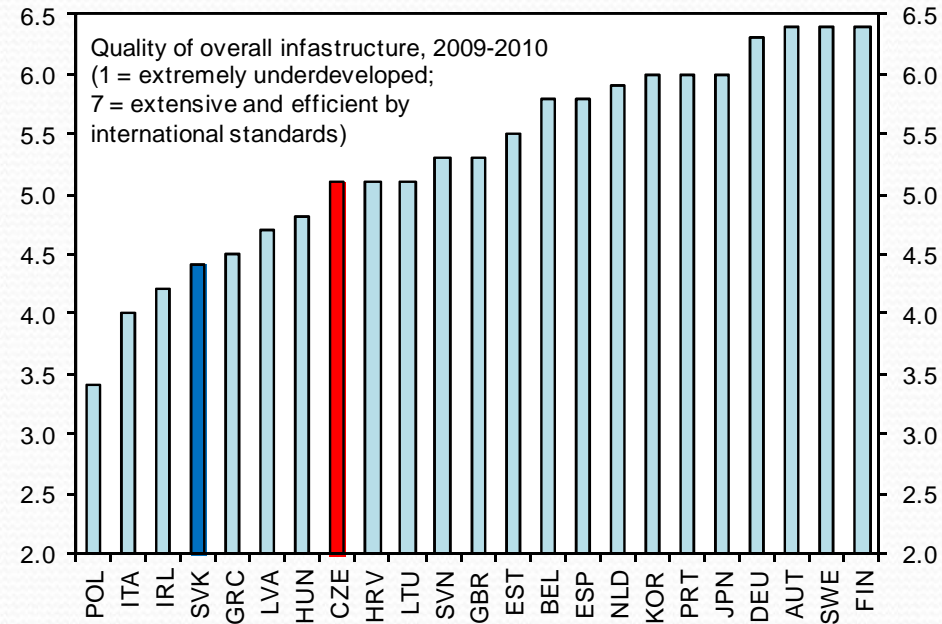


Sources: World Bank Development indicators and IMF staff calculations

3. Human capital: still relatively low level of higher education



4. Infrastructure: relatively low quality



Source: Global Competitiveness Report, 2010



5. Quality of the business environment

- Standard surveys show areas of strength, but also remaining weaknesses
 - E.g. World Economic Forum, Global Competitiveness Report; World Bank, Doing Business; IMD, World Competitiveness Yearbook
 - Key strengths: e.g. macroeconomic environment, relatively low tax rates, good access to financial services
 - But also key areas for further improvements: e.g. infrastructure and network industries, corruption and inefficiency in government, legal framework and judiciary
- Yearly change of Slovak ranking reflects developments domestically but also in other countries: ranking can slip if other countries improve more than Slovakia

□ Short-term Exchange Rate Misalignment

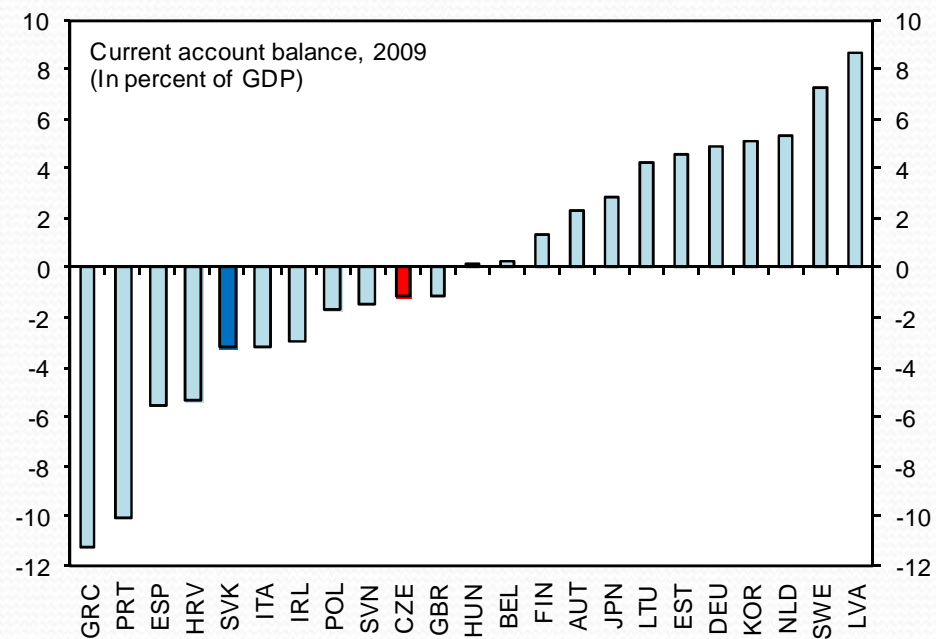
Application of CGER Methodologies to Slovakia, Fall 2010

	Overvaluation, in percent
Macroeconomic Balance approach	-0.2
External Sustainability approach	-6.8
Equilibrium RER approach	1.7

Source: IMF staff calculations.

No clear evidence of significant over or undervaluation.

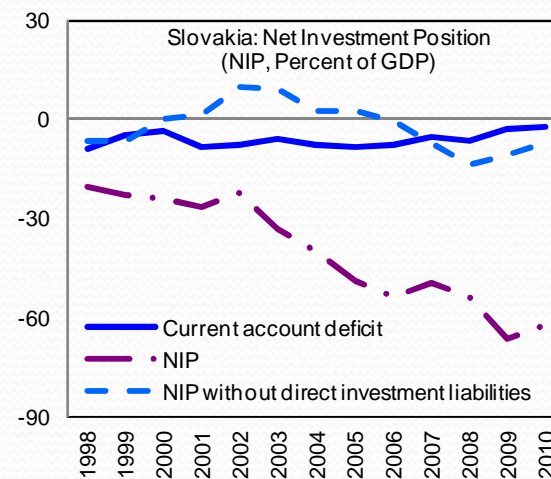
Macroeconomic Balance Approach: Current Account in Line with Economic Fundamentals



Source: IMF World Economic Outlook.

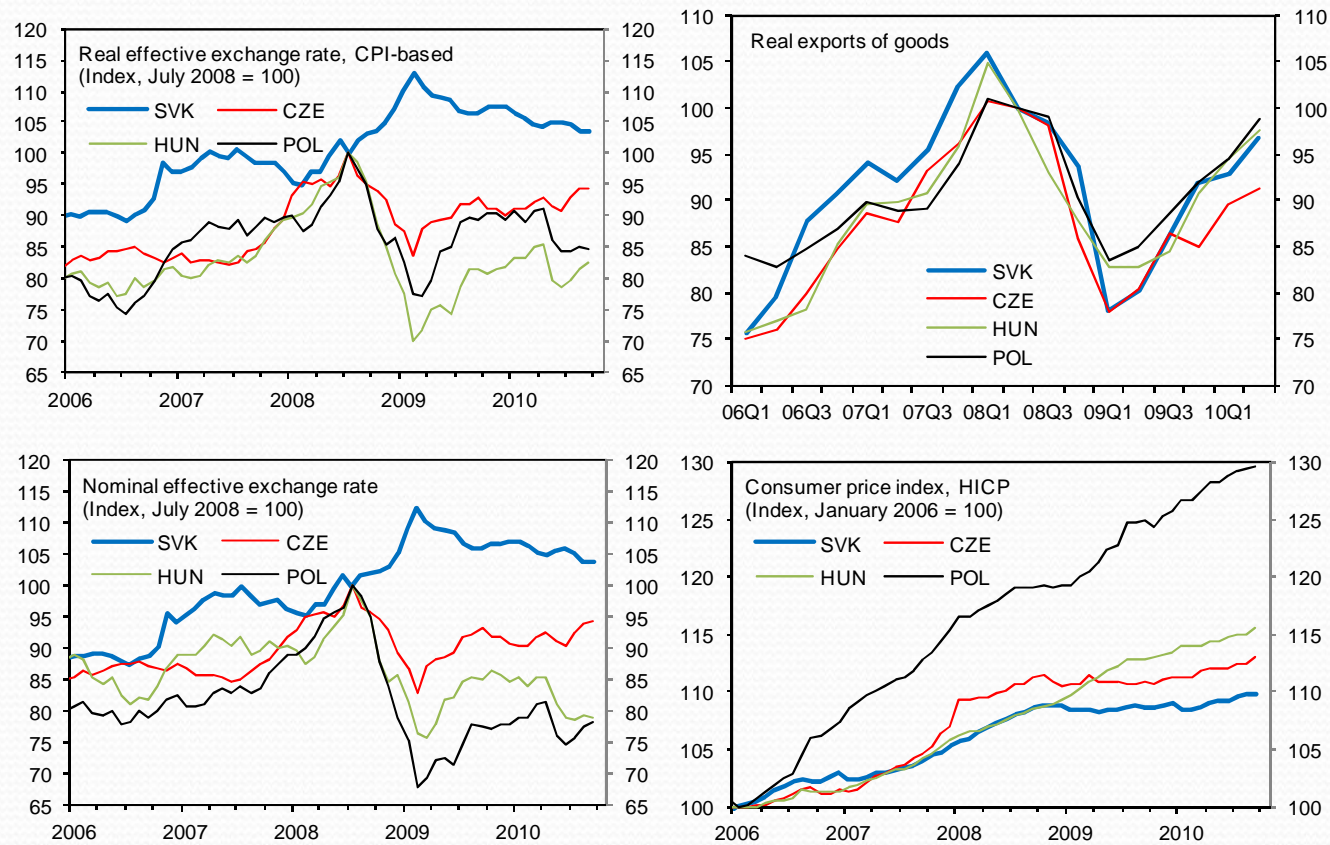
External Sustainability Approach:

- Net investment position excluding direct investment liabilities (share of GDP) is only modestly negative



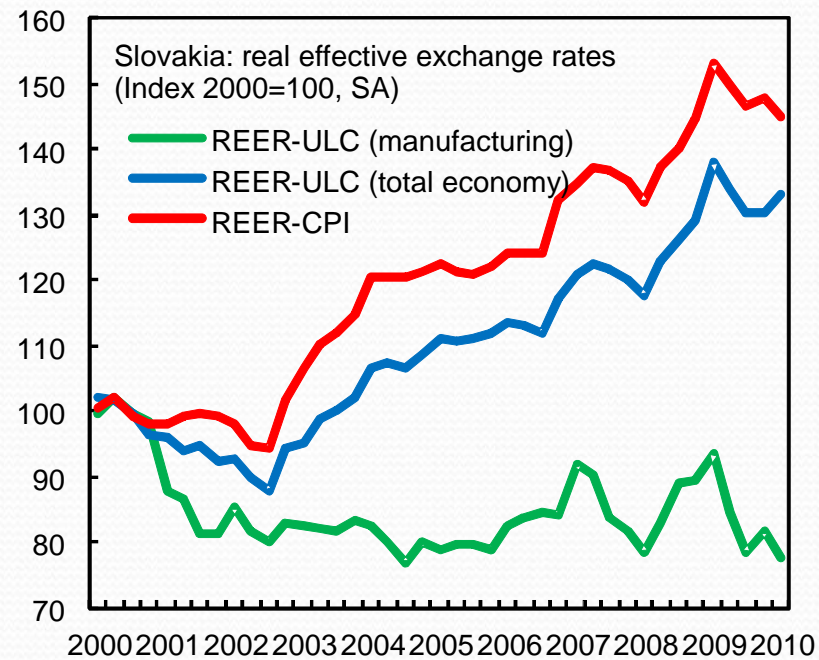
- Current account deficits (share of GDP) are projected to stabilize at a moderate level

REER approach. Exchange rate appreciation in 2008–09, followed by depreciation but no differences impact on export



Sources: Haver Analytics; and IMF staff calculations.

Unit Labor Cost (ULC) appears a better measure of competitiveness...



Source: OECD; and IMF staff calculations.



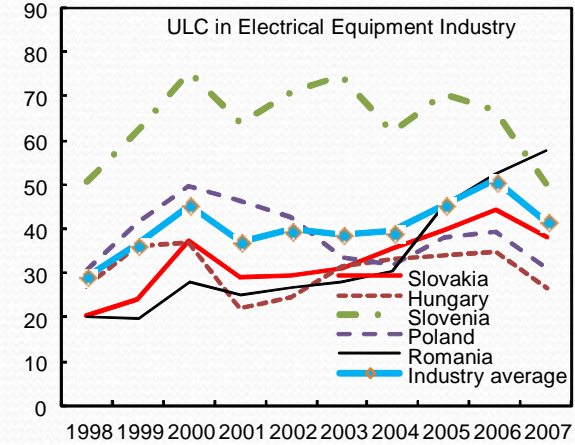
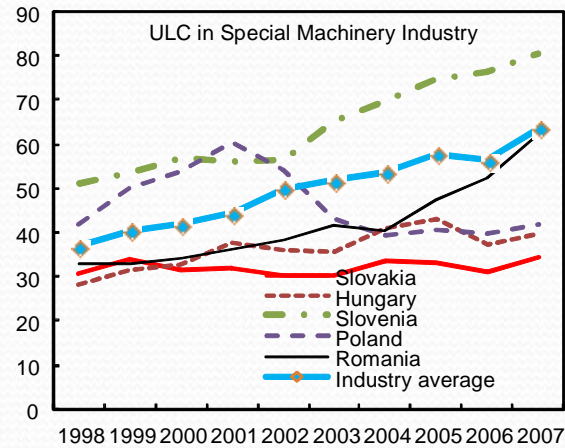
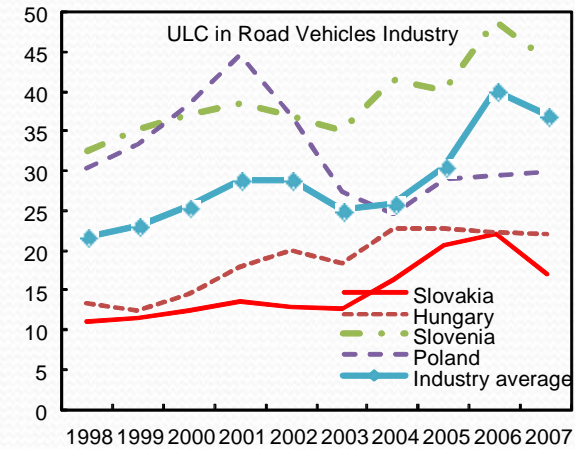
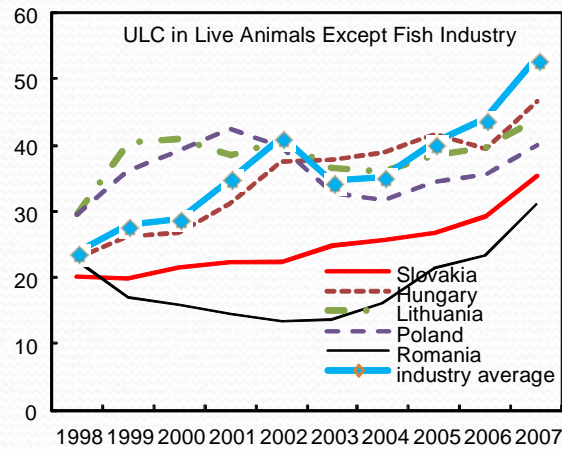
...but may reflect differences in economic structure and does not yield insight on developments in the economic structure.

A New Approach

Evaluating competitiveness in different sectors:

- A deeper and more precise measure of competitiveness .
- Allows insight into the different sectors in the economy and the dynamics.
- Captures the facts that sectors could have different ULC dynamics ,which could bias the aggregate measure.

ULC: Different Dynamics Across Sectors and Across Countries





Evaluating Competitiveness

- Estimating for each sector in each country the norm level of ULC.
- Competitiveness in each sector is measured as the deviation of the actual ULC from its norm.

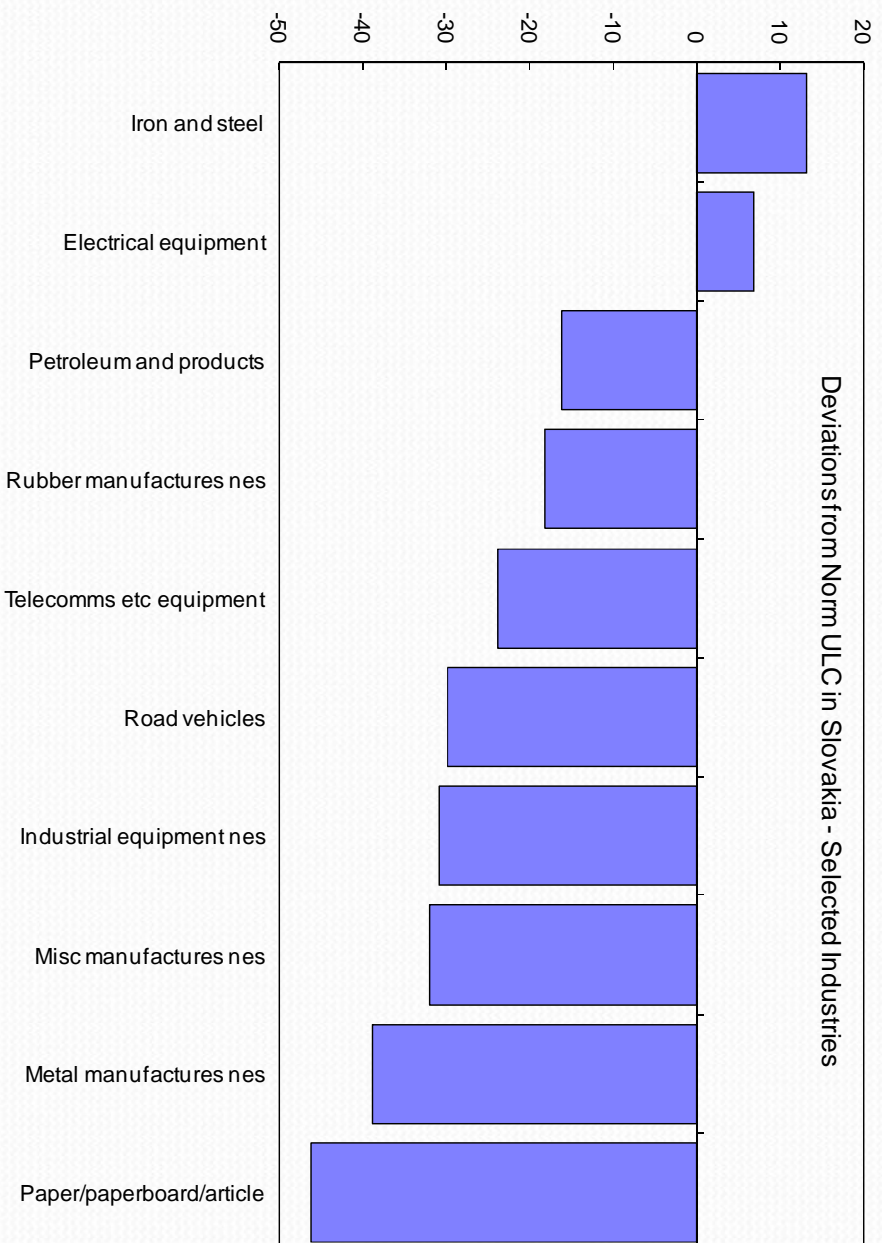
Estimating Norm ULC in Each Sector in Each Country

Regressing ULC Relative to Industry Average (in sector i, country j, time t)

Dependent variable: ULC Relative to Industry

Log of real GDP per capita (PPP)	-11.07*** (1.197)
Lag of unemployment rate	-1.006*** (0.101)
ULC country average	0.450*** (0.022)
Size of industry in country's exports	-0.485** (0.242)

Measure of Competitiveness in Slovakia in Selected Sectors



Competitiveness Impact on Export Growth

Dependent variable: Growth in Export Share_{ij}

Deviation from ULC norm	-0.07** (0.03)
Size of industry in country's exports	4.34*** (0.47)
ULC norm	-0.23*** (0.08)

The proposed competitiveness measure has the expected impact on export share growth



Conclusion

- Overall, the analysis suggests that most sectors in Slovakia are competitive and that competitiveness has improved, as is reflected also in export growth.
- Need to enhance fundamentals for long term growth to continue the transformation among sectors and maintain competitiveness and rapid export and economic growth.