



Main Competitiveness Challenges for the Czech Republic

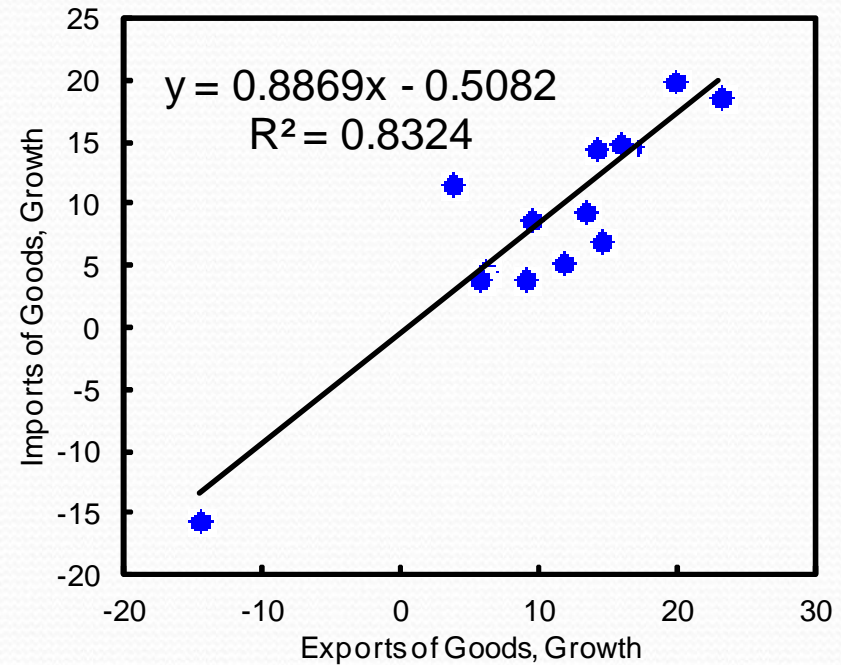
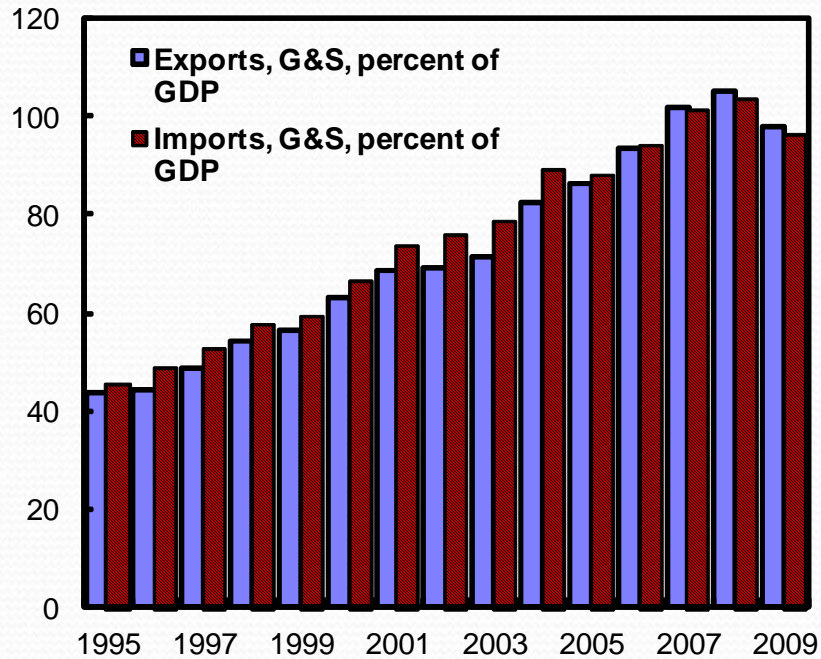
Presentation by Zuzana Murgasova
Advisor, European Department, IMF
Seminar Organized by the European Commission, DG ECFIN
“The Czech and Slovak Economies: 17 Years After”

Overview

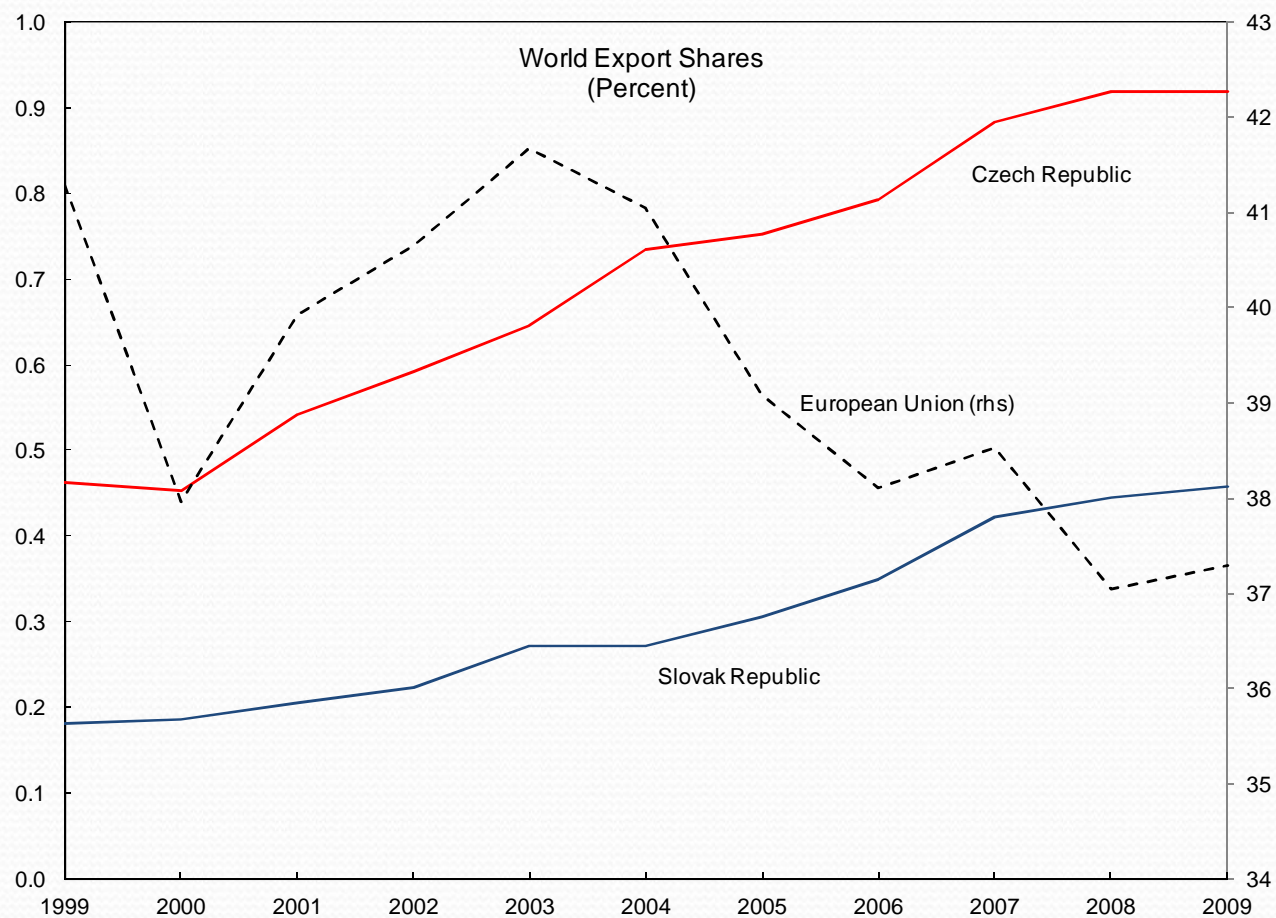
1. *Introduction*
2. *Export performance*
3. *Exchange rate fundamentals*
4. *Competitiveness challenges going forward*
 1. *Direction and composition of exports*
 2. *Boosting labor supply*
 3. *Boosting productivity*
 4. *Business environment*

2. *Export Performance*

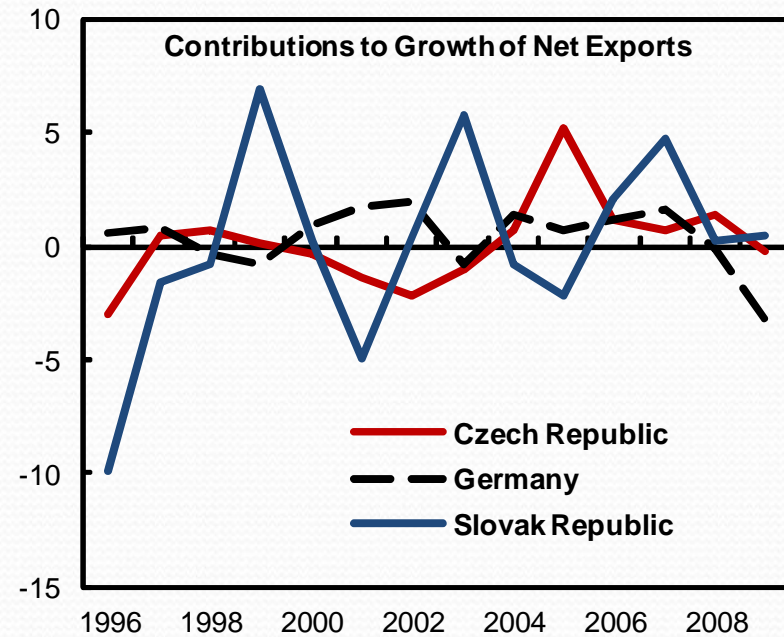
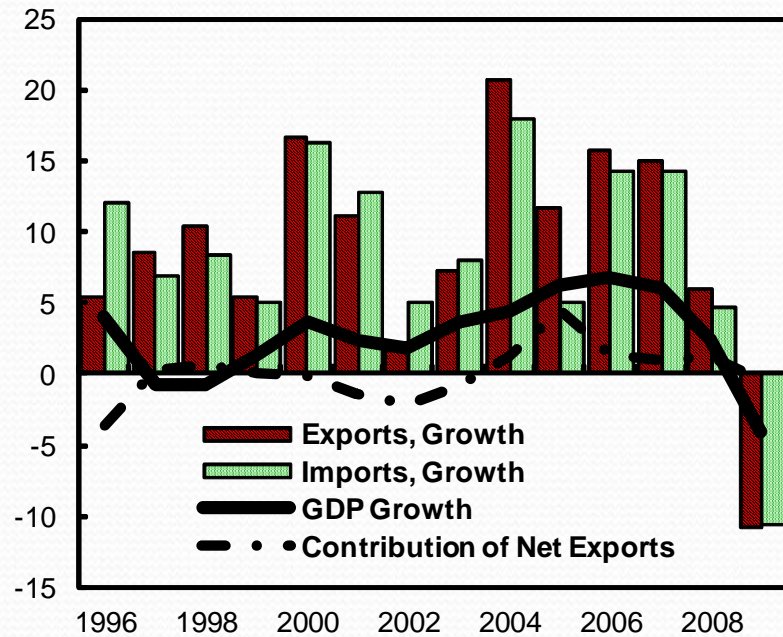
Exports and imports grew rapidly and concordantly



The share in world markets steadily expanded



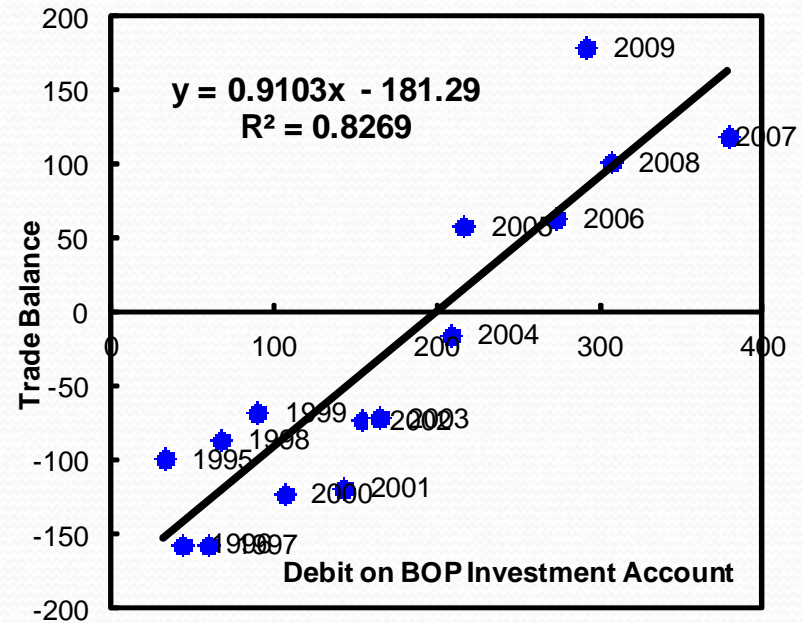
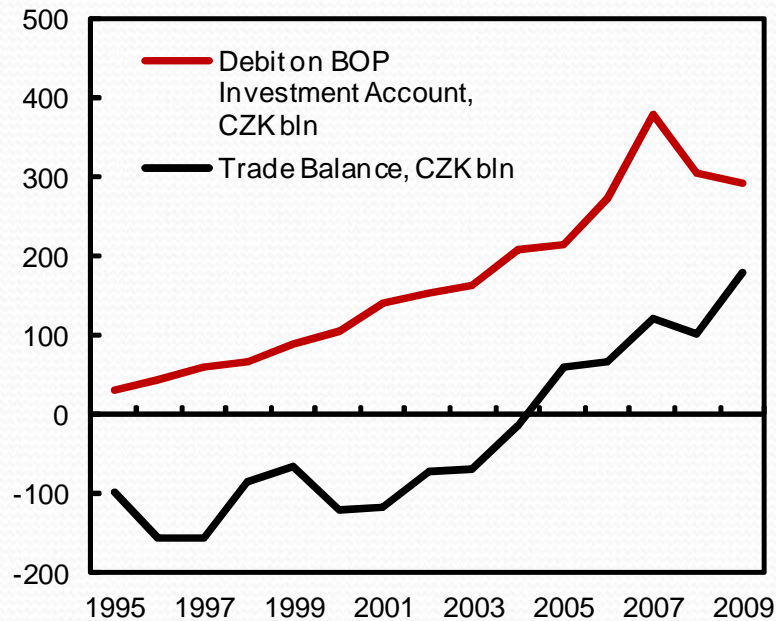
Contribution of net exports to growth increased significantly post 2004



Direct vs. indirect benefits of openness

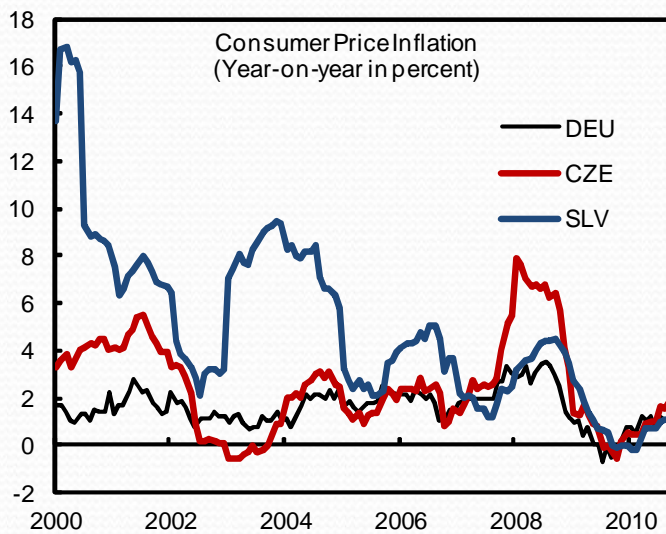
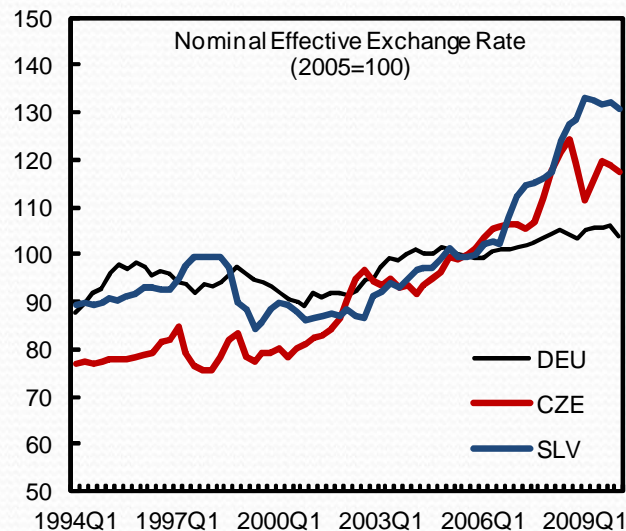
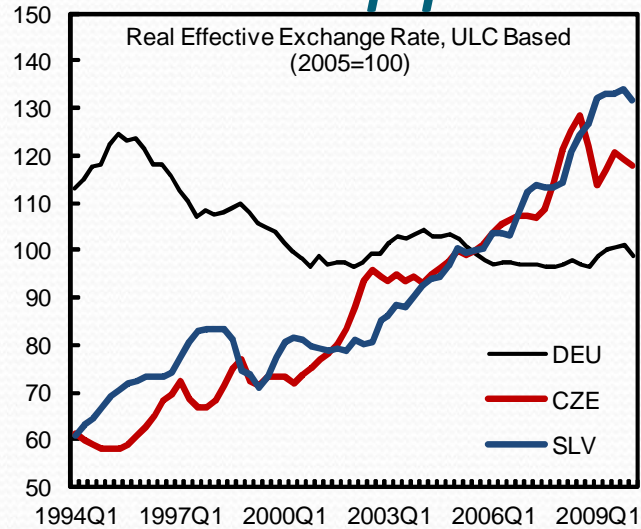
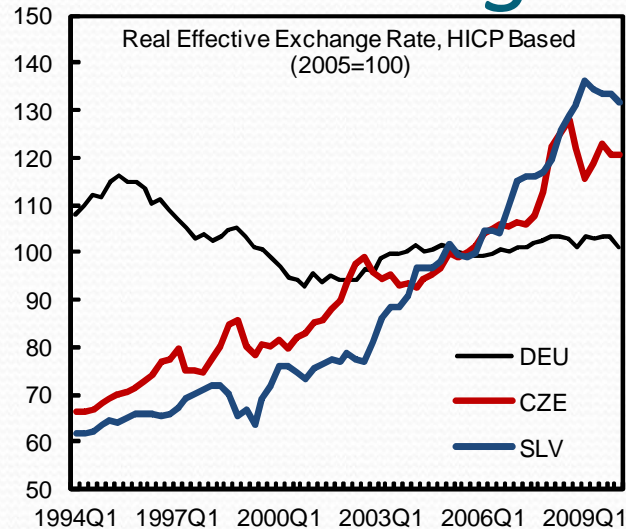
1. Even though CZE is now more open economy, net exports are not the main source of growth and direct (cash) spillovers to the domestic economy are limited.
2. Domestic demand is of high importance in the long run.
3. But higher openness still benefits the economy through creation of jobs, higher tax base; transfer of technology and know-how, managerial skills (FDI).

Rising trade surpluses translated into profit repatriations



3. Exchange rate fundamentals

Real exchange rate has appreciated



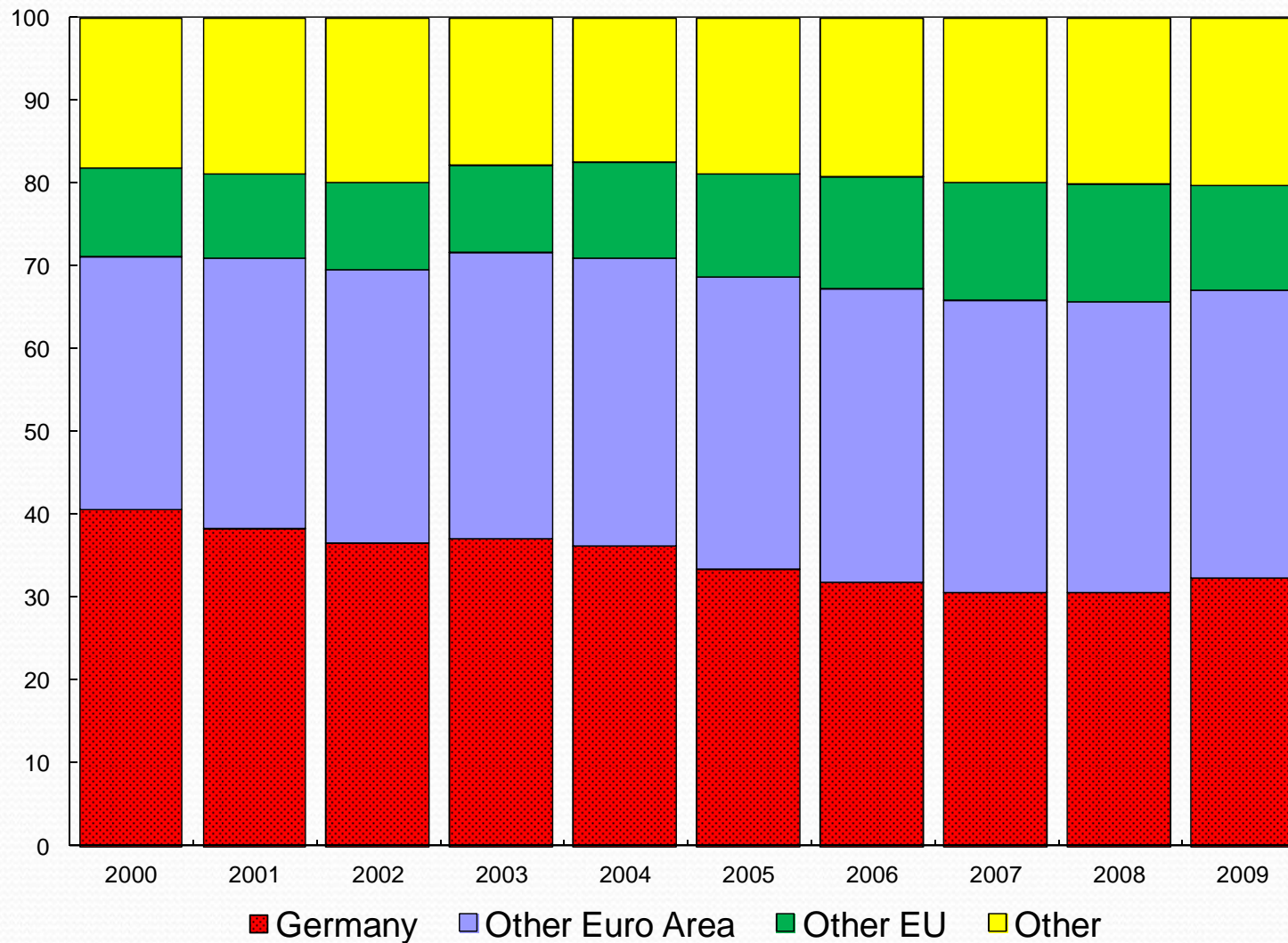
CGER estimates: exchange rate is broadly in line with fundamentals

CGER APPROACHES	
Macroeconomic Balance Approach	-7%
Equilibrium RER Approach	12%
External Sustainability Approach	-10%
Overall Assessment (Fall 2010)	About 0%
Overall Assessment (Spring 2010)	About 0%

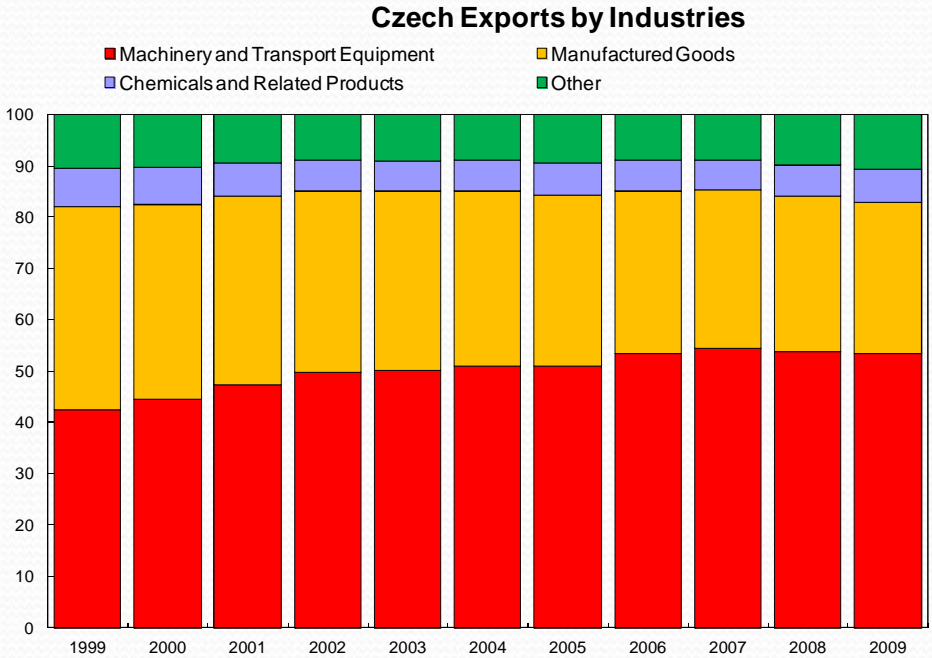
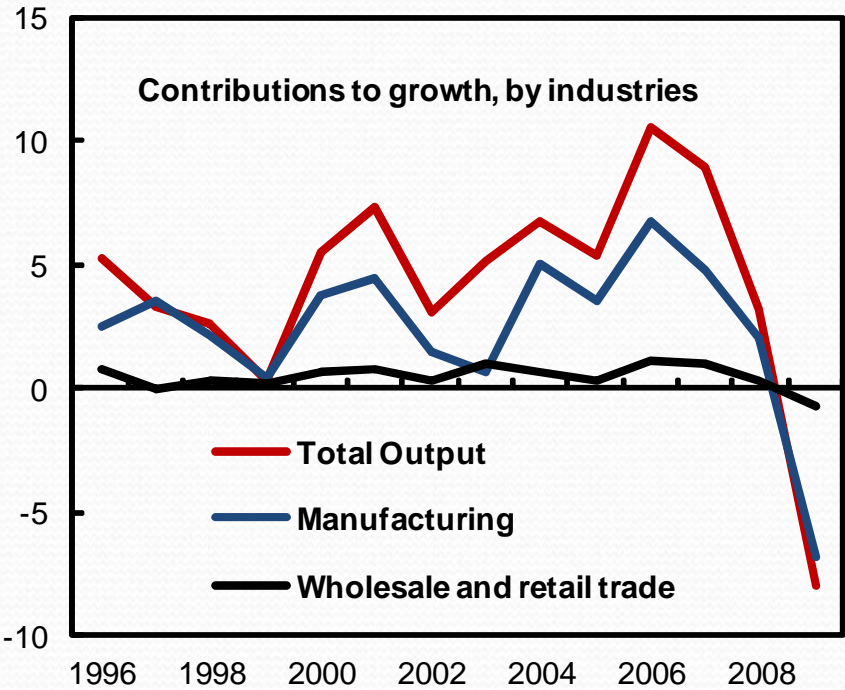
4. Competitiveness challenges going forward

4.1 Direction and composition of exports

Reliance on demand in advanced economies



Czech exports and output are dominated by manufacturing



Czech exports face stiff competition

Changes in the Market Shares for the Imports into EU from

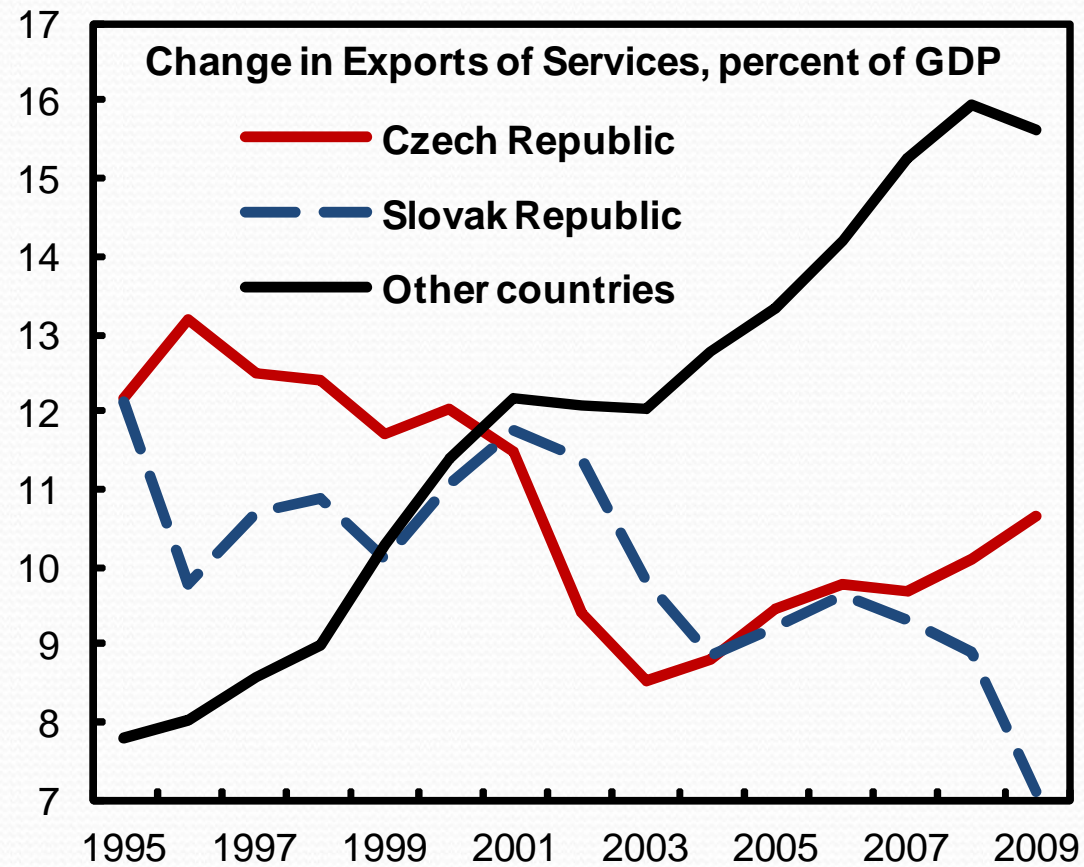
Machinery & Transport Equipment

	1999-09	2007-09
China	8.0	1.8
United States	-3.7	0.7
Poland	2.0	0.7
Czech Republic	2.2	0.6
Romania	0.7	0.4
Spain	0.2	0.3
Slovak Republic	1.0	0.3
Hungary	0.9	0.1
Turkey	1.0	0.0
India	0.4	0.3
Switzerland	-0.1	0.2

Manufacturing

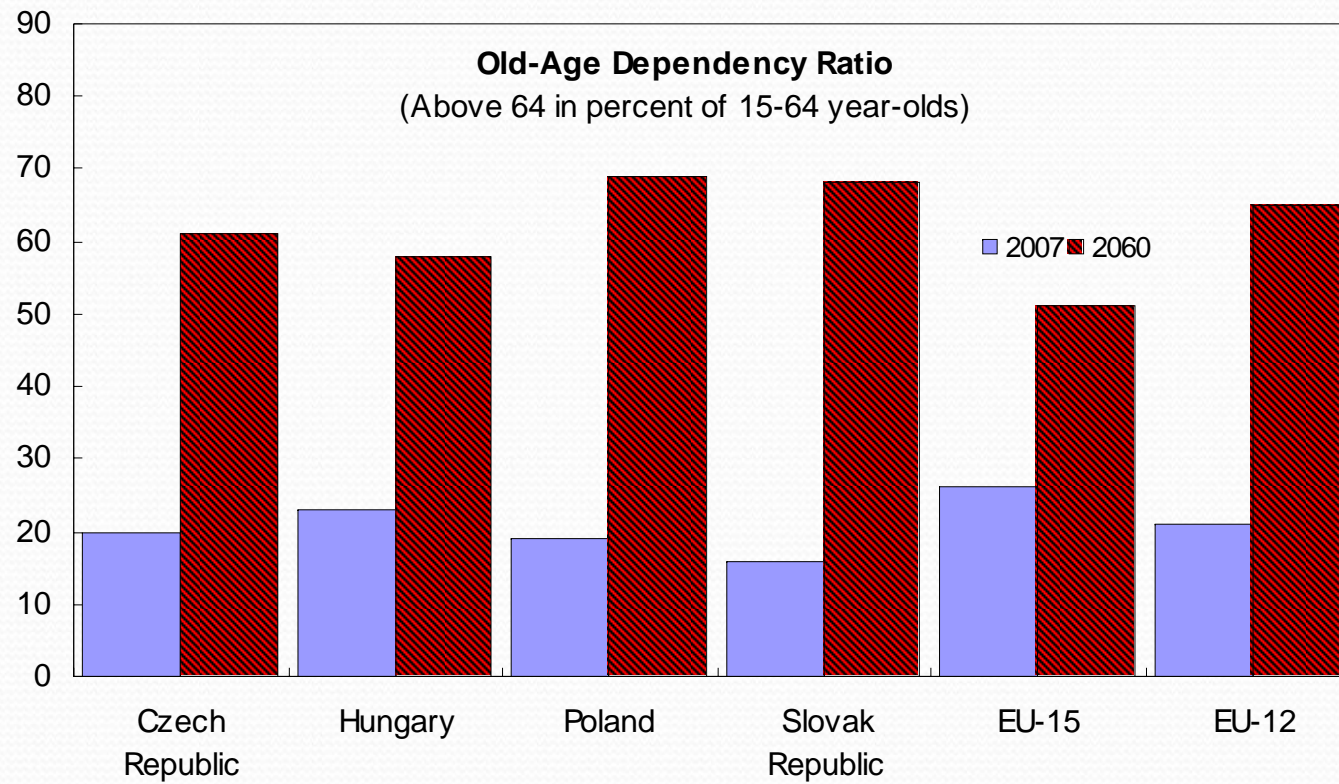
	1999-09	2007-09
China	9.2	2.1
United States	-1.2	0.5
Poland	1.0	0.4
Switzerland	-0.5	0.4
Japan	-1.1	0.3
Netherlands	-0.3	0.3
Bangladesh	0.5	0.3
Turkey	0.6	-0.1
India	0.6	0.2
Czech Republic	0.5	0.1
Slovak Republic	0.4	0.1

Exports of services started gaining only since EU accession



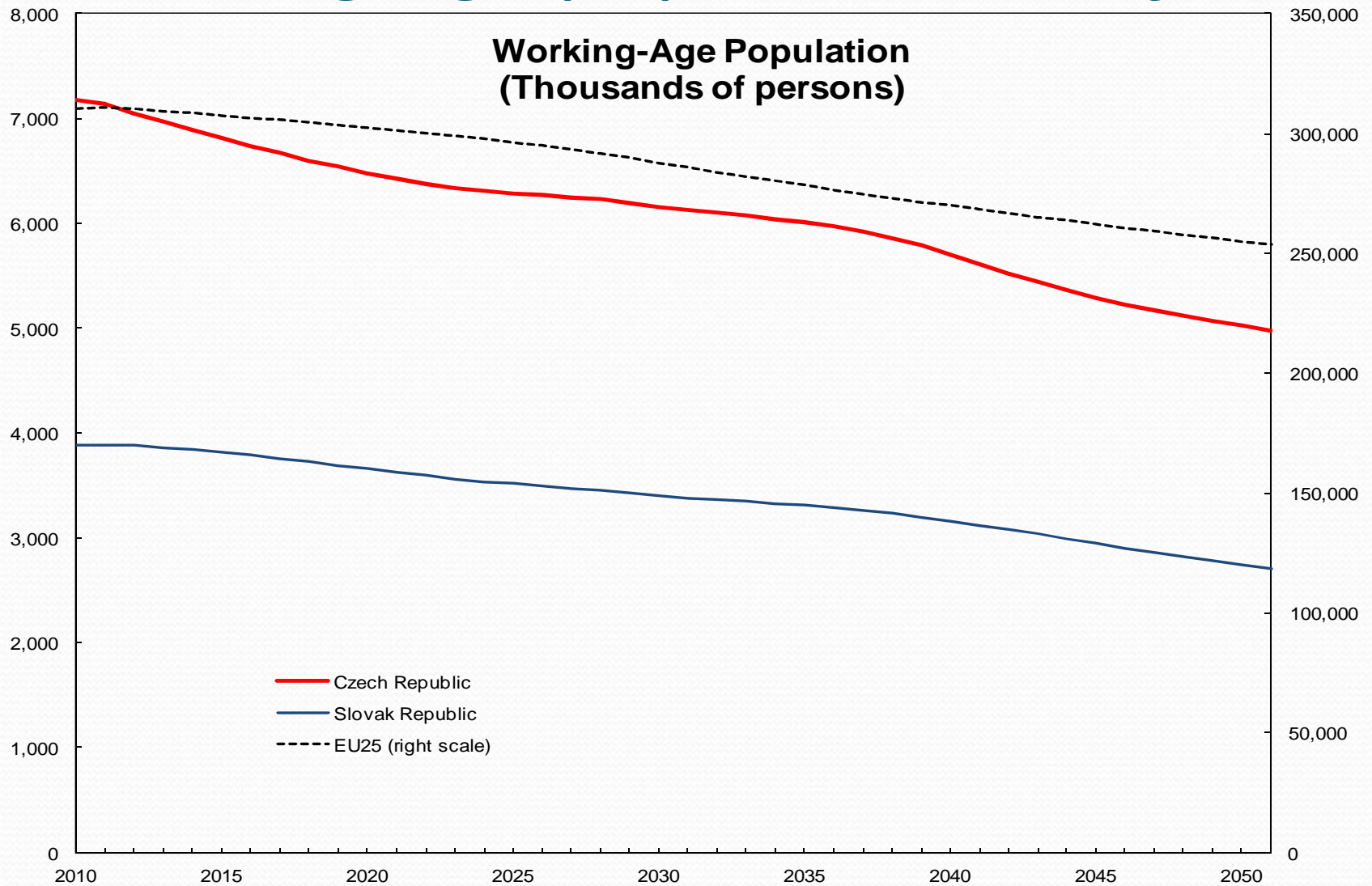
4.2 Boosting labor supply

Czech population is projected to age fast



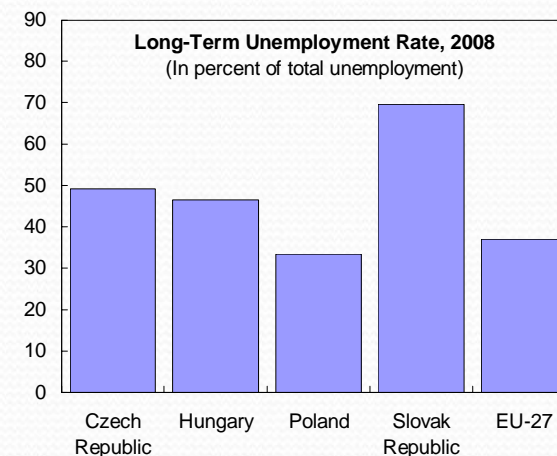
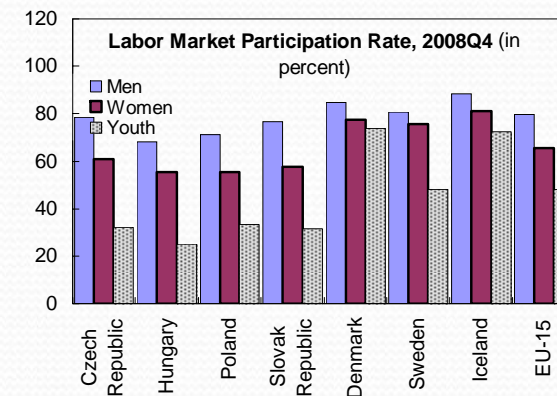
Source: European Commission.

Working age population will fall



Potential to increase labor supply

- Youth participation, while in line with rest of the region, declining and well below EU-15 average
- Female participation, while in line with EU-15, lags behind best performers in Europe
- Long-term unemployment remains high, in line with the rest of the region



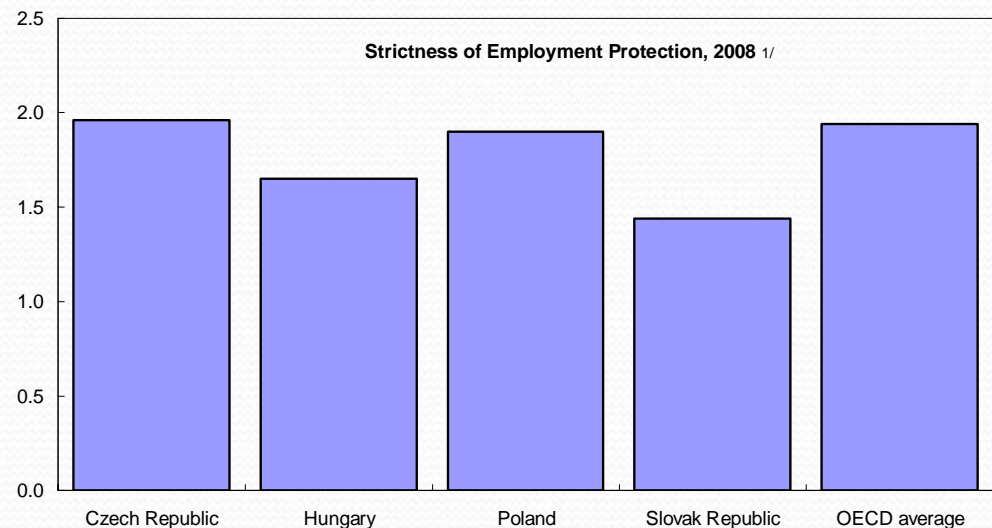
Source: European Union.

Reforms to boost labor supply

- Further improve work incentives for low-income households
- Enhance access to affordable daycare to further promote female labor participation
- Remove barriers to part-time work, including the minimum social security contribution
- Reduce age limit for eligibility for tax credits and child benefits from 26 years to 18 yrs

Reforms to boost labor supply (cont.)

- Reduce costly dismissal protection for short-term employment—link it to length of employment?
- Full liberalization of the rental market to promote labor mobility



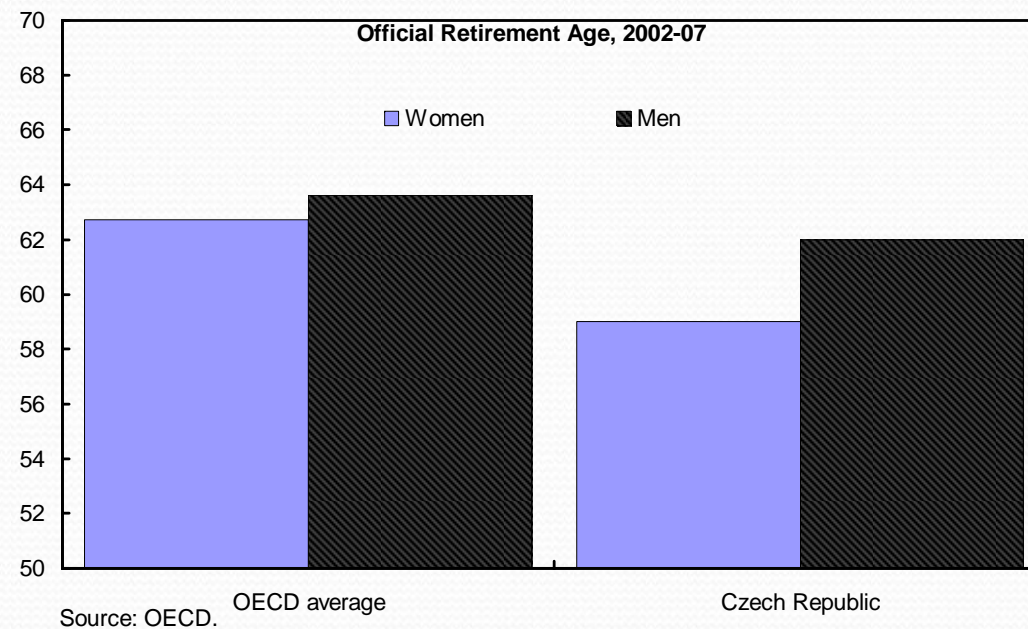
^{1/} The strictness of regulation on dismissals and the use of temporary contracts in a scale of 0-6.

Source: OECD

Current pension system allows early retirement

- Current *statutory* retirement age is low compared with most European and OECD countries
- *Effective* retirement age is even lower, reflecting *generous early retirement schemes and disability pensions*

Low statutory retirement age reduces labor force participation

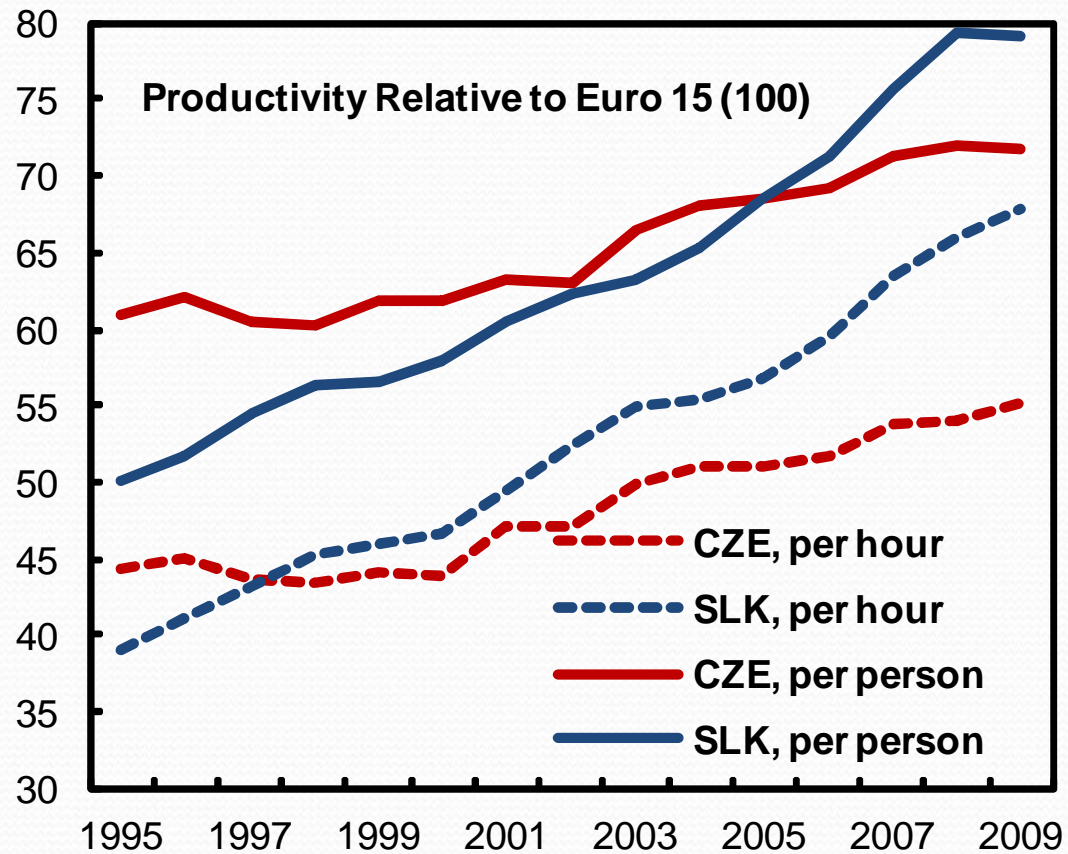


Further parametric changes to PAYG system would boost labor supply

- Recent parametric changes of the 2007 welfare reform package increase effective retirement age
- Moving forward to 2020 the increase in the statutory retirement age to 65 and introduce same retirement age for men and women?
- Further review overall work-retirement incentives, including reconsidering lengthening the period for early retirement to 5 years?

4.2 Boosting productivity

Productivity is still lagging



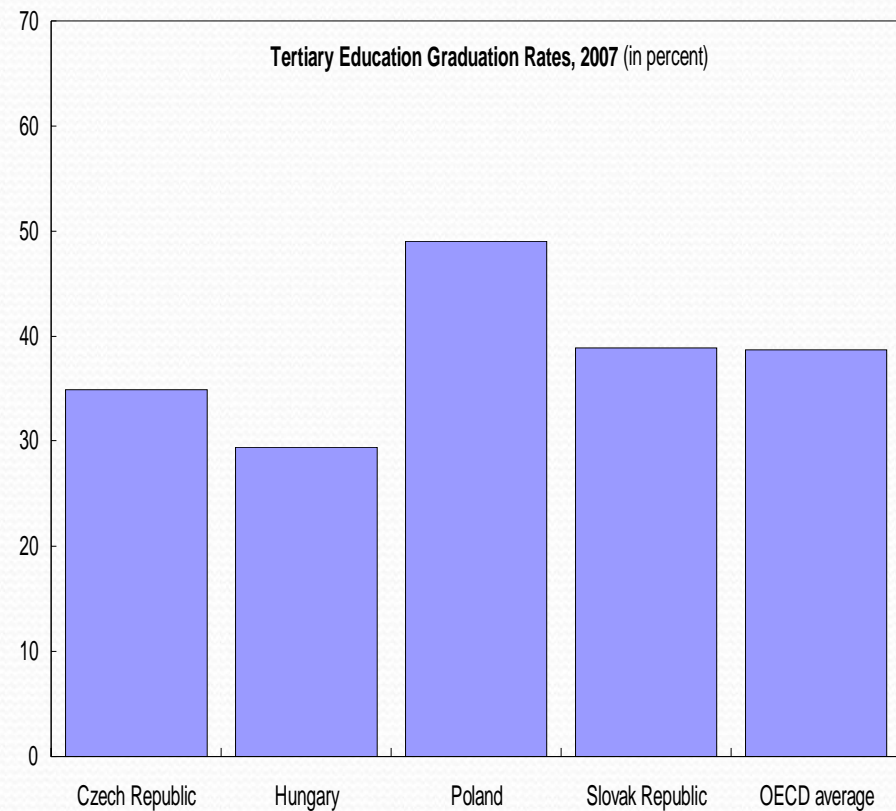


Concerns about Skills Mismatch, and Declining Productivity

- Too many vocational schools oriented toward traditional industries? Not sufficient capacity for more general pre-university secondary schools?
- Labor productivity has fallen sharply during current crisis

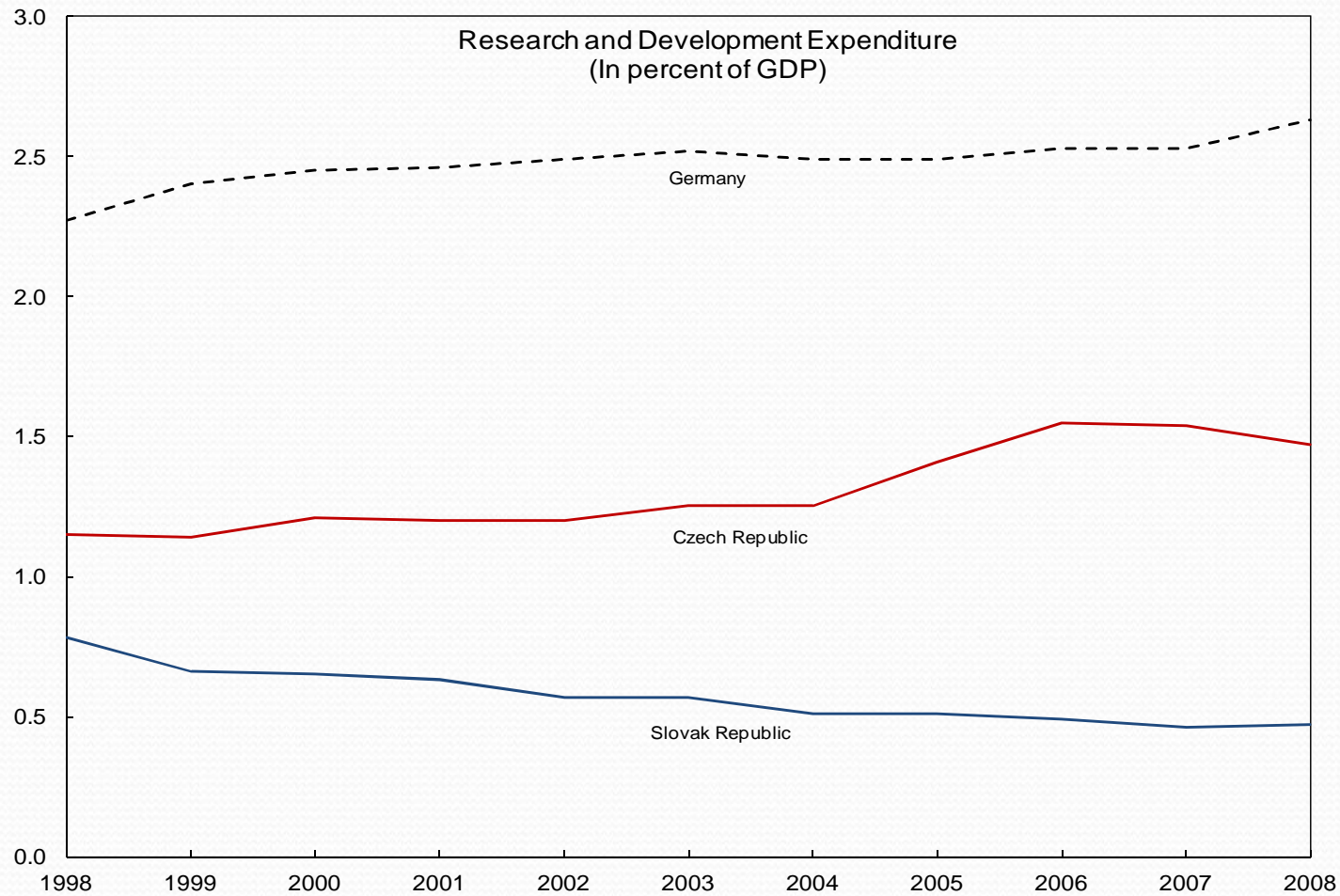
Graduation Rates Remain Low

- As economies matures, increasing demand for more general skills
- While tertiary education in the Czech Republic has expanded rapidly, graduation rates remain relatively low
- Recent EU study ranks Czech public spending on tertiary education system among the least efficient



Source: OECD

Spending on R&D is lower

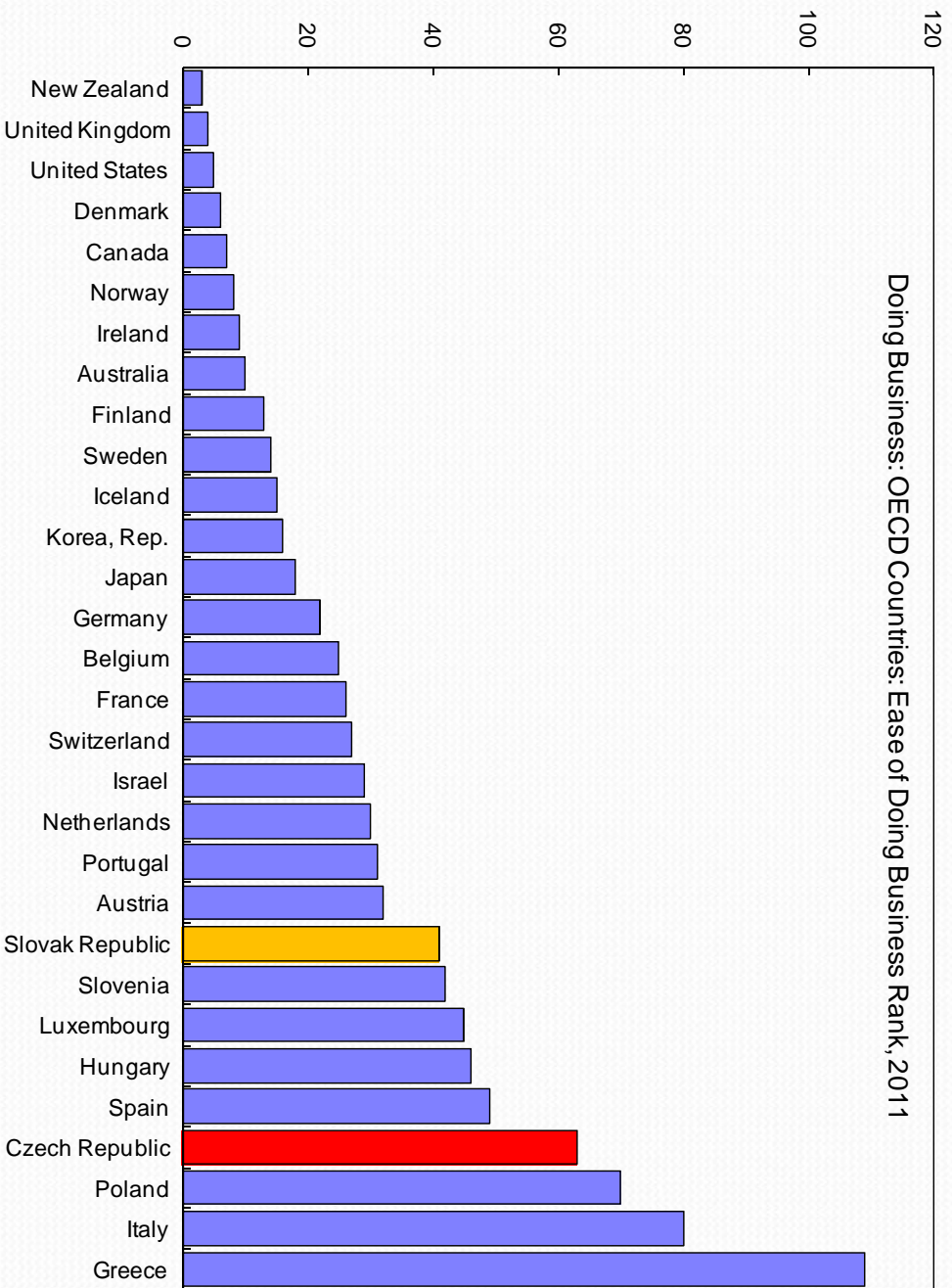


Reforms to Promote R&D and Productivity Growth

- Introduce university tuition fees to raise revenues and enhance efficiency, backed by student loans with income-contingent repayments
- Enhanced collaboration between employers and universities/research institutes to cope with changing skill requirements
- Expanded range of programs and improved access for adults, including through shorter-term studies
- Enhanced access to secondary training with greater emphasis on general competencies

4.4 Improving business environment

Business climate will be key to attract FDI and boost productivity



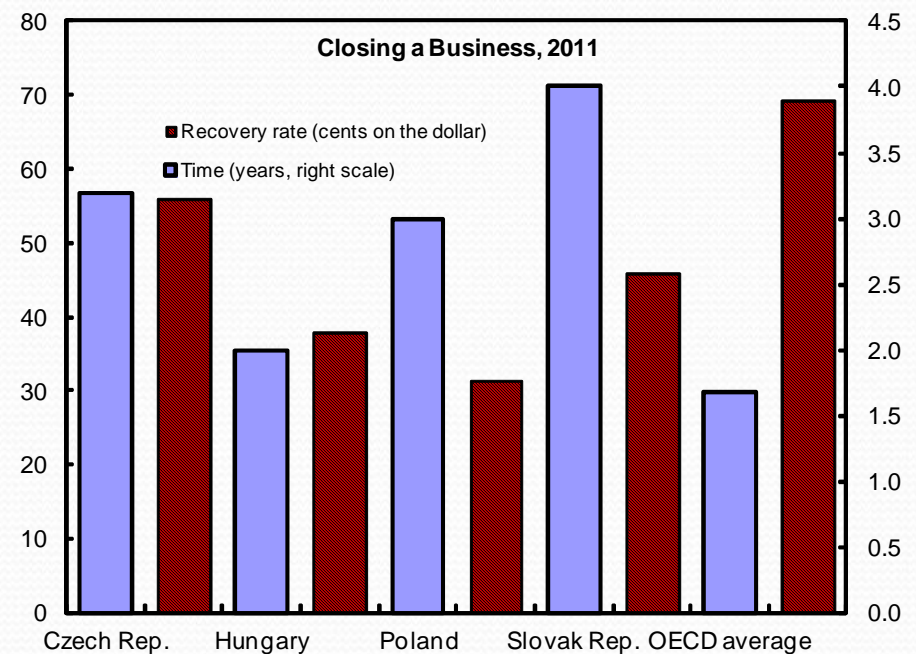
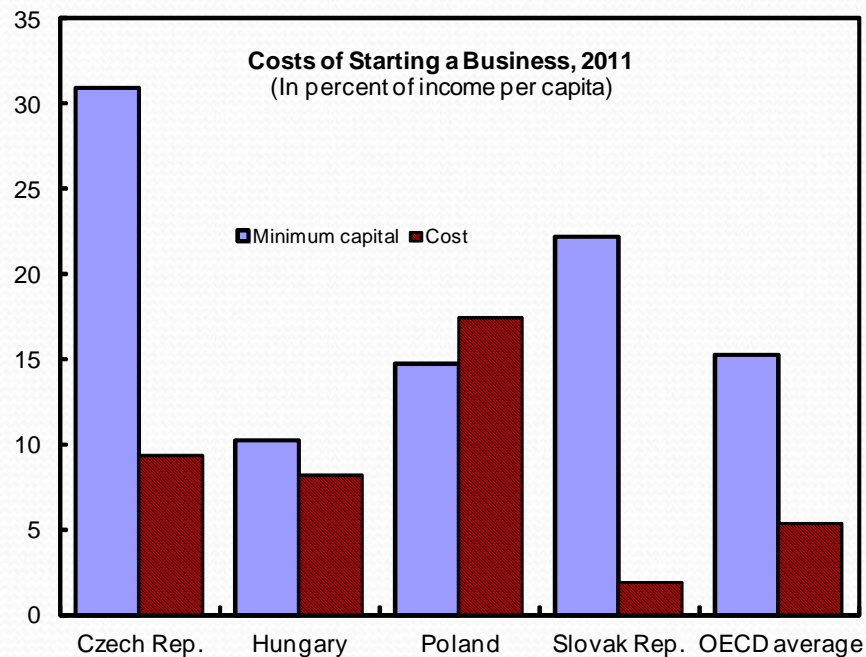
Business climate will be key to attract FDI and boost productivity

Doing Business: Rankings by Category, 2011

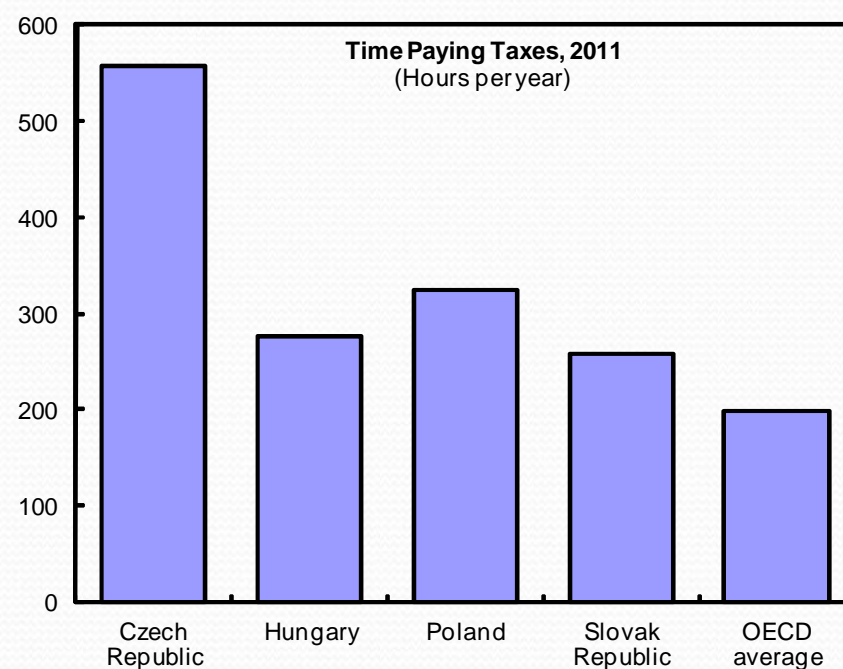
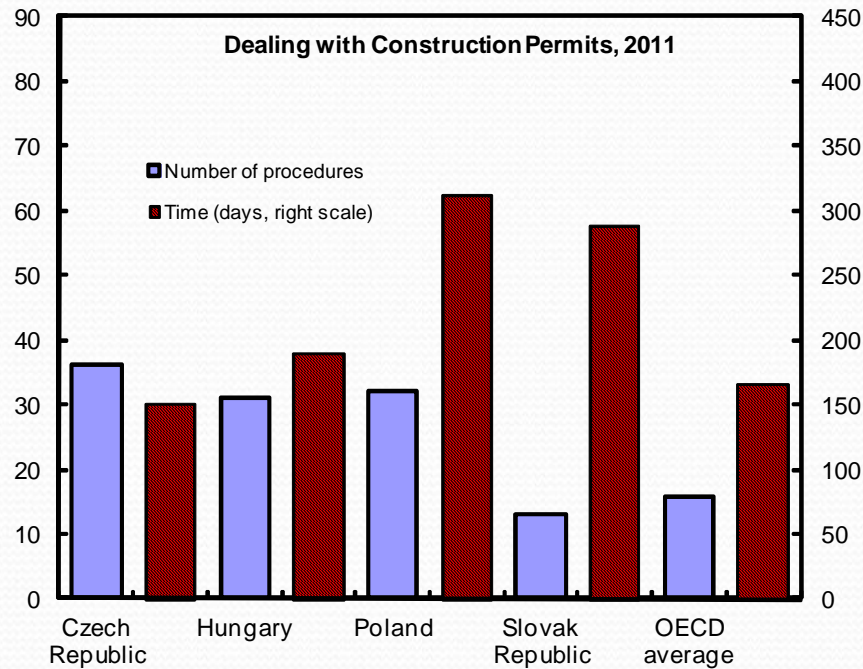
	Czech Republic	Slovak Republic	Germany
Ease of Doing Business Rank	63	41	22
Starting a Business	130	68	88
Dealing with Construction Permits	76	56	18
Registering Property	47	9	67
Getting Credit	46	15	15
Protecting Investors	93	109	93
Paying Taxes	128	122	88
Trading Across Borders	62	102	14
Enforcing Contracts	78	71	6
Closing a Business	32	33	35

Source: Doing Business.

World Bank Doing Business Report 2011: Starting and Closing a Business Particularly Difficult in the Czech Republic



Other concerns: Dealing with Construction Permits and Paying Taxes



Reform Proposals to Further Enhance the Business Climate

- Further streamline implementation of new trade and insolvency laws to encourage entrepreneurship
- Improve communication of rules and procedures
- Facilitate new business entry by reducing state ownership in network industries and strengthen competition in the gas sector
- Further focus on full implementation of e-government (business registration, paying taxes, public procurement, obtaining licenses and permits ...)



Thank You for Your Attention!