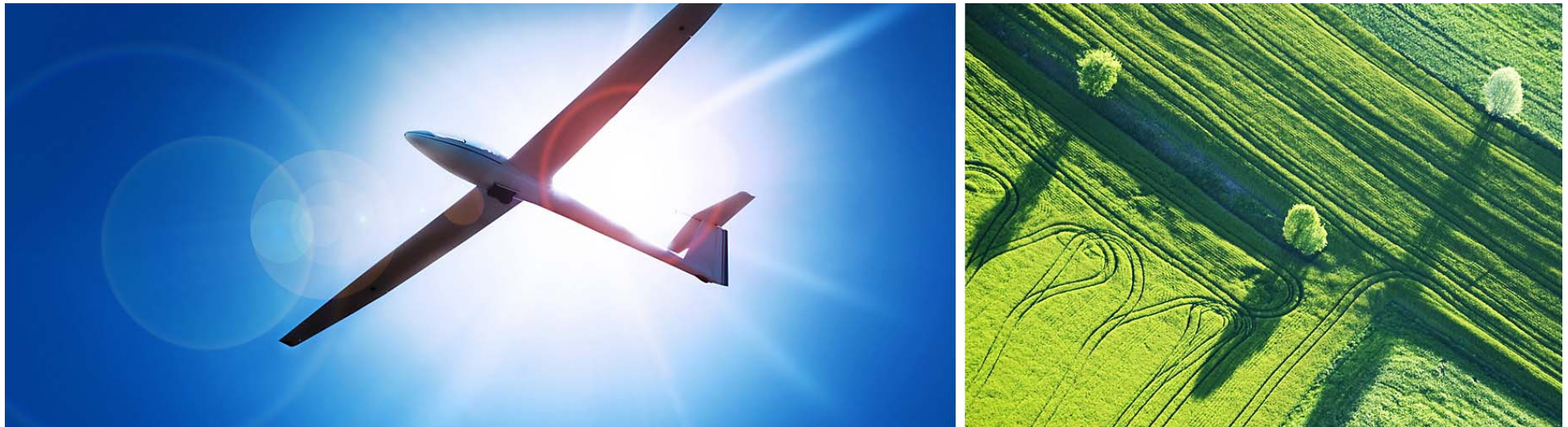


Czech competitiveness

Small things can make big difference (?)

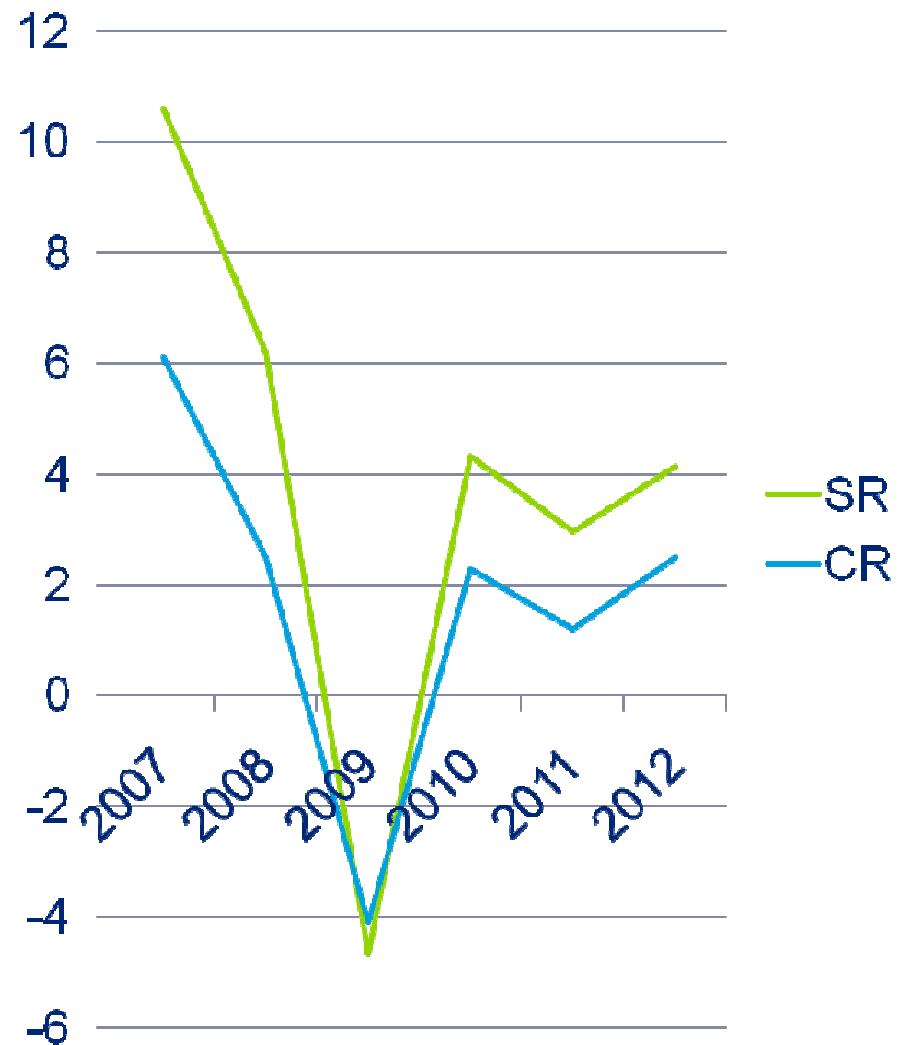


Luděk Niedermayer, Deloitte CR, CBA
Brussels, November 2010

Future growth – new normal?

- After years of prosperity, crises have changed the situation completely
- Despite of sound macro and financial situation growth outlook is far from pre crises level
- Combination of external factors (demand for export, over capacity, improving competition in some regions) and internal factors (nominal catch up, some weak domestics policies) can reduce future potential
- Also protectionism can hurt prospects for economies like Czech and Slovak

While there are domestics policies, that can improve outlook, impacts of uncertainty and possibility of weaker growth can not be in long run excluded



Macro/fiscal issues

- Most likely, fiscal outcome for 2010 and 2011 will be good, but the tools used are lagging behind the results
- Future budgets will depend on 2011 reforms, but they are far from being clear
- Also the sustainability of some policies (for more than one election period) is on stake

While the macro/fiscal situation in next years can be rather good, the key issue for business sector is uncertainty, both in short time (reforms) and also in long run (policy change)

Some uncertainty is there even in short run (taxes, some ad hoc measures etc.)

Key structural reforms

Current situation

- One of the worst demographic situations in the region
- One of the highest level of solidarity in pension systems
- Health care sector was benefiting from the fast growth of the economy, but now is experiencing deficits

Likely outcome

- Pension reform (if done properly) will be expensive and unpopular
- Health care sector problems can be even more pressing and could present problem even in shorter run

Further hesitation with the reforms can negatively influence the economy and increase uncertainty (who, how and when will pay the costs)

Labor market

- Economy is benefiting from good mix of costs, quality and infrastructure, but competition is stronger
- Regulation of the market is on EU average, but some requirements are rather extreme (cost of lay off)
- Even average EU regulation is not granting good results
- Some instruments, that can improve functionality of the market, are under utilized (part time jobs, flexible contracts)
- Other issue is unequal situation of employees and self employed, and small and large firms

Consequences

- Firms prefer to avoid hiring for permanent work contracts
- Most regulations have unequal impact on enterprises - for small firms some requirements are very restrictive and expensive, while large enterprises can deal with them more easily

„Small“ / Other / Micro issues

- Education – low quality, wrong incentives, weak link to development of the economy combined with high cost (state) and inability to make (propose and enforce) reforms
- Quality of public administration – often weak in all levels, transparency limited, no evaluation of the performance or efficiency. SOE management „political“, corporate governance not functioning
- Legal system – slow, unpredictable, often not understand business. Independence of judges is important factor
- Corruption, strange/incompetent tenders etc. – no comments

The consequence is higher cost of doing business, higher taxes etc
Level of inefficiency can not be easily compared with other countries
Progress so far seems to be limited

Big issues

Euro

- Contrast between objective needs of the economy and political position
- Very negative interpretation of current (negative) development even slows down the discussion

EU positions

- Bit short in competence and pragmatism, long in ideology
- Not efficient use of EU funds reducing potential of the economy

Issues are now highly political, structure of the economy is "European"

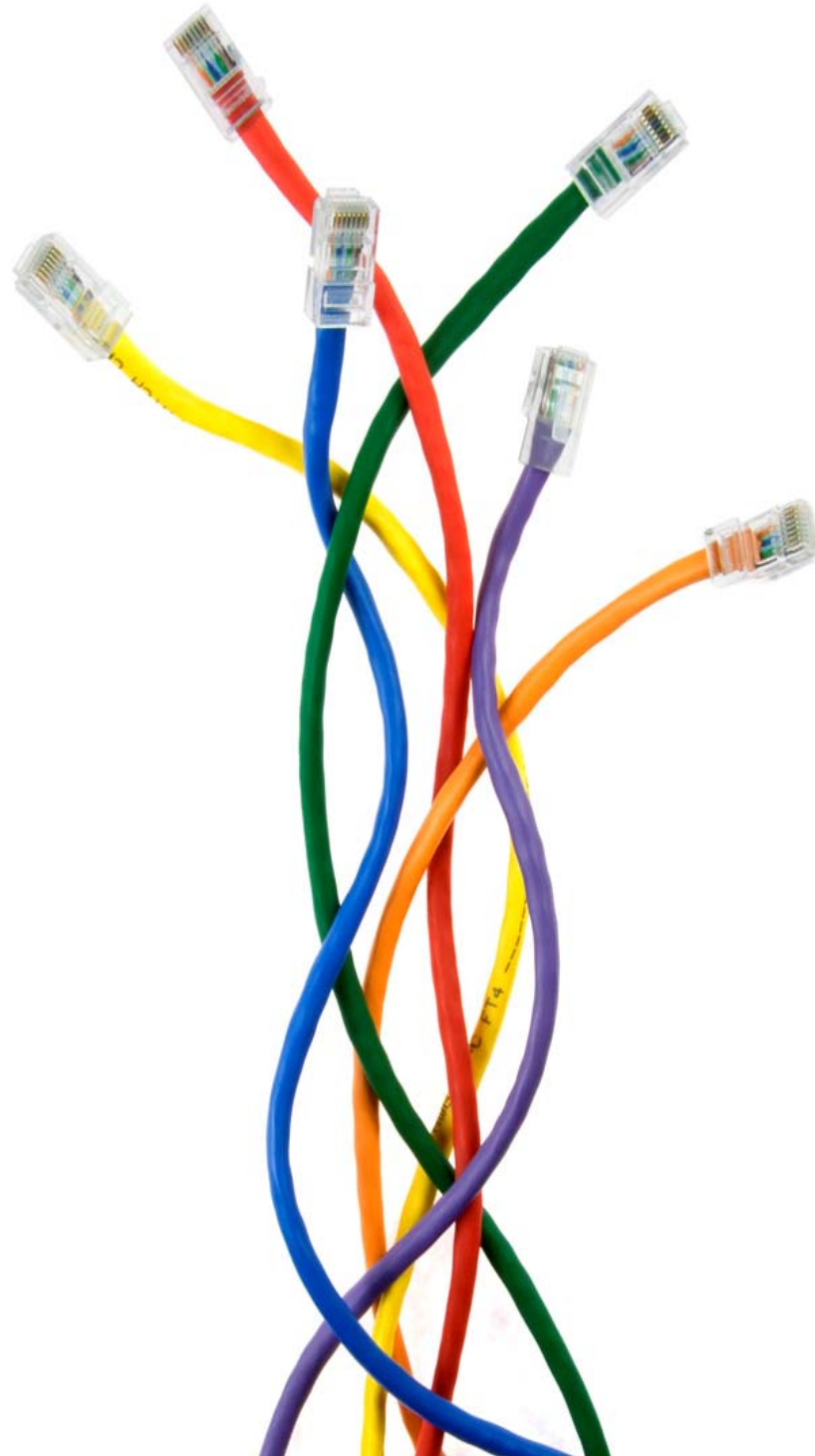
Also progress in nominal convergence was substantial

Upside from existence of monetary policy is now very limited

The currency risk is for economic growth substantial

Costs (regardless of currency development) for real economy are high

Summary



Czech bright future

- CR is not „on the cliff“ and „good time - bad policy“ holds for long time and also now
- Fiscal issue is (in EU perspective) manageable easily
- The „big issues“ (pension, healthcare) should be addressed competent way and asap
- Politic position on euro adoption can be costly for the economy
- Other „small“ issues should not be neglected. They are reducing our competitiveness, future perspectives and some are creating unequal positions for firms

Czech future?

- In absolute term, after progress at beginning of decade, improvement is not large, strong economy in decade is part of the reasons
- In the case of weaker performance, the pressure on policy will increase
- In relative terms, other countries in the region sometimes set quite a weak benchmark



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