Progress in economic catching-up with attention on trade and competitiveness

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In this paper an outline of economic growth, structural changes in foreign trade and its competitiveness is briefly presented. Due emphasis is placed on comparison and changes in foreign trade structures with respect to selected countries in transition - EU Candidates (the Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia).

1. Present level of economic development and short-term evolution in the Czech Republic and in comparison with selected countries

The economies in transition of Central and Eastern Europe are acceding to the EU with economic levels well behind those of current Member States. The Czech economy is the only transition country attempting to join the EU in the first wave, which went through four distinct phases of economic development during the 1990s. It recorded an initial transformation crisis (1990-1992), followed by economic growth (1993-1996), interrupted by a new economic fall (1998-1999). Indications of economic recovery emerged in the last part of 1999 (the whole year ended with –0.8 per cent), strengthen in 2000 (2.9 per cent) and further improved last year (with 3.3 per cent). The Czech Republic reached its prerevolutionary economic level first time in 2001 (GDP in constant prices compared with 1990).[1]

The Czech Republic as part of the Central and Eastern Europe is among the most economically developed countries of this sub-region. Per capita GDP (in purchasing power parity) has reached more than 60 per cent of the EU-15 average, for Hungary and Slovakia such indicator is app. 50 per cent, for Estonia and Poland it is app. 40 per cent. Only Slovenia has reached a higher level of more than 70 per cent.

[1] The Czech Statistical Office and A. Holub Study: Hlavní tendence vývoje ceské ekonomiky a její strukturální zmeny, Institut integrace VŠE, Praha, CR, 2002.

The economic level of the Czech Republic could be put on the similar level as in the time of pre-accession in Ireland and Greece and higher than the level of Portugal in the year they joined the EU. As far as the structure of GDP is concerned, the largest sector is the services sector and the share of the agricultural sector in the Czech Republic is comparable with the developed countries of EU. The Czech Republic is also well furnished with social and economic infrastructure.[2]

In restructuring and modernising its economy the Czech Republic, however, has made progress at a slower pace than some other candidate countries in the 1990s, as already indicated earlier. A good news is that in 2001 the Czech Republic achieved a GDP growth (3.3 per cent) of two percentage points more than EU-15 average and in this year it is expected to be more than one per cent (according to the Czech National Bank and the Economist forecast). Analyses point to the fact that this process is of a lasting nature, at least over the medium-term (by 1.2 - 1.8 percentage points).

The higher economic level already achieved and relatively high national savings in the Czech Republic have carried with it and are reflected in a higher rate of investment than in other countries in transition. However, the real investments are much lower than in the EU. The gross fixed capital formation per capita in the Czech Republic has been app. 60-80 per cent of the average level of the EU-15 (in purchasing parity standards). In other candidate countries the level was between 30-60 per cent (apart from Slovenia). As a result of past activity, the endowment with economic infrastructure is at a comparably higher level in the Czech Republic than in other candidate countries, except Slovenia. Anyhow, investments into modernization remain a key condition for a shift towards a more sophisticated production, which corresponds better to the education level of the labour force, its experience and traditions. Such a strategy is more in line with the conditions in the Czech Republic.

[2] For example the European convergence indicator, the DCEI shows that the Czech Republic has regularly achieved the best results of all the Central and Eastern European countries (currently with 78 points out of a possible 100).

According to the convergence scenarios[3] it is assumed that the current conditions in the Czech economy will allow, as already mentioned earlier, for 1.2-1.8 points in the average annual per capita GDP growth rate over the growth rate of the EU-15. This optimistic version of forecast means that the level of per capita GDP will come closer to the average EU-15 level, to around 70 per cent between 2008 and 2010 (from today's app. 60 per cent). In a case of enlarged EU (i.e. EU-25) a level of 70 per cent would be achieved as early as 2005 and in 2008 the ratio will have risen to more than 75 per cent. This level is a "threshold of competitive maturity". Owing to the extensive flood in August a lower rate of growth is expected this year. Next year, however, the GDP increment is expected in comparison to the earlier forecast.

2. Radical changes in external economic relations - foreign trade

As a result of advancing economic transformation and convergence, the foreign trade system and its functioning have principally changed. There has been some differences among countries as far as speed of these changes is concerned. It could be said by now that in all selected candidate countries the transformation of foreign trade system has been completed. In order to review its functioning, liberalization of foreign trade is a never ending process. There exist a permanent fight between liberal and protectionist practices among countries and or their integrated groupings (e.g. agriculture commodities, steel, etc.). They temporary end with a specific compromises, limited by time, area and intensity.

As a result of political and the above-mentioned institutional changes, the countries in transition have been more and more integrated with the developed countries and in this way increasingly affected by their economic and trade cycles. The countries in transition in order to support growth of exports in the 1990s they tried and partly succeeded in commodity diversification, improved trade flexibility and improvements in competitiveness, first of all in manufacturing industries. There was an

[3] It was prepared by a team of experts in accordance with a project assigned by the Czech Government Council for Social and Economic Strategy. The title is "Social and Economic Consequences of the Czech Republic's Integration into the European Union", Prague, May, 2002, p. 17.

increase in exports all over the decade except for 1998 and 1999, mainly influenced by recession and a lower demand of developed countries. Growth of exports resumed in 2000 and 2001 but with a lower rate and this trend continues also in 2002. There are differences among the countries with respect to foreign trade, taking into consideration both external and internal influences. Those countries which have progressed more in transformation (e.g. Hungary and Slovenia) show better results in trade than the others.

After a radical territorial trade restructuring in the beginning of the nineties its new shape has been further strengthen and in the end of the twentieth century the share of exports to the developed countries reached more than 80 per cent for Estonia, 3/4 of total for Hungary and Poland and nearly this level for the Czech Republic. There are some differences with respect to import shares, particularly for Slovakia (53 per cent) and Estonia (62 per cent), in other selected countries the share corresponds more or less to export figures. Substantial decrease all over the period has been recorded in trade among the countries in transition and with the developing countries.

The trade with the EU has undergone a rapid increase during the nineties. The highest level of integration in this respect has been demonstrated with Hungary and Poland, the lowest with Slovakia. As far as the trade balance is concerned, active results with the EU has Hungary since 1997, the Czech Republic and Slovakia since 1999, nevertheless, the Czech Republic recorded a slight deficit in 2000, changed it again to active balance in 2001. Growth of exports and positive changes in the trade balance have been favourably influenced by diversification of commodity structures and by higher trade flexibilities at the end of the analysed decade. The ongoing integration into the production and trade nets of multinationals resulting in increased participation of these countries in the western economies have had positive influence on trade dynamics.

The commodity structures have also shown a positive change in the analysed decade. It is first of all an increased share of machinery and transport equipment in total exports and at the same time the share of semifinished products and materials have decreased. Such trend is the most visible in Hungarian trade with the EU. All analysed countries have demonstrated decreasing dependence on imports of fuels, particularly

Hungary and Slovenia. As far as all food items and live animals are concerned, there has been decreasing trend in exports for all countries, the highest for Hungary and the Czech Republic, influenced by the EU agricultural policy and subordination of respective countries. At the same time, there has been recorded a decreasing dependency on imports of these commodities, but rather slower than with respect to decreasing exports.

3. The leading role of investments - key factor in improvement of trade competitiveness

The most complex analysis of competitiveness has so far been elaborated by the International Institute for Management Development, Lausanne, Switzerland.[4] The overall national competitiveness rating for the Czech Republic was the 35th position for 2001 (out of 49 countries), with a better rating position than Slovakia and Poland but worse than Hungary. Evaluating the overall position, based on the four groups of factors, the Czech Republic was the best in the group of economic performance, the worst in business efficiency (e.g. management practices, financial and labour markets/.

An important competitive factor and advantages for Central and East European Countries have so far been a lower labour costs in comparison with the developed countries, i.e. above all in labour-intensive manufacturing industries (textiles, clothing, footwear, fruit and vegetables, meat processing etc.). At the same time the analysis demonstrates that these industrial branches have not contributed to the competitive benefits, on the contrary. A number of commodities coming from a more sophisticated industrial branches like motor vehicles, electrical machinery, radio, television and other telecommunication equipment, all these have contributed to the competitive gains and demonstrate a market penetration as one could see e.g. from the attached table of the Czech case study. Similar conclusions could be found in the research results of Peter Havlík (Havlik, 1999).

[4] The World Competitiveness Yearbook 2001, Lausanne, Switzerland.

Table 1 Selected branches of Czech export with effective growth (%)

Industrial Branch	Total export		Export to EU-15	
	1995	2000	1995	2000
Motor vehicles	8.9	17.7	7.6	18.7
Electrical machinery	6.7	9.9	8.2	10.4
Radio, television and telecommunication equipment	3.5	5.3	2.1	3.2
Office equipment incl. computers	1.1	1.9	1.3	1.2
Manufacturing industries	100.0	100.0	100.0	100.0

Source: Sociální a ekonomický vliv vstupu CR do EU, vláda CR, Praha, brezen 2001.

Reflecting foreign trade demand, structural changes in the Czech manufacturing industries resulted in increase of four branches from 20 per cent share in total export of 1995 to 35 per cent of total in 2000. At the same time, the share of EU-15 in the total exports improved from about 19 per cent in 1995 to 33.5 per cent in 2000.

Growth of industrial specialization and increased export of engineering commodities has been accompanied by decreasing share of labour-intensive branches requiring lower qualification as well as research and development characteristics. It is related first of all to textiles, clothing, followed by foodstuffs, footwear and leather and woodworking industries. These trends, in the case of the Czech Republic, are recorded in the following table (see Table 2).

Table 2. Czech export according to the selected branch structure (%)

Industrial Branch	Total export		Export to EU-15	
	1995	2000	1995	2000
Textiles	7.5	4.7	5.9	4.3
Foodstuffs and beverages	5.0	3.2	0.7	1.3
Woodworking	3.1	2.2	4.6	3.8
Footwear and leather	2.6	0.9	2.5	1.2
Clothing	2.5	2.1	5.1	2.8
Manufacturing industries	100.0	100.0	100.0	100.0

Source: Sociální a ekonomický vliv vstupu CR do EU, vláda CR, Praha, brezen 2001.

It could be seen that the total export of the recorded branches decreased between 1995-2000 by 7.5 per cent. Only in the case of foodstuffs there was an increase in the share of export to EU-15 due to the transfer from other territories. To sum up, it could be said that the Czech ability to compete on the markets of developed countries has improved in the second half of nineties, first of all on the EU markets.

It has been proved in several countries in transition that a fast way of improving competitiveness as well as other economic characteristics, is to support inflow of foreign investments. Particularly, if the internal resources are not as much as is needed, in the case of these countries. Foreign direct investments (FDI) especially have advantage which is connected with easier entry into foreign markets with goods manufactured elsewhere. Legislative measures and investment incentives both have proved to produce good results. In a short period of time there has been substantial increase in inflow of FDI, as one could see from the following table (see Table 3).

There had been some fluctuations in inflow of FDI up to 1997, after this year we could see a rapid growth, which is among others influenced by legislative measures. An increasing confidence of investors with respect to the transformation process and the proximity of accession to the EU have played into their hands.

Table 3. Inflow of foreign direct investment into the selected Central and Eastern European Countries, 1990 - 2000[a/] (Million dollars)

	1990	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
Central Europe[b/]	480	9230	7979	9 462	15478	18748	20104
Czech Republic	132	2562	1428	1 300	3718[c/]	6324[c/]	4595
Hungary	311	4454	2275	2 173	2036	1970	1700
Poland (cash basis)[d/]	10	1132	2768	3 077	5129	6471	8294
Slovakia	18	202	330	220	684	390	2075
Slovenia	4	177	194	375	248	181	176
5 Countries total	475	8527	6995	7 145	11815	15336	16840
Baltic states	.	454	685	1142	1863	1139	1173
Estonia	.	202	151	267	581	305	387

Source: Economic Survey of Europe, 2001 (Table B.17)
Note: a/ Inflows into the reporting country.
b/ Excluding Bosnia and Hercegovina and Yugoslavia,
c/ The Czech data for 1998-1999 incorporate also inter-company loans,
d/ 1990 net of residents' investments abroad

Effects of FDI, some of them already mentioned, are far from being incontestable, a number of negative directions can be said here. Increasing foreign investor interests create opportunities for firms to participate in subcontracts for the final products. Such opportunities require great reinforcements from the local companies as well as governments. The results have been so far rather weak. FDI have in many cases created enclaves surrounded by backwardness, capacity destructions and lay-offs of the workforce.

At the national level, it could be related to growing foreign trade deficits as well as social tension. Without going into details, it is therefore essential to overcome step by step the present situation and utilize the opportunities connected with inflow of foreign capital at both corporate, regional and national levels. At the same time, it is necessary to create adequate conditions to continue with foreign investors on long term basis. Otherwise, there will be slower pace in restructuring, improvement in competitiveness, which could lead to problems in catching up with the EU.

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