



**Presentation at the conference held in Guatemala City  
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**La atracción de inversión extranjera directa, la  
promoción de exportaciones y el desarrollo exportador  
en el marco de las alianzas público-privadas**

# **Policies for Competitiveness and Development in the Czech Republic**

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**The presented study is a part of the ECLAC project on  
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# What is the value added?

Most varied policies of transition and restructuring:

- \* from planning to markets (& planning)
- \* from autarchy to globalization
- \* from middle income to high income
- \* from state monopolies to SME & to MNC
- \* via adjustments to changing comparative advantages:
  - in simple labor
  - in financial capital
  - in human capital
- \* via balancing the economic and social objectives.



# Czechia : 10,5 million inhabitants / as in Portugal, Cuba, Ecuador o Guatemala

In 2007:

<i>GDP nomin.</i>	<i>\$ 175 bil.</i>	<i>Venezuela, Columbia</i>
<i>at PPP</i>	<i>\$ 249 bil.</i>	<i>Portugal, Chile</i>
<i>per capita nomin.</i>	<i>\$ 17 069</i>	<i>S. Korea, Trinidad</i>
<i>at PPP</i>	<i>\$ 24 235</i>	<i>Portugal, Bahamas.</i>

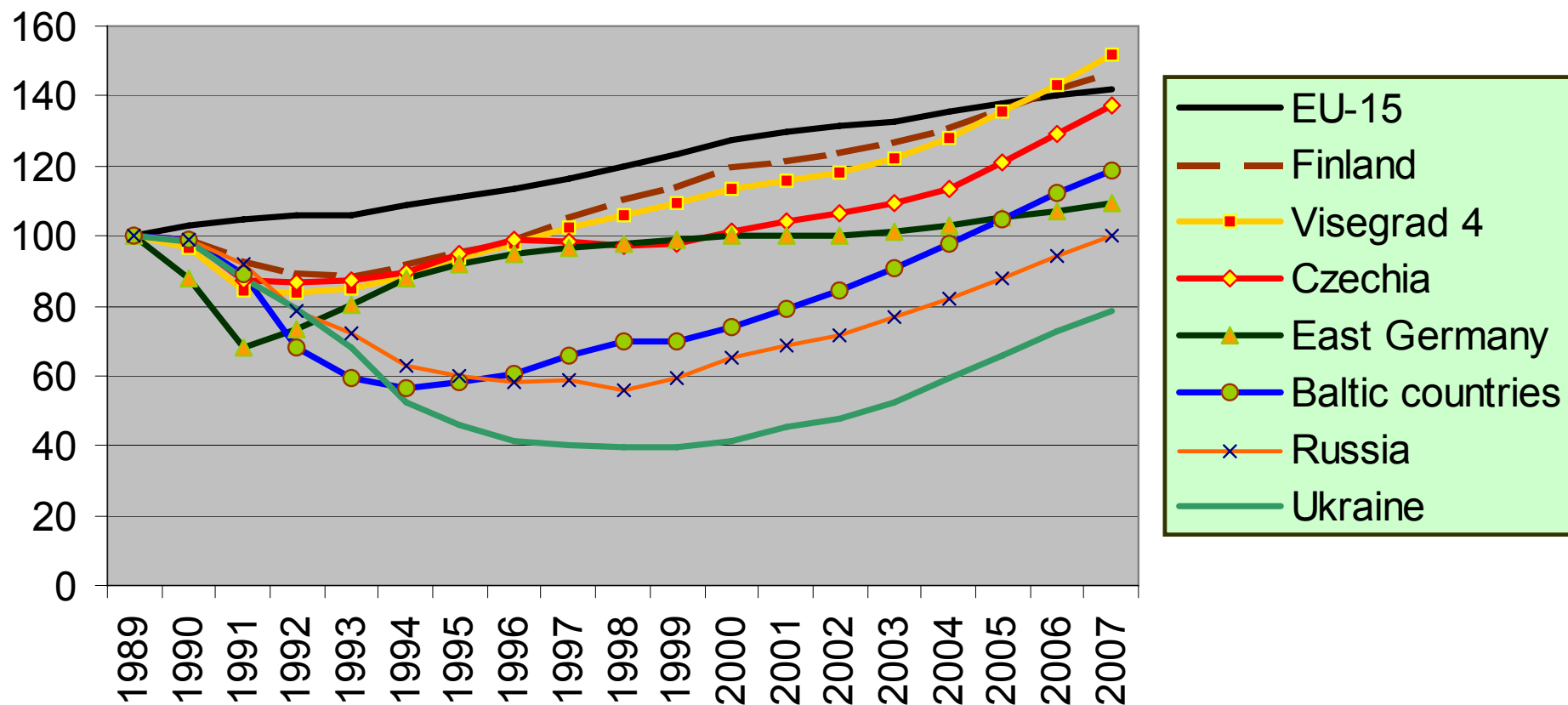
**Stress on the government's microeconomic policy side:  
Structure of firms in the Czech economy 1990 – 2006**

INDICATOR:	1990	1991	1993	1996	2000	2006
All registered firms	19	179	1119	1321	1963	2388
Physical entities (self-employed)	17	124	983	1001	1426	1681
State enterprises & institutions	1.6	3.5	3.3	2.2	1.2	0.7
Private firms and corporations	0.5	5	39	113	188	257
Joint-stock companies	0.043	0.7	4	8	13	17
Firms with limited liability	0	3	32	131	165	222
*Firms with foreign owners	0	0.5	9	35	81	131
Unemployment rate in %	0,8	4,1	2,6	3,9	8,6	7,3



# The real GDP growth of transition countries in 1989-2007 - comparison with the EU-15

Source: UN ECE, Geneva, 2008



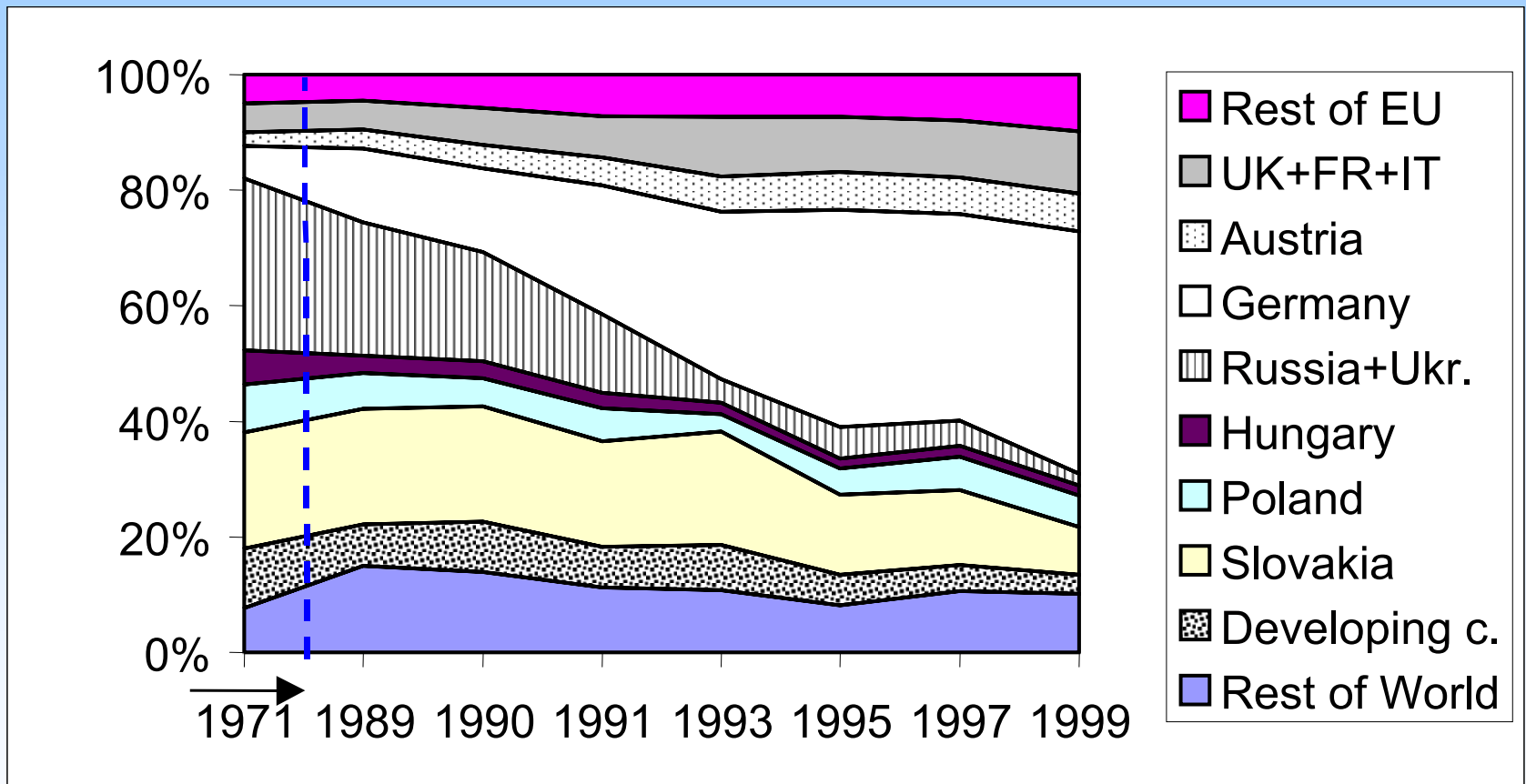


# Czech achievements after 1989

- \* Macroeconomic stabilization in 2 years (low inflation, stable ER, balanced budget, unemployment 4%).
- \* Peaceful separation of the country and its economy.
- \* **Trade diversion completed in 4 years.**
- \* Privatization completed in 7 years (2% vs 82% share on GDP).
- \* EU accession in 2004.
- \* **Growth of trade to EU-15 at 13% (1993-2008).**
- \* **80% of the export growth driven by quality upgrading.**
- \* 62% of exports contain high or medium technologies.
- \* **Success in promoting the FDI inflows.**
- \* Development policies based on strategic planning.
- \* **Economic policies sensitive to social equality and cohesion.**



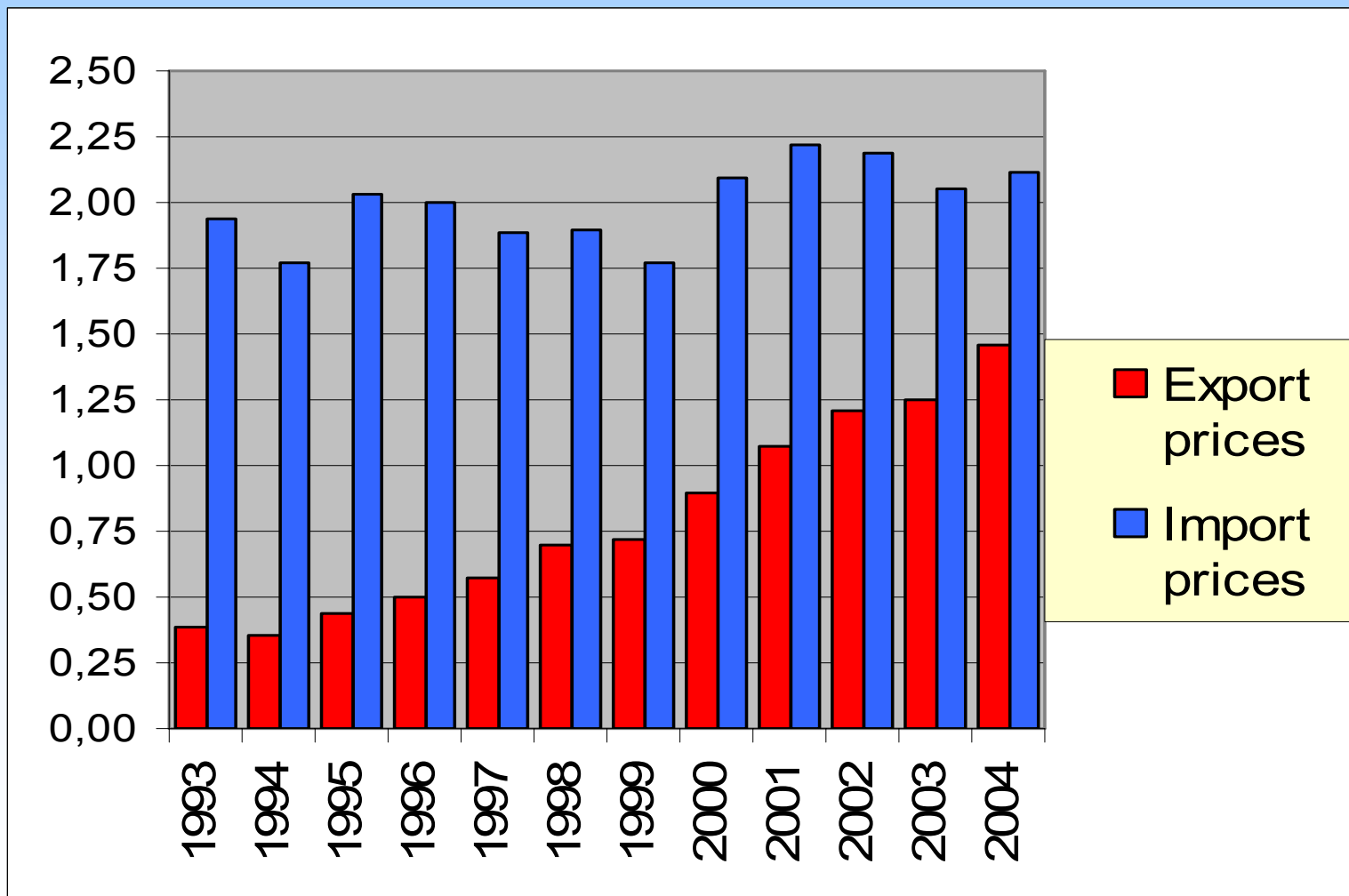
# Geography of Czech exports: 1971 - 1999



Source: Trade statistics, Czech Statistical Office, 1973, 1994 and 2000



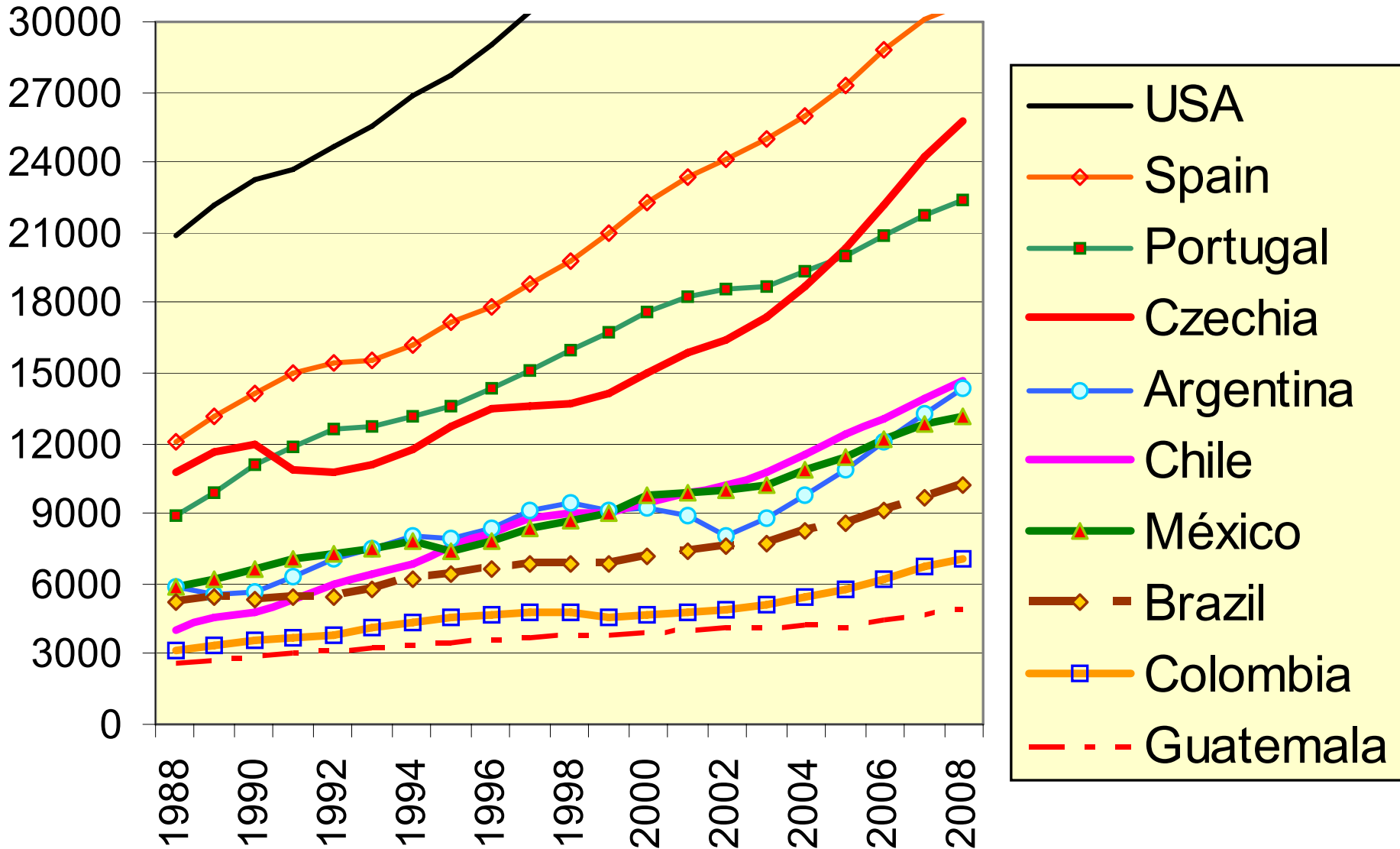
# Unit (kilogram) prices of Czech exports & imports with the EU in real EUR



# Economic growth in Europe and America

The Real GDP at PPS in constant \$ per capita

Econstats, the WB, 2008





# Catching-up in the GDP 1989-2008

## Czech GDP per capita vs. México and Guatemala

Econstats, the WB, 2008

### NOMINAL GDP \$ per capita:

	Czechia	México	Guatemala	Méx/Cze	Gua/Cze
1989:	\$ 5 589	\$ 2 730	\$ 963	49%	17%
1991:	\$ 2 636	\$ 3 709	\$ 1 035	141%	39%
2001:	\$ 6 077	\$ 6 282	\$ 1 714	103%	28%
2008:	\$ 20 607*	\$ 8 914*	\$ 2 619*	43%	13%

### PPP GDP in intl \$ per capita:

	México/Cze	Guatemala/Cze
1989:	53 %	24 %
1991:	64 %	28 %
2001:	62 %	25 %
2008:	51 %	19 %



# Czech development & industrial policies - reforms & strategies

**Transitions: command system – libertarian capitalism –  
home-tailored market economy**

- **Performance of int. trade and FDI** **+++**  
Quality upgrading, export of HK, fast growth,  
clusters, regional cohesion
- **Entrepreneurship in private and public sectors** **++-**  
MNC and SME cooperation, spillovers, competitiveness
- **Restructuring, innovation and growth** **++-**  
Support to reallocation, education, R&D, ICT,  
infrastructure and “sound banking”
- **Institutional revamping** **++-**  
Performing laws, judiciary, public services, regional  
development; income equity, social welfare, civil society,  
sustainable growth



# Two domains of development & competitiveness

## In internationally traded sectors

Evolution of comparative advantages – L-K-H endowments  
Economies to scale & product diversification  
Access to oligopolistic networks  
“Optimal” exchange rate & low transaction costs.

## In internationally non-traded sectors

Is their competitiveness (efficiency) irrelevant ??? :  
Endogenous prices (Balassa syndrom)  
Externalities of the NT sectors  
Collusion between the public administration & private enterprises vs. PPP opacity & corruption capture.

**The danger of a two-speed economy:  
the trap of two discontinuous policy regimes.**



# Czech experiences with the PPP

## Experimenting with 4 models of the PPP:

- Authoritarian without private capital – 1948-89
- Neo-liberal / US style – 1993-96
- Conservative pro-national – 1992-97
- Open to world competition under industrial policies – 1998-2008

## Lessons:

**PPP is omnipresent (explicitly or implicitly) !!!**

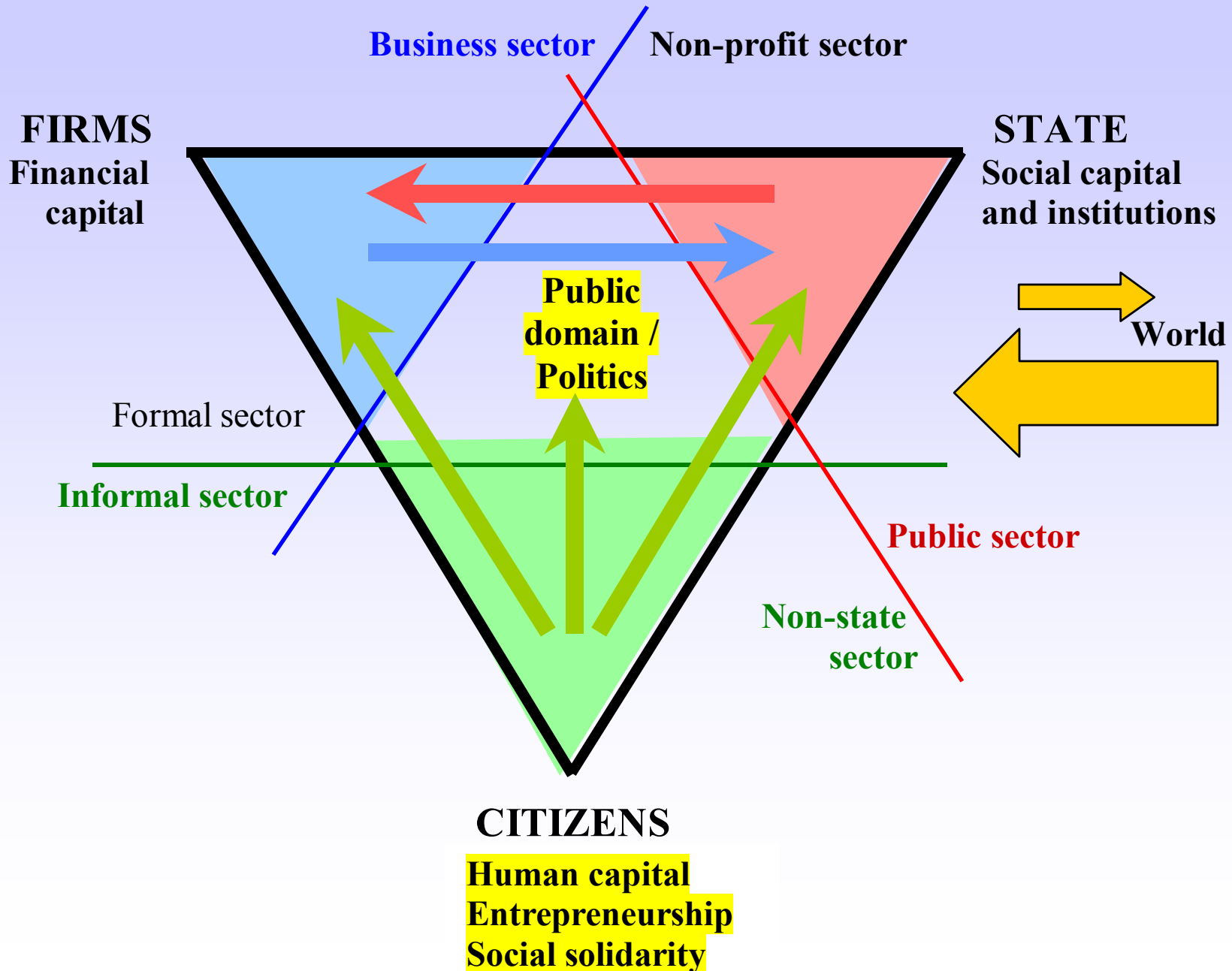
**Politics & governments can never be neutral**

**Objectives and institutions do matter**

**You cannot leapfrog over the stages of  
development**

**Flexibility & transparency of policies are crucial.**

# The gradual buildup of the democratic social governance





# P-P alliance for investment attraction, innovation and export development

## Necessary conditions:

- \* **Consensus** in the public domain (politics).  
Triangular hedging – checks and balances.
- \* **Entrepreneurial productive** aims in all partners.
- \* Complementary relationship between public administration and enterprises in solving **information and coordination externalities**.
- \* Government targets the provision of **public goods only**.

*Negat.: rent-seeking, capture, corruption, subsidisation of private goods.*



# P-P alliances as policies of long-run development and entrepreneurship

## Rules to be followed: DOs

- 1/ Macroeconomic stability – necessary but not sufficient condition
- 2/ Prudent finance – conservative private banking
- 3/ Entrepreneurial spirit – FDI, SME, competent public administration
- 4/ Legislation & judiciary – contracts with low transaction costs
- 5/ Market failure prevention – government surveillance/intervention
- 6/ Indirect development policies – hard budget discipline, pro-investment climate, critical factor development (e.g. human capital, ICT, infrastructure) – Dani Rodrik, 2004
- 7/ The government needs **the best brains** (Singapore) – design of policies, supervision and moral guarantees.

## To be avoided: DON'Ts

**The government is not a natural principal – risk of moral hazard, government capture, opacity, adverse selection and corruption**

**The main danger to development comes from inside (weak domestic politics), not from outside.**



# The buildup of P-P infrastructures (policies) I.

**How to divide labour, decision-making and responsibility between public and private spheres ?**

**Criteria:**

**What is the share of public good & externality on given activity? What is the cost of a policy?**

**→ opportunity cost /benefit/ analysis **or ...****

**→ learning by an intelligent immitation.**



# Reforms & the social considerations:

## Keeping a fair distribution of the income per capita

### Gini coefficients of the income distribution (in %):

Country	Year	Gini coef.	Year	Gini coef.
EU-15	-	-	1996	32
Czechia	1988	20	2002	27,3
Slovakia	1987	19,5	2000	27,8
Hungary	1987	24,4	2001	28
Slovenia	1987	19,8	2001	28
Romania	1989	23,3	2002	32
Poland	1987	25	2002	35
Bulgaria	1989	21,7	2000	37,1
Russia	1991	26	2001	51,8

Source: The World Bank, Social Statistics, 2004



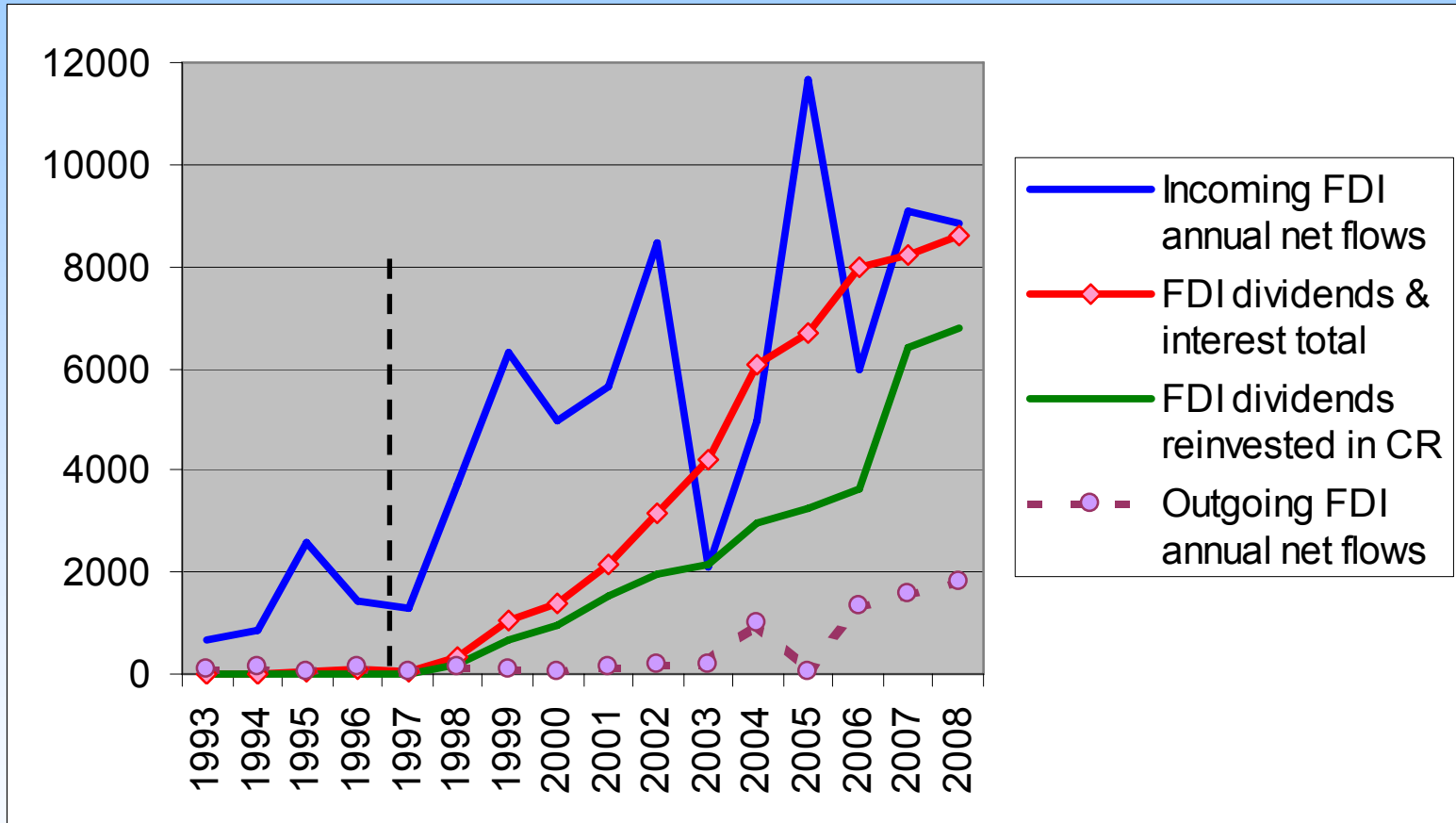
# CZECH FDI STATISTICS in \$ mil.

## Incentive schemes were launched in 1997



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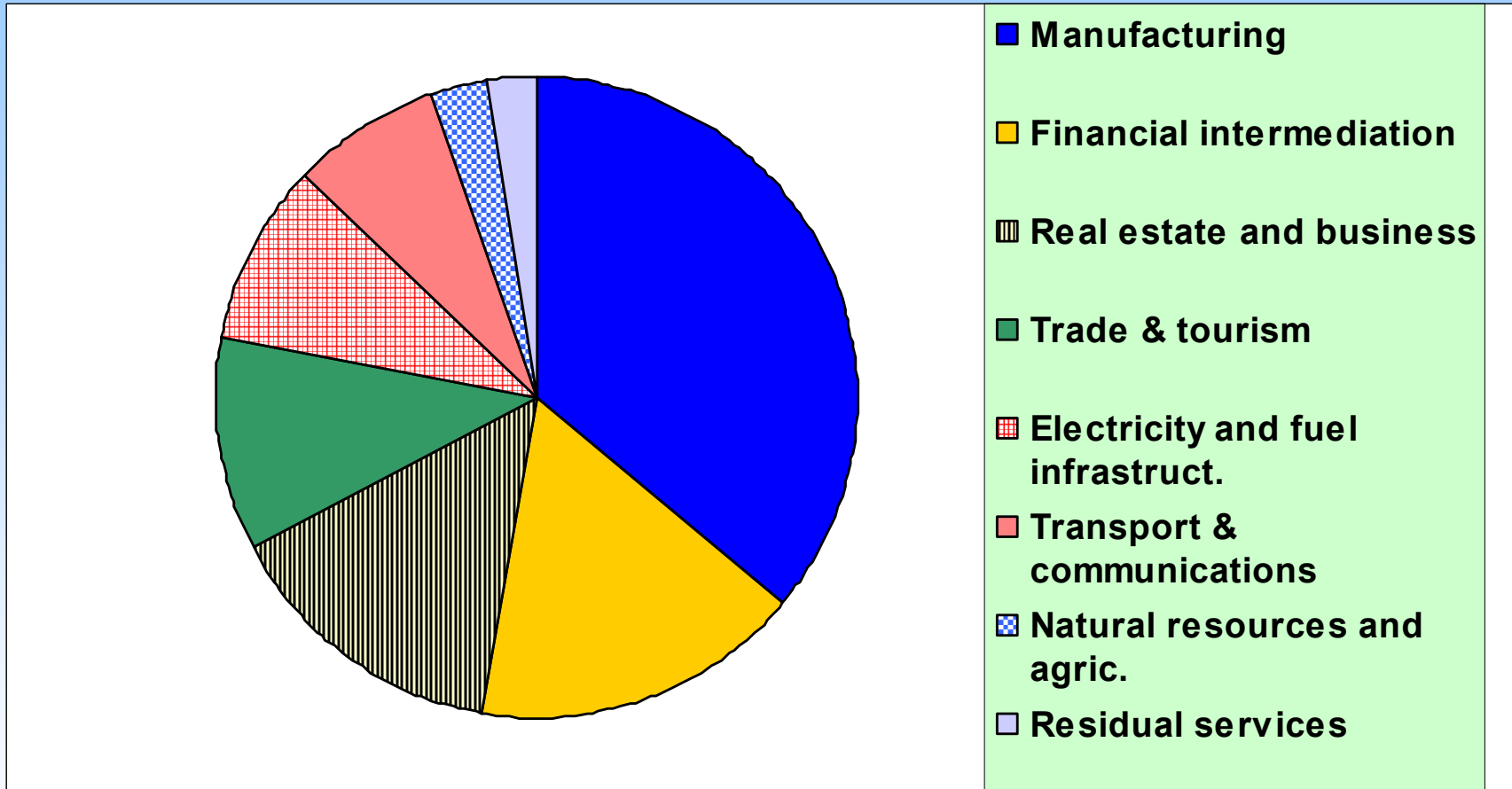
CEPAL



**FDI stock in 2008 = 124% relative to GDP nominal**  
**32 % of all productive capital stock**  
**\$ 9648 per capita in prices of 2006**



# The structure of FDI stocks in 2006



**FDI stock \$ 80 billion, of which manufacturing \$ 29 bil., (automobiles \$ 8 bil., machines & instruments \$ 6 bil.)**



# **First Principles for the Big Bang period (1993-97):**



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## **List of DOs:**

- 1/ Political partnership, social peace**
- 2/ Privatization needs performing laws, banks and safety nets.**
- 3/ Build SMEs and support the self-employment even under tax holidays.**
- 4/ Guard the market competition & contestability.**
- 5/ “Infant market” policies:**
  - hard budget constraint,**
  - pro-investment climate,**
  - support of the fringe competition.**



# Quality Development Period – 1998-2008



## Government document

**"Strategies of Economic Development 2006-2012"**

**followed by a parallel plan of CzechInvest**

**"Strategies of Growth Promotion 2007-2013"**

**Matrix of barriers → Development programs:**

Constraints resolution ↓	R&D / innovation creation	R&D / innovation transfers	Entrepreneurship – R&D implementation
Human resources	...	...	...
Financing	...	...	...
Legislation	...	...	...
Organization/environment	...	...	...
Coordination, cooperation	...	...	...



# Quality Development Period – 1998-2008

## **Government infrastructure:**

**Strategy of Sustainable Development / 2015: Government Taskforce  
of Experts**

**National Development Plan I + II (2007-2013)**

**Research and Development Council of the PM: National Innovation  
Strategy + R&D Policy + National Innovation Policy for 2005-2010**

**CzechInvest: Economic Growth Promotion Strategy**

**CzechTrade: Export Strategy 2005-2010**

**Strategic Reference Framework for the EU Funds 2007-2013:**

**\$ 1.5 bil annually for projects in education, R&D and innovation.**

**Plus Government R&D spending of \$ 1.2 bil.**

**Export Bank, Export Guarantee & Insurance, Academy of Ec. Diplomacy**



# Main actors in the new strategy of Quality Development 1998-2008

- 1/ Vice Prime Minister for Development**
- 2/ Ministries: Industry & Trade; Education & Science; Finance; Regional Development.**
- 3/ Partner ministries: Labor & Social Affairs; Justice; Transport; Healthcare; Academy of Sciences.**
- 4/ Tripartite board of social partnership: government–businesses–trade unions.**

**Coordinator: CzechInvest**

**Private sector partner: Association for Foreign Investments.**

**The use of public funds:**

**More state aid to the interface between manufacturing and services (CZ 3% of the value added while in EU-15 1.5%)**



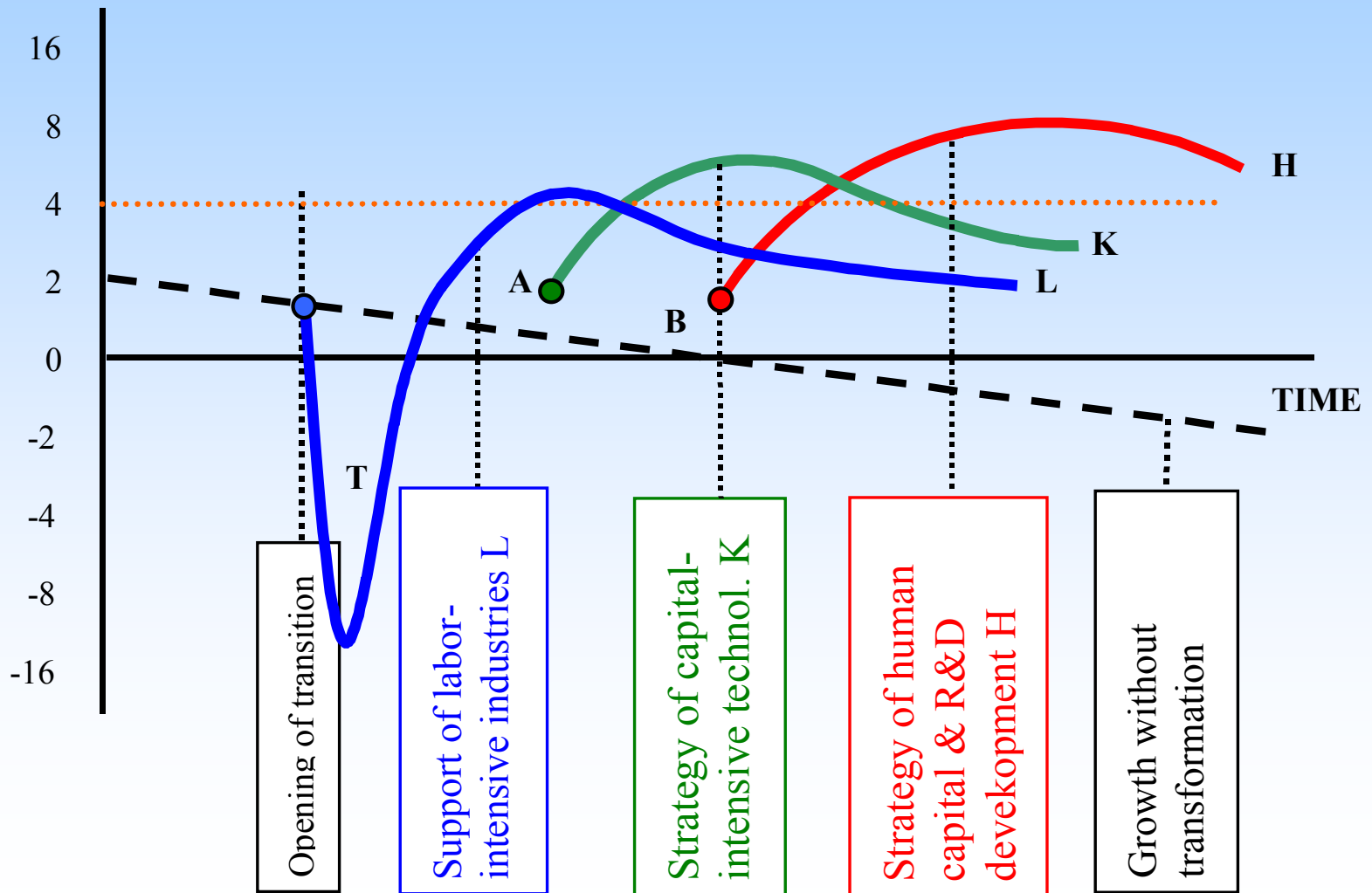
# DO's of the Quality Development period 1998-2008:

- 1/ Support the supply of human capital – restructuring of secondary and tertiary education.**
- 2/ Promote the demand for knowledge and technologies - promotion of investment into “new activities”.**
- 3/ Building a cross-ministerial development agency (CzI).**
- 4/ Clear rules for industrial policies (benchmarking, criteria, sunset clauses, externalities, competences, “arm’s length” communication in the P-P alliance, public entrepreneurship & innovation.**
- 5/ Converging of rules for traded and non-traded sectors.**
- 6/ Strict rules of co-financing in the P-P alliance.**
- 7/ Subsidiarity in public involvement (central – regional – municipal gvts.)**
- 8/ Prudent banking supervision for handling with debts.**



# Shifting of comparative advantages by policies of factor development L, K, H

Growth rates in %





# **CzechInvest**

**Investment and Business Development Agency of MIT**

**Established in 1992, transformed in 1997, 2000, 2004 and 2007. 300 employees**

**Free of charge services for investors:**

- \* information assistance to inv.**
- \* investment incentives / subsidies**
- \* investor – public administr. interface**
- \* supply chain clustering & aftercare services**
- \* SME development**
- \* access to EU funds**
- \* R&D promotion**
- \* management ISO 9001:2000**



# **CzechInvest – gradual development**

## **Promotion of FDI in manufacturing - priorities:**

**automobiles & componetes**

**electronics**

**fine chemistry**

**precise machinery**

**industrial zones/parks**

**aircraft industries**

**biotechnologies**

**medical instruments**

**technological centers**

**software, ICT**

**call centers, customer support**

**financial infrastructure**



# CzechInvest – incentives paid

Since 2000 the incentives for investments above \$ 10 mil. are regulated by law specifying the conditions.

Minimizing the corruption.

Clear caps for support.

Compatible with the EU/EC rules

13 regional offices for field contact.

Categories:

- Job creation (by zones of unemployment)
- Land purchase from municipalities (by ind. zones)
- Infrastructure
- Employee requalification
- Tax breaks



# CzechInvest - performance

**1998-2007 (Aug.)**

**776 projects investing \$ 20 bil. (i.e. 32% of all FDI)  
creating 153 000 jobs**

**Cost of public finance: \$ 5 bil. (incl. pending tax breaks).**

**State contribution per private seed capital:**

**smaller projects usually 50%**

**big projects 15%**

**average 31%**

**Since 2006 there are more Czech applicants than foreign.**

Promotion of indigenous firms since 2004:

“Industry & Entrepreneurship” \$ 480 mil. for 2870 projects

“Human Resources” – univ., tech. parks and businesses



# CzechInvest - organization



**Chair /CEO:** subordinated to the minister of Industry & Trade.

Past chair the vice-PM.

**Strategic Planning and Development Div.:** internal coordination, risk management, world trends, quality management.

**Competitiveness Div.:** programs supporting enterprises via the gvt & EU funds; cooperation with municipalities & academia; infrastructure; interface to ministries.

**Investment & Applied Research Div.:** in contact with investors at home and abroad; mediates networks and R&D spillovers.

**Properties & Infrastructure Div.:** prepares greenfields & brownfields; interface to developers and human resources.

**Regional Cooperation:** 13 regional offices.

**Staff: 300** – paid as government servants (annual salaries € 14 000 = \$ 20 000; average age 32 years !)



# CONCLUSIONS



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- \* Czech policies of stabilization, restructuring and development: very heterogenous & flexibly restructured.
- \* The “trial & error” approach to policies ... but ... there were political checks & balances and sunset clauses.
- \* Policy-making leaders: MIT / CzechInvest - strategic plans.
- \* Entrepreneurship based on FDI and SME support.

## **WEAK INSTITUTIONAL CHAINS:**

Main dangers: corruption, bureaucracy and political rivalry.  
Some ministries were not partners of equal contribution:  
Min. of Finance (low strategic vision); Min. of Education (politically weak) and Min. of Justice (too slow).

**➔ Resultant ec. growth of 6% was great ... but performed by 2% below potential. However, it was robust enough to withstand ups and downs in the world & domestic economy.**