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Tošenovský, Filip

Silesian University, Opava, Czech Republic

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# **FUTURE ECONOMIC STRATEGY OF THE CZECH REPUBLIC AS AN EU MEMBER STATE**

**Filip Tošenovský, Silesian University**

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## **1. EU Entry, Benefits and Prospects**

We can hardly argue that in the last decade there was a greater change that swept through the Czech Republic than its entry to the European Union in May 2004. The reason behind it is that the membership of the Czech Republic in the EU affected indirectly its every citizen because the country's legislation had to be harmonized with that of the European Union, among other things. The legislative adjustments started in 1998 and lasted for six years. Not many people realize today an obvious fact, to give an example of the harmonization, that the mandatory two-year guarantee imposed on our products is a guarantee extension resulting from our EU membership, or that technical norms which recommend how product characteristics should look like did not fall out of the blue, but are documents which describe in detail requirements anchored in European directives. And European directives are mandatory for the member states. The significance of our membership is even greater in light of the fact that the adopted European legislation is related mainly to economy as the Union focuses on creating a functional single European market. We can state many examples of how the EU membership positively affected the Czech Republic in the economic sense. To name a few of those examples: barrier-free transfer of commodities, cancellation of duties, convergence of legislation in the business sphere, prohibition of imposing extra requirements on imported goods which do not have to comply with extra conditions in the target country, antidumping policy and removal, at least partially, of technical trade barriers by the introduction of European technical norms elaborated by CEN and ETSI standardization organizations. We can also see positive effects at the macroeconomic level where the harmonization of economic policy and financial policy have been reducing transactional costs. All this is undoubtedly a positive impact of our membership.

On the other hand, it is an imperative to emphasize that individual member states cannot perceive the EU as an almighty mechanism. Not all that is invented by the EU central bodies represents an ideal to all member states. This comes as no surprise, but from the purely economic point of view as well, an excessive cohesion supported by the EU in some economic areas cannot be welcome. It is not a surprise that the United States, one of the most powerful economies in the world, is technically a federation. Its states are independent to a great extent, economically speaking, and their economic behavior is not dictated by a multinational body. This simple example supports the ideas that an excessive convergence of the EU states is not the right scenario. In fact, not only such a convergence is beyond capabilities of the EU, but also – and that is more important – it should be in the EU's greatest interest not to allow such a convergence (again, I stress that it's about an excessive convergence). There must be some competition among the member states if the EU wants to flourish in the future. And that is something the EU needs as it lags behind highly developed Asian states and the North American states. What does this all mean for the Czech Republic? It means that the state must take into account its duties towards the EU on one hand, but it also must realize its economic and political sovereignty and the necessity of its greater self-

sufficiency in the future, regardless of how much funds it draws from the EU and let alone the fact that it even has problems to draw the funds in time. So, how should the Czech Republic's strategy look like in the coming years as far as EU is concerned?

## **2. Economic Pitfalls of EU Expansion, Education**

I would start with an issue which is related to the Czech Republic's membership in the EU and seems to have more of a geopolitical flavor, but it also might have a great impact on the Czech economy, and not only on that economy. European Union has expanded in the last few years at an unprecedented rate. What I have in mind are the Eastern European and Baltic states. As this wave has not drifted away yet, voices demanding further expansion grew stronger. Top EU statesmen have been arguing whether other states should be accepted or not and they support their arguments by political and economic stability or sometimes also by the ideology that prevails in the potential candidate states. That is all perfectly fine. However, even if the stability in the economic and political sense was in place, the danger of larger migration across Europe remains. This is a danger that only a few people realize. The Czech Republic does not have a problem with that today because it is a matter of culture. The migration is more about deeply rooted cultural habits today, not about a temporary economic or political instability. Europeans are far more used to being settled, which makes them different from other populations. This is a historical fact. The migration is already under way and countries like France have big problems with this phenomenon. If there wasn't the danger of migration, EU could accept more states. But who can be sure of that? I am not. This potential new wave would be a problem for the entire Europe as all member states would have to share the responsibility of taking care of the population growth. The reason for this is that the new immigrants would gain the "status" of EU citizens. In other words, a strong pressure on the state budgets would arise. And I am afraid the Czech Republic and other current member states would not be happy about this. Not only the Czech Republic, but other states as well have been fighting the budget deficits with Germany, the Europe's biggest economy, and some other EU countries being even reprimanded in the past for not having fiscal discipline. Some of you might ask why the migration should end up in the Czech Republic? The reason I am saying this is that this is what the European policy suggests. Some political commentaries already elaborated on this issue, proving indirectly that countries which already have problems with immigrants may try to force an agreement guaranteeing that EU novices including the Czech Republic should share the immigration wave. Since this could place a burden on our state budget, such a development would be highly adverse. The Czech Republic cannot balance its budget even now when it experiences a strong economic growth. These pressures are a significant latent danger to me and I think that Czech Republic should pay an extra attention to this in the near future.

The second area I'd like to draw our attention to is research and education. This a sphere to which the Czech Republic should reorientate itself. The Czech government adopted some measures in this respect, which is laudable. Let us hope that the measures will actually be put into practice. I consider the education and research one of the biggest problems of the Czech Republic as well as entire Europe. Of course, there are exceptions to the rule and the Czechs should pay an extra attention to them as well. A great example of this is Ireland. The Czech Republic resembles Ireland a lot in that it is a small country which does not abound in raw materials. Ireland serves as a good example of how education can be exploited. The country invested heavily in education in the 70s and 80s and the investment brought back huge

results. Ireland thrived economically and is now considered a European technological hub. Another example of such an approach is Finland.

So far, the Czech Republic has succeeded in the motor and electricity industry, but that does not suffice, and a way leading to a state with cheap labor, thus an easily replaceable one, would mean becoming a developing country. We must make a greater effort at developing our own know-how. Such an attainment takes a long time and requires a good breeding ground, which is something that should be taken care of by the state as the redistributor of wealth. I said this is a rather European problem. To outline the situation, surveys conducted last year and published in daily newspapers showed that there are not more than four European universities among the world's top fifteen tertiary – education establishments. The rest comes from the U.S. and Asia.

### **3. Economic Prerequisites for the Right Track**

Since the Czech Republic must be strong enough to withstand both the external pressures and the build-up of know-how centers, it must be in good economic condition. This is the situation of today, none the less there are some imbalances shaping up which I would like to comment on in the end. The first of these imbalances is our bank credit policy. The Czech consumer credit position has approximately doubled in the last few years. Although the development is not extraordinary yet, the growth is rather dynamic and if it persists in the future, we might experience problems similar to those in the U.S. We didn't have problems to get bank credits because of low interest rates. However, if the economy slows down – and this will happen one day as the current expansion cannot be sustained in the longer term – the rise of unemployment accompanying the slowdown will get many people in trouble. We are not as familiar with living on debt as Western Europe as we had not had such financial instruments for decades. Therefore I think that the banking sector should in advance regulate the credits more strictly. The Czech currency is very strong these days, so strong that the Czech National Bank said there were no fundamental reasons behind the strength. Thus, if investors take their profits on the Czech crown and inflation additionally doesn't drop as assumed, there will be a danger of not having the crown as an instrument limiting the price growth. In the case, it is very likely that the Czech National Bank would be forced to raise interest rates and that would be no good news for any credit holder.

Another prevailing problem is the state budget deficit. The current government adopted some measures to reduce the deficit. The approved reforms lower this year's deficit to 70 billion crowns, or to 110 billion crowns after adjustments for financial results of health insurance companies and municipalities. This is slightly under 3 per cent of GDP, meeting one of the euro zone criteria. However, this might not be enough, given the fact that key reforms were approved and the domestic economy grows strongly. When the economy decelerates, state social expenditures will rise and investors will probably also lend funds to the state at a higher interest due to a greater economic uncertainty, so the state budget deficit can then easily rise to 5 per cent, for instance, which would mean that we would be where we were before the reforms. The state must strive for a steeper deficit reduction because the current economic conditions are very favorable for this purpose. This means that other reforms will have to be approved, but this is unfortunately a political decision. I also see problem in the structure of the Czech state deficit. Expenditures on research have been cut and the Cabinet also supports the employment policy too much given the current economic growth of the country.

The final problem that I would like to mention is the labor market which has not been optimized. The truth is that the unemployment rate has dropped in recent years and came closer to five per cent. But, of course, we cannot judge the labor market on a single indicator. A significant part of the unemployment is represented by prolonged joblessness. It has been steadily between three and four per cent since the end of 1990s. The indicator suggests that the jobless are to a great extent the same people. Also, the prolonged unemployment concerns the so-called economically active people. All this considered, it looks like the flexibility of the labor market is not good yet. In my opinion, a better legislation, in particular a wider range of labor contracts could help the situation because it would allow the labor market to react better to the actual needs of the industry.

Most of what I mentioned will depend on the political will, which in itself is a problem of the Czech Republic. Political parties are often not even willing to agree on key issues and what this country needs most of all is a certain momentum as far as reforms are concerned. Slovakia has an advance on the Czech Republic in this respect and this is also the reason why Slovakia is ready to enter the euro zone much earlier than the Czech Republic.

#### **4. Conclusion**

The membership of the Czech Republic in the EU is extremely important for the country's political and economic stability. Despite that, however, the country must keep in mind that there are economic and political areas where it cannot be helped by the EU or it can even be misled, perhaps unintentionally. The state should also shift its focus as far as its future economic prosperity is concerned because technological or scientific advance is one of those few areas which can push it farther for a longer time. The Czech Republic cannot rely on a single industry as the epoch is overly turbulent and changes very swiftly. In order to behave that way, the Czech Republic must continue with its reforms which will smooth out potential economic imbalances and will turn the country in right direction.