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Modeling Economic Growth in Contemporary Czechia

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Foreword

Czechia is a medium-sized country in the middle of Europe. Next year, together with the other new EU Member States, we will mark the 20th anniversary of our accession to the European Union. In 2021, Czechia reached 91% of the EU27 average, measured by GDP per capita in purchasing power parity standards. While this level is higher than Portugal or Spain (75% and 84%, respectively) and close to Italy (95%), Czechia has been growing at the slowest average rate in recent years in almost the entire EU and by far the slowest in the group of Central and Eastern European countries. Between 2005 and 2021, this indicator increased by 63% in Czechia, while it increased by 119% in Poland, 75% in Hungary and 65% in Slovakia. Most recently, between 2021 and 2019, the growth gap is even more pronounced with Czechia +1%, Poland +10%, Hungary +7% and Slovakia +2%. During this period a number of developed Member States (e.g. all Nordic countries, Benelux, Germany, France, Ireland) also grew faster than Czechia.

It is therefore clear that economic convergence towards more advanced countries has stalled. And the Czech economy is losing its ability to catch up, let alone overtake more advanced economies. The medium-term perspective is burdened with a number of complex challenges. Therefore, we must think hard about what the future of the Czech Republic in general and its economy in particular should look like.

This book undeniably comes at the right time and provides us with a lot of inspiration for this thinking. The right therapy in medicine as well as in economic policy cannot be established without a good diagnosis, i.e. an analysis of the state of affairs and the previous developments that have brought us to our current state. In this methodologically correct approach, I find the greatest contribution of this publication. This book provides a professional analysis of many key areas of the economy and the economic policy applied in recent years, using the example of a medium-sized and medium-developed open economy such as Czechia.

The existing model of the Czech economy has been largely based on massive inflows of foreign investment since the second half of the 1990s, which continued de facto throughout the first decade of the current century. This capital has been directed mainly towards industrial capacities, often linked to automobile production. In addition to a long industrial tradition, targeted government support, a favourable geographical location and a well-equipped infrastructure, these investments also found a cheap and high-quality workforce in Czechia.

However, over the last 5–7 years, the situation in Czechia, as well as worldwide, has changed dramatically. The COVID-19 pandemic and the subsequent

disruption of global value chains, as well as the ongoing European energy crisis and Russia's subsequent aggression in Ukraine, symbolise the end of the 'golden' era of globalisation that has shaped world development for the last 30 years.

Labour has long been a scarce commodity in Czechia. We have had the lowest unemployment rate in the EU for a long time, and similarly, the employment rate exceeds 80% and is also well above-average EU standards. The share of foreigners in the labour market is around 15%. The Czech economy is highly energy intensive. Too many companies operate in a subcontracting position so that they do not have the full opportunity to exploit the added value from, for example, research and development and from the sale of their own products. These are perhaps the key structural problems of the Czech economy.

In a certain sense, the Czech economy is facing the challenge of overcoming the so-called middle income trap. That is to say, finding a way to move from the level of a medium-developed EU country to the desirable position of approaching the above-average developed countries. I believe that whether we succeed or not will be determined by how successful Czech society is in making a fundamental qualitative shift in the key areas of our country's governance, which are institutions, innovation and infrastructure.

Economic policy in the narrow sense cannot deliver these priorities. However, its successful management, which in the end means, above all, maintaining the overall macroeconomic balance, is a necessary condition for any positive shift in these priorities. Finding the appropriate monetary and fiscal policy settings appears to be the biggest challenge for the period ahead. This will lead to a sustainable restoration of price and fiscal balance while maintaining adequate growth potential of the Czech economy.

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