

4 Strategic Directions for Czech Economic Policy

Executive Summary

The objective of this document is to start a discussion of how the Czech Republic can set a strategy (allocate its current economic and political assets) in order to improve its economic performance over the next ten years. The document will be used to hold roundtables with all willing policymakers, both in the public and private sector, in an attempt to create consensus on the economic direction of the country. For that reason, it is viewed as a working document which will be amended through debate.

The Czech Republic has increased its GDP by 46% since 2005. It is now solidly in the middle of EU economies, and has separated itself from other “developing” economies in the region. To maintain or improve this performance, the country will need to set a new strategic economic policy that develops existing competitive assets and reforms non-competitive assets.

We propose four strategic directions:

- 1) Exploit current manufacturing base by identifying a number of value-added exports (not industries, but specific products). These products must already have a significant market share or sales in five developed economies, a significant number of existing or potential suppliers of high value-added components, and require extensive research & development to maintain competitive advantage over competitors. The intention is to create clusters around this product by developing a “toolkit” of economic policies that would assist in the development of the next generation of that product. **(Strategic Asset: Manufacturing Capacity)**
- 2) Exploit the job and business creation capacities of the Brno-Prague-Ostrava region. Co-ordinate city and national strategies to turn this triangle into the leading source of successful business start-ups in the Central and East European region. Policies in this area would create top universities, turn the cities into magnets for foreign talent and capital, and connect the cities both physically and through communications technology. **(Strategic Asset: Prague Quality of Life, Brno Industrial & IT base, Technical Universities, Prague Airport, Research Centers/Supercomputer, Transport & Communication Infrastructure)**
- 3) Utilize the major resources government expends on health care to create an export industry in health care products. Extended lifespans and an aging population will require governments all over the world to spend more and innovate more. The Czech Republic should try to capture some of this market by setting ambitious goals (such as the current plan to increase healthy life years by two years), building an e-commerce system that can measure the impact of policies on this goal, and transforming the procurement system to force innovation. **(Strategic Asset: Government Spending)**
- 4) Turn government into a competitive advantage. The Czech Republic relies more on government spending to generate GDP than most countries. Public spending, therefore, must create more value than in other countries. A public procurement system that focuses more on setting clear policy objectives, forces innovation through competitive bidding, and increases accountability of elected officials for achieving those objectives would increase the value provided in almost every area of government policy. **(Strategic Asset: Government)**

Setting an Strategic Direction for Czech Economic Policy

Since 2005, the Czech Republic has increased its GDP per capita by 46%. During the same period, the country rose two spots from the 18th highest GDP per capita in the EU to the 16th highest. This underscores just how difficult it is to compete in the modern global economy, and within the EU. To be successful, we need dynamic companies, creative universities, and sophisticated government policies. Each individually will help us become more prosperous, but to maximize our full potential, we need each to be aimed at a common goal. No single entity or individual can determine that goal; for it to last beyond election cycles and management changes, it must be the outcome of a constellation of conversations and agreements among policymakers in both the public and private sector.

This letter lays out our ideas about the strategic direction of the economy and serves as a request to organize a roundtable with you and your colleagues to discuss your views with the hope of forming some consensus on how to construct our future prosperity. The ideas expressed in this letter represent the distillation of our discussions with businesses, universities and government officials, and we recognize they do not reflect all options, or perhaps even the best options. They are meant to serve as a starting point for debate, not the conclusion.

Setting an Overall Objective

The public is often presented world rankings of competitiveness as the standard by which countries should be compared. Yet, competitiveness is a means to an end, not the end itself. The economic goal of every country should be prosperity. Therefore, when we consider what policies should be reformed or introduced, we do so by asking the question: which policies will contribute most to a durable rise in the GDP per capita (a proxy for national prosperity) and net earnings (a proxy for individual prosperity).

CZECH PERFORMANCE	2005	2010	2014
GDP PER CAPITA (PPS)	18,600	20,600	22,900
NET EARNINGS (EURO)	2,927	4,897	4,807

What if GDP per capita could be increased by 60% over the next ten years? Such an increase in the past ten years would have raised us to the 9th rank in Europe. In other words, we should aim to be a top ten economy in Europe. If that happens, net earnings per individual should double. These seem to be desirable goals for people of all political persuasions and would benefit all groups of citizens regardless of socio-economic status.

Achieving such growth will not be easy. The outstanding success of the current combination of investment incentives and bank privatization has likely reached its limit of effectiveness. Investment incentives attracted unprecedented foreign direct investment, which not only replaced the jobs lost by domestic industrial restructuring, but created a reliable customer for hundreds of domestic small to

mid-sized enterprises. Banking privatization introduced commercial soundness to the allocation of capital, and helped those small-to-mid-size enterprises expand their production to meet demand not just locally but in export markets. These two policies have constructed an enviable foundation on which to craft the next stage of economic policy.

What can replace them? The answer will not be found by replicating policies of other Central European countries. The Czech Republic has separated itself from other former Soviet markets, and has begun the ascent into the economic sphere of Europe's most prosperous countries. Our benchmarks are no longer Slovakia and Poland, but Austria, Finland and Germany. The policies required to compete at this level

EU Countries by Economic Outcome			
Elite Economies	Luxembourg	73,500	+20%
	Ireland	36,800	+17%
	Netherlands	36,000	+47%
	Austria	34,900	+20%
	Sweden	34,100	+1%
	Germany	34,000	+23%
	Denmark	33,900	+19%
	Belgium	32,400	+47%
	Finland	30,200	+13%
	United Kingdom	30,000	+16%
The Middle	France	29,400	+26%
	Italy	26,400	-8%
	Spain	25,100	+29%
	Cyprus	23,200	+9%
	Malta	23,200	+7%
	Czech Republic	22,900	+46%
	Slovenia	22,600	+64%
	Portugal	21,400	+31%
	Slovakia	20,900	+23%
	Estonia	20,300	+15%
	Lithuania	20,200	+59%
The Rest	Greece	19,600	+16%
	Hungary	18,700	+83%
	Poland	18,500	+51%
	Latvia	17,200	+13%
	Croatia	16,100	+8%
	Romania	14,600	+19%
	Bulgaria	12,500	+3%

must have a more targeted focus and will require greater integration into areas such as education, health, culture and immigration. The best strategy is not to try and guess better than policymakers in other countries, but to concentrate on the development of the basic economic assets of a country- people, companies, and patented technologies- in a way that delivers short-term economic growth that produces a positive feedback loop, thereby creating the greatest chance of sustainable, long-term prosperity.

For the past several years, we have been consulting with leading business people, economic experts, and policymakers on what policies will create the most prosperity for the people of the Czech Republic. What follows is a short description of those policies by strategic chapter. We know that these are not the only solutions, and others could help us reach greater prosperity faster. We hope, however, that they can be a starting point for further discussion with you about what steps we can take to assure the next period of the Czech economy will have as much success as the first.

Four Strategic Directions

Economic strategy depends on effectively deploying current assets to develop both more capabilities and more prosperity. We started by identifying assets where the country may already have a key competitive advantage or disadvantage, and suggested policies to exploit or rectify them. From this study, we identified

two strong advantages (manufacturing, region comprising three cities: Prague-Brno-Ostrava) and two current underdeveloped capabilities (health care as export generator, good governance). These four areas, we believe, will generate the most short and long-term economic growth of any strategic direction.

The home of value-added manufacturing. The Czech Republic has become one of the centers of manufacturing in Europe. To gain more prosperity from this base, the country now needs to shift from attracting manufacturing quantity to manufacturing quality by concentrating more of the value created from the manufacturing process in the country. Our expertise should move from final assembly of products to their conception, development and the manufacture of the most sophisticated component.

Our proposal is to create a diverse toolkit of policies that will enable current manufacturers of high value-added export products develop a next generation of products. Instead of designing general policies, the government could introduce a pilot project for up to 10 export manufacturers. These manufacturers would need to meet certain criteria: 1) already having a 10% market share for that product in five highly developed markets, 2) having the potential to create an industrial cluster through outsourced components, and 3) already possessing or being willing to integrate product research and development in the Czech Republic. This pilot project would not only seek to develop industrial clusters around these products, but it would test new industrial policies that then could be applied on a wider basis.

Proposed Goal: To increase from 55% to 65% the value-added in the Czech Republic per crown of export over the next ten years.

Policies Affected:

- 1) **Education.** To introduce certain professional certifications into the curriculum at technical universities.
- 2) **Training Incentives.** Innovation in manufacturing could be assisted by providing training subsidies or tax breaks for retraining existing workforce when improving or expanding production lines.
- 3) **Research.** A certain amount of public research money should be allocated over a five year period for basic and applied research related to the development of the next generation of the company's product. The priority for this money should be basic research on materials and scientific knowledge that has a wider application than the specific product. This research may require the import of leading researchers who will both conduct research and educate graduate students.
- 4) **Investment.** If necessary, the government could consider investment into the public infrastructure that would make the current physical location of the product's production a significant competitive advantage.

Prague-Brno-Ostrava Creative Triangle. The country has produced several national economic strategies and city development plans. As of today, the two have never been combined. Since cities tend to be the source of economic innovation and growth, the next economic plan should incorporate cities and regions into the national agenda. With their attractiveness to businesses and youthful talent, Prague and Brno could become one of the world's most attractive regions for creative companies.

Proposed Goal: to double the number of successful start-ups in Prague, Brno and Ostrava with more than Euro 5 million in non-Czech revenue and 20 plus employees.

Policies Affected:

- 1) **Tax.** Change tax policy to give greater incentives to angel investment.

- 2) **Labor.** Change immigration policy to attract long-term educated non-EU citizens.
- 3) **Education.** Change education policy to attract more international professors and students.
- 4) **Education.** Introduce software programming into primary and secondary education.
- 5) **Tourism.** Increase the number of final destination arrivals at the Prague Airport by 7% annually over the next ten years.
- 6) **Culture.** Change cultural policy to make the two cities a desired location for young talent.
- 7) **Infrastructure.** Invest in transport and other infrastructure to increase exchange between the two cities.
- 8) **Infrastructure.** Increase affordable access to broadband internet in the regions around and between Prague, Brno, and Ostrava through a combination of public investment and incentives for private investment. Target: 100 mpb in 85% of households by 2025.
- 9) **Infrastructure.** Modernize the Prague Congress Center so that it offers the highest standard facilities, including ecological requirements increasingly demanded by major conference organizers. At the same time, secure long-term funding for the Prague Convention Bureau.

Health Care as an export industry. Health care, in particular the care of the elderly, will be in increasing demand over the next three decades. By demanding innovative solutions to its own health care needs, the government can turn the sector from a black hole for public finance to a key contributor to the country's economic growth.

Proposed Goal: To double the value of health-care related exports over the next ten years.

Policies Affected:

- 1) **Research.** Change research policy to support the generation of exportable health care related products.
- 2) **Health Care.** Set clear objectives for the provision of health care- for instance, the increase of healthy life years by two years over the next ten years- and create incentives for providers to achieve these objectives. This will require the creation of an integrated e-health system for monitoring outcomes.
- 3) **Public Procurement.** Change procurement policy to encourage innovation in health care provision.

Government as a competitive advantage. A substantial amount of a country's economic power is collected and redistributed by the state. The Czech Republic has one of the highest ratios of government consumption to household consumption in the EU. What is most important about that redistribution is not how much the state spends, but how well it spends that money. For an economy to benefit from its government, public decisions on investment and procurement must achieve a comparable or superior return to those made by its private sector. If a government achieves a lower return, it becomes a drag on the economy, and the more it spends, the worse effect it has on the country's prosperity. This is especially true in economies that rely on people, and not natural resources, as its essential economic asset.

Proposed Goal: To reform the government's decision-making processes to place more emphasis on proper planning, setting of objectives, accountability of decision makers, and publication of decisions and outcomes.

Policies Affected:

- 1) **Public Procurement.** Public procurement process should place emphasis on proper planning of procurements, publication of decisions and outcomes, and accountability of elected officials for the performance of procured items or services. This includes establishing some publication requirements for procurements under the threshold for supervision by the Act.
- 2) **Funding of Political Parties.** Political party financing should be reformed to establish a securely funded and independent supervisory body armed with sanctions including the loss of public funding of parties. Limits for private and company contributions should be set, and donations by elected or appointed officials banned. At the same time, the business community should support a public campaign to remind the public that democracy has a price, and that price is private contributions to political parties.
- 3) **Public Administration.** The reform of public administration should be extended into the area of compensation. Given the higher-than-average contribution of government consumption to GDP, public officials should receive more education, have competitive remuneration with the private sector, and be both accountable and rewarded for performance that has a beneficial impact on the economy and society.
- 4) **Tax Efficiency.** Develop a long-term framework for achieving the maximum level of revenue at the lowest possible rates. This approach would focus on 1) increasing willingness to pay taxes through increasing public trust in government and 2) improving collection in uniform and fair ways.

These four strategic directions are what we believe will most effectively achieve the economic objective of increasing GDP per capita over the next ten years. As we wrote at the outset of this letter, we present them to show that we are not simply demanding that government provide the country with a strategic direction, but are willing to do our part in creating and implementing the policies that will lead to greater prosperity in the future. We know that reaching any goal (the one proposed here or any other) will require consensus among the political, academic and business leadership of the country. That is why we would like to meet with you and your colleagues to discuss both economic objectives and strategic directions and see if we can reach agreement on an action plan that will make the Czech Republic a more prosperous and secure country in 2025. Thank you for your attention.