

EU MONITOR

Has the time come for a Czech Regional Policy?

Vít Havelka

- **During the last 5 years, the Czech Republic has experienced an unprecedented GDP growth, moving the country from 83 % of EU average GDP in 2013 to the 91 % EU's average GDP in 2019¹. Simultaneously, Czech wages rocketed by more than 7 % annually in the last three years².**
- **The Czech Republic is slowly moving from its economic model based on well-educated and relatively cheap labour to a higher income country. This also means that its economic model might soon hit a glass ceiling and without economic transformation, the country might get trapped in the middle of the EU, not converging with EU15 or Germany anymore.**



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The following decade will likely be determining for the future success of the Czech Republic. The global economy and its supply chains are undergoing a significant shift; Asian states are slowly becoming innovative leaders rather than being a cheap labour pool. Furthermore, the Czech Republic is heavily dependent on the automotive industry³, which is under pressure not only by stricter emission regulation, but also disruptive market change such as autonomous systems, digitalization and electrification. It is likely that old market strategies will prove obsolete as it happened in case of cell phones.

Along with the changing global economy, the Czech Republic is nearing to a point where it will not be fully able to rely on the EU Cohesion Policy anymore. The country has reached the threshold of 90% EU's average GDP, and if the current economic development remains the same, the Czech Republic will not have access to Cohesion Funds after the coming MFF, and it will receive significantly less money from the EU budget. The problem is that regional disparities within the Czech Republic remain high, especially between the capital city Prague and the rest of the country. Simultaneously, since the EU accession in 2004, the Czech Republic relied mainly on the EU Cohesion Policy in terms of providing funding for regions, supplementing the EU's activity only with minor national contributions. As a result, the country does not have a well-developed culture of regional policy that would be nationally funded, and there is not even a discussion in the media about national solidarity with disadvantaged regions.

The following paper aims at discussing a possible way forward for the Czech Republic, especially in the context of expected changes in global economy and simultaneous decrease of EU Funding that could help mitigate the impact of economic disruptions. The focus will be laid on possible

reaction to lower income from the EU, as it is presumed that a solid regional policy is crucial in maintaining internal cohesion and contributes to mitigation of economic turbulences.

Impact of the EU Cohesion Policy on the Czech Republic

Since 2004, the EU Cohesion Policy has had a significant impact on the Czech economy; between years 2004-2015, the amount of funding invested into Czech economy represented 1,7 % GDP. An analysis conducted by the Czech office of the Government determined that every 10% decrease in funding from the EU would shrink the Czech GDP by 0,15 points.⁴ Another study⁵ showed that between years 2007-2016, the EU funds covered on average 2,21 % of Czech annual GDP, however, the numbers differed significantly through the period due to poor project preparedness in 2007-2009.⁶

If we look at profitability of different investments (human capital, infrastructure, R&D, private sector and technical support) by QUEST III analysis, the highest return was found in the area of investment in human capital (every invested 1€ should produce 4,8€ by 2024), followed by infrastructure (1€ produces 1,6€ by 2024). On the other hand, investments in infrastructure had the most immediate impact on Czech GDP; investing in R&D and human capital started paying off after several years and generate profits over a longer time span than infrastructure projects. Finally, RHOMOLO analysis showed that the EU funds had the greatest impact in South Bohemian Region (cumulative impact of 6% of its GDP by 2016) followed by Central Bohemia (5% GDP by 2016) and Moravia-Silesia (4,8% by 2016). The least impact was recorded in Prague (cumulative

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<https://ec.europa.eu/eurostat/databrowser/view/tec00114/default/table?lang=en>

2 https://www.czso.cz/csu/czso/prace_a_mzdy_prace

³ If the whole automotive left the Czech Republic, Deloitte estimates that the Czech GDP would decrease by 25% and 1,4 million Czechs would lose their jobs.

<https://www2.deloitte.com/content/dam/Deloitte/cz/Documents/d>

[eloitte-analytics/Automobilovy-prumysl-znovuobjeveni-automobilu.pdf](https://www.vlada.cz/assets/evropske-zalezitosti/analyzy-automobilu.pdf)

⁴ https://www.vlada.cz/assets/evropske-zalezitosti/analyzy-EU/171204_Dopad_ESI_fondu_na_hospodarsky_rust_CR_final.pdf

⁵ <https://www.vlada.cz/assets/evropske-zalezitosti/analyzy-EU/Dopad-ESI-fondu-na-hospodarstvi-CR.pdf>

⁶ The EU funds represented only 0,6% of the Czech GDP in 2009, whereas in 2015 this number reached 3,5 % of the total Czech GDP.

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1,5 % of GDP by 2016).⁷

	2012	2016	2020	2024
Infrastructure	0,4	0,7	1,2	1,6
Human resources	-0,3	0,8	2,7	4,8
R&D	-0,1	0	0,4	0,9
Private sector	0,9	0,8	0,9	0,9
Technical support	0,1	0	0	0
Total	0,4	0,7	1,2	1,8

TABLE 1; CUMULATIVE MULTIPLIER IN DIFFERENT POLICY AREAS, SOURCE – OFFICE OF THE GOVERNMENT, 2018

Although the numbers suggest that the Czech economy would not break down if it had no access to EU funding, it would significantly hamper the internal economic coherence, and convergence with Western Europe. One might presume that the Czech growth might have remained at the German levels, rather than being 1-3 p.p. above.

Finally, the main question is whether the Czech Republic would be willing to employ its own cohesion policy if it did not have access to the EU funding. The EU policy plays a crucial role in restructuring of old coal regions such as Ostrava, and pumps funds into infrastructure and human capital in the least developed Czech regions. The EU essentially substituted a part of the Czech state's function – due to convenience coupled with apathy and lack of regional solidarity and focus amongst Czech political elites – and basically eradicated any discussion about Czech internal solidarity.

Outlook for 2021-27 MFF period

If the Commission's proposal for the new Multiannual financial framework is adopted unchanged, the Czech Republic will receive 24% funding from the EU when compared to the current period⁸. This can be considered a very generous offer given the rapid national economic development of the Czech Republic. The allocations would

be significantly lower if calculated only by standard equations. Simultaneously, Czech GDP in PPP per capita reached 90% of Unions average only in 2018, so the country will still have access to Cohesion Fund. Without exaggeration, Czechs can talk about luck as they are now exactly at the economic point where they will still be significant beneficiary from the EU budget, but reasonably economically developed.

The main question is how the Czechs are going to use the funding from the national envelope – the upcoming period is probably the very last one when Czechs receive a significant contribution. The European Commission sets that at least 75% of funds allocated in ERDF and CF must address two objectives – a Greener Europe and a Smarter Europe. This is strongly criticized by the current Czech government, which would like to mainly invest in infrastructure projects such as highway and railway networks⁹. Although many different projects can be branded as "green" or "smart", the trajectory of Czech government policy is clear: they want to allocate as much funding as possible into hard projects that will improve the Czech infrastructure, instead of focusing on "soft projects" (e.g. investment in human resources¹⁰), despite all evidence pointing to the fact that so-called "soft projects" provide a higher return on investment long-term.

One might ask why the government is eager to allocate the EU funding into projects that, at least according to the Office of the Government analysis, do not bring the highest profit over a longer period. Infrastructure is valuable, yet without human capital they will probably obfuscate the Czech economy in its current position in the global production chain and will attract low added value production. The simple answer might be public opinion. Czech society is upset with the state of infrastructure and demand its development. Simultaneously, it is much easier to politically sell opening of a new highway rather than a requalification

⁷ <https://www.vlada.cz/assets/evropske-zalezitosti/analyzy-EU/Dopad-ESI-fondu-na-hospodarstvi-CR.pdf>

⁸ https://www.eca.europa.eu/lists/ecadocuments/rcr_cohesion/rcr_cohesion_en.pdf

⁹ <https://euractiv.cz/section/evropske-finance/news/summit-pratel-koheze-staty-pozaduji-vice-penez-na-zemedelstvi-a-politiku-soudrznosti/>

¹⁰ <https://zpravy.aktualne.cz/ekonomika/babis-potrebujieme-penize-z-eu-ovsem-ne-na-nejake-mekke-proje/r~df2ff410ee5411e882ca0cc47ab5f122/>

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course that enabled a number of Czechs to return to employment. It is important to keep in mind that the Czech Republic has the lowest unemployment rate in the EU (2,2 % in December 2019¹¹), and wages have been growing by 7-8 % in the last three years¹². In such a situation, it is not surprising that the demand focuses on infrastructure rather than human capital.

More strategic thinking needed

Based on the information mentioned above, it is clear that the Czech Republic needs more strategic thinking. The country is experiencing a solid economic growth as well as increase of living standard. However, if it does not manage its transition from lower-added value economy to a higher-income economy (in European terms) properly and successfully, it might be eventually trapped in stagnation as it happened to southern European states. Simultaneously, strong regional disparities are still present in the Czech Republic, especially between the capital and the rest of the country. Given that the EU Regional Policy has been addressing – or at least mitigating the worst excesses of this discrepancy – since the Czech accession to the Union, one can justifiably be alarmed at the lack of foresight in terms of regional development. This leads to two points that needs to be mentioned.

Firstly, the Czech policy makers must carefully think over what they expect from the last significant pot of EU funding the Czech Republic will probably receive. As mentioned in the previous chapter, the Czech ruling elite prefers investment in infrastructure, and skipping human resources area. Whereas this might be beneficial in the short-term, economic studies show that the highest return provides investment in people's skills. This is especially important to keep in mind in the time of structural changes

in industrial production. Czech companies and employees will be under severe pressure from automatization and digitalization of industry. Therefore, the government should carefully assess where it pays off the most to direct funding, not sticking to an old 20th Century thinking or addressing public demand that counters economic evidence.

Secondly, although it is unlikely that the EU Regional policy will completely disappear from the Czech Republic, the regions will receive less aid than they used to. Keeping in mind that the regional disparities remain present in the Czech Republic, it is worthwhile to debate about substituting parts of the missing funds so that the internal coherence of remains at least on the same level as nowadays, and preferably improves it. The need to discuss Czech national regional policy is even more important in the light of the fact that deliberation of differences in regional economic output has seemingly disappeared from the Czech public discourse. If the Czechs talk about different living standards, they usually do not think in terms of how the core areas could help the peripheries, but rather what problems poor living conditions entail. This needs to change as in the future. The EU will not be stepping in to compensate for the deficiencies of an absent national regional development policy.

Vít Havelka

Vít Havelka is a Ph.D. student at the Department of European Studies, Institute of International Relations, Charles University in Prague. Mr. Havelka focuses on institutional relations of the EU and its member states, the EU budget, Europeanisation, and the transformative power of the EU. Since 2016 Vít Havelka was employed as the Political Officer at the Norwegian Embassy in Prague, and from February 2018 he is a Research Fellow at EUROPEUM.

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¹¹ <https://www.novinky.cz/ekonomika/clanek/cesko-ma-stale-nejnizi-nezamestnanost-v-eu-40309555>

¹² https://www.czso.cz/csu/czso/prace_a_mzdy_prace