The perfect neoliberal economic revolution – Czechia's economy since 1990

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(a critical evaluation)

This paper is motivated by a need for evaluation of neoliberal economic/convergence model applied by Czechia in the last 25 years. In 1990 the Czechoslovak (CS) economy was an ideal example of planned economy (level of state control was second only to the USSR). As late as 1990 the CS economy had been virtually untouched by any kind of liberalization (ongoing for years in Yugoslavia, Hungary, Poland and since 1985 also in the USSR). In 1980s 87% of the national product was realized in state owned enterprises, another 10% in socialist cooperatives, only 2% in the private sector (just 1.2% of employment). The country was shielded from international competition – export to GDP ratio was rather low for such a small economy (19,4 % in 1987). Out of these 70% was exported into other communist bloc countries under official international bilateral agreements. Foreign trade was centrally planned state-run monopoly. Foreign investment into the CS economy was very limited, foreign capital was employed in just about 50 firms in 1990 (compared to approximately 500 in Hungary and Poland). Banking system consisted of single state-owned national bank.

During 1990s the Czech economy undertook most fundamental reforms fully embracing the neoliberal economic doctrine. National economy was almost completely privatized and liberalized with little concern for industrial policies, buildup of incumbent (native) capital or maintaining institutions for social dialogue in the new economic system. Reforms were conducted in the context of strong neoliberal/monetarist beliefs of Czech (CZ) policymakers and dominance of neoliberal doctrine in the EU (during the continuous drive for deregulation of single market which was considered necessary for the solution to problems with international competitiveness. Accompanying the EU accession process was the acceptance of prohibition on government subsidies and of complete liberalization of capital transfers by CZ policymakers during the accession period (completed 2004).

The legitimacy of these policies in Czechia was quite high as they were implicitly considered (by both experts and the public) the fastest way for convergence towards the EU's standard of living. These expectations partially materialized since the rate of convergence in GDP per capita was particularly strong in the period of 1999-2008. One of the most important sources of GDP growth were massive FDI inflows – in the process taking over majority of the CZ manufacturing industry, commercial services and significant portion of public utilities. As the result the CZ manufacturing industry is now from two thirds controlled by foreign capital whereas commercial services are controlled almost entirely by foreigners. The CZ economy has subsequently become massively incorporated (due to the geographical position; solid infrastructure, suitable mix of factors of production; massive privatization) into global value chains. The CZ trade balance has been very favorable over the last several years as long as standard indicators of export performance (trade balance, value of exports/imports) are concerned.

The great recession (2008-2015) unveiled some of the hidden problems of the CZ economy. As we show, between 2008-2014 the real consumption in Czechia stagnated. This just accentuated the uncomfortable fact that in terms of real consumption (contrasted to GDP growth) the CZ economy had been growing rather slowly even during the episode of "fast convergence" (1998-2008). Despite large and growing trade surpluses the CZ current account had been in deficit until 2013. Until then the repatriation of capital (mostly dividends) from Czechia outweighed the positive trade income. Furthermore, capital inflows have been gradually slowing down (and 67% of inflows of FDIs were already repatriated by 2014). This has been happening regardless the fact that (foreign owned) CZ firms earned the highest profits of all OECD countries during the 2008-2014 period. Recently, the income component of the current account amount to a deficit of 8,7% of GDP a year! As our research shows, largest share of FDIs came from tax heavens (typically Netherlands, also Cyprus) – raising important questions about the motivation behind these practices. As the OECD global value chain analysis shows, Czechia also has the lowest (and further declining) value added (VA) performance among the organization's members (particularly in the CZ top export segments – transport equipment and electronics). In the context of its high export surplus in the large majority of high-VA products (i.e. sophisticated car components) these data hint at possible issues with transfer pricing by MNCs. The poor CZ record in retaining MNC's profits is to a large extent the result of very weak position of the CZ labor during wage negotiations. The CZ labor has usually been negotiating with the foreign owners with very limited support from the CZ government (as MNCs have been threatening CZ government officials with withdrawing their operations from the country, these threats are less credible in services, where almost all sales are realized on the CZ market).

Therefore, Czechia is has become an example of integrated dependent periphery within the industrial core of the European economy with little control over its own production base. As such it has been facing both problematic practices of foreign owners of domestic firms and economic and political strength of states of the core of the European economy that were attempting to influence the position of their own economies in the international division of labor.

The goal of this paper is to provide a critical reflection of the neoliberal revolution in the CZ economy. It was one of the most fundamental transformations from almost totally planned economy to economy – to an unprecedented level – controlled by MNCs. Our research is mostly empirical and we primarily use the level of convergence towards economic level of EU's core economies as an indicator for evaluation of applied economic strategy. Among other things we focus on development of the level of the real consumption of CZ nationals and on the evolution of division of labor (i.e. graduation towards high-value added productions). While we don't attempt to contribute to theoretical debates directly, we do think that this case can be important and in some respects even revealing for further discussion about prospects of similar economic revolutions.

We have found that the fast GDP growth of the CZ economy has been strongly dependent on FDIs inflows. These were followed by very strong capital outflows associated with rather limited growth of consumption. Despite the CZ production and strong export of typically high-VA products (automobiles and electronics) there has apparently been a weak ability to retain the VA. The findings underpin the importance of further research of this case – we stress that the aforementioned problems are typically more profound in the case of Czechia (other central European countries also suffer from similar problems although usually to a lesser degree) than in all other countries in the world (both OECD and DCs). Such research should focus on issues such as: regulation of prices inside MNC production chains (i.e. the low VA of the CZ economy is in contrast with its production of automobiles completely on its territory), reasons for MNCs to invest through tax havens (in the CZ case the typical immediate investor country is the Netherlands while the ultimate investor country is Germany). More generally – how will such fundamental "integration" of a national economy into international value chains in a common market influence the position of a given economy in the international division of labor in the era of strengthening calls for industrial policy in several economic powers (both in the EU and in the World).