

When will we finally catch up with the West?

Not before 2030, but maybe never. It is mainly subject to the functioning of democracy, the quality of education and good country governance.

After the fall of the Iron Curtain, many people dreamed that, in a few years, the economic performance of our country would be the same as in Western Europe. This still has not been achieved. In 2015, 26 years after democracy took over, the GDP per capita of Slovakia in purchasing power parity, in proportion to the average of the 15 old EU member countries, was at 71%. And that's even despite the fact that our economy was one of the fastest growing economies in post-socialist Europe.

Our starting position was relatively low, however, comparable with Poland and Hungary. Back in 1995, our economy was at the level of 40% of Western economies. It was 36% in Poland and 43% in Hungary; however, it was as much as 66% in the Czech Republic.

Thus, over the last 20 years we have caught up with the West by 31 percentage points (pp), with an average rate of exactly 1.51 percentage points each year. If we were able to keep the same rate, we would get to 100% in 19 years, i.e. in 2035. We would be first among the V4 countries. By using the same methodology, Poland would catch up with the West in 2043, the Czech Republic in 2049 and Hungary in 2055.

Use the INEKO calculator to calculate when we will catch up with the West

From the point of view of Slovakia, the numbers look even better if we have a look at the development for the last 10 years only. That is to say, since 2005, Slovakia has been closing the gap with an average rate of 1.83 percentage points per year, which is approximately the same rate as the one in Poland, but twice the rate of Hungary and the Czech Republic. If we kept the same rate, we would get to the level of the old EU members as quickly as in 16 years, i.e. in 2032. Poland would join us in 2035, the Czech Republic in 2042 and Hungary in 2065.

However, the calculation for Slovakia gets much worse if we look at the last 5 years. During this period, the catch-up rate decreased to 0.87 percentage points per year, which is less than in the Czech Republic and Poland, and just a little bit more than in Hungary. By keeping such a rate, the moment of catching up to the West would move to as late as 2049. The Czechs would get there in 2036 and the Poles in 2042. Hungarians would follow in 2065.

Table 1: Average annual rate of the V4 countries catching up and the estimated year of reaching the EU15 average (GDP per capita in purchasing power parity)

	Average annual speed of catching up (year of catch-up)		
	1995-2015	2005-2015	2010-2015
Slovakia	1.51 pp (2035)	1.83 pp (2032)	0.87 pp (2049)
Czech Republic	0.64 pp (2049)	0.80 pp (2042)	1.05 pp (2036)

Poland	1.33 pp (2043)	1.93 pp (2035)	1.39 pp (2042)
Hungary	0.95 pp (2055)	0.76 pp (2065)	0.75 pp (2065)

Source: Eurostat, INEKO calculations

When interpreting the numbers above, it is necessary to consider that gross domestic product does not necessarily provide information regarding the quality of life. Therefore, new composite charts of countries are created that include indicators regarding the state of education, health care, the health condition of the population, infrastructure or democracy. One of the best known is the Human Development Index (HDI), calculated regularly by the UN and the results are published [here](#).

Obviously, history is different than the future. Therefore, all the numbers are for illustrative purposes only. Our catch-up rate could easily fall down to zero, just as has happened to Slovenia during the last 10 years. In such a case we would never catch up with the West. On the other hand, the rate of convergence may rise to 2.18 pp per year, like Romania in the last 10 years, or even to 2.61 pp per year, like Lithuania in the last 5 years. That would mean catching-up to the West in the following decade.

If we would like to catch up with the USA, where GDP per capita is at 136% of the old EU 15 average, it would take longer. With the rate achieved over the last 20 years, Slovakia would manage to catch up in 2059; in case of a higher rate, recorded in the last 10 years, we would get there in 2049. However, in the case of the rate recorded in the last 5 years, we would not catch up with the US until 2189.

So what does the catch-up rate depend on? Quite a steady lift-off is possible by importing high-quality technologies. However, while closing the gap the going will get tougher. To become competitive, copying is not good enough. It is necessary to develop own, competitive technologies. Can we influence this process in any way? What should we do to catch up with the West as soon as possible? In the following text, we provide various sources of growth that, according to us, play a key role in V4 countries; however, they are not generally mentioned often in relation to growth:

1. The Quality of Democracy

The start of the catching-up process of the V4 countries was possible due to the fall of the totalitarian Communist regime and subsequent transition to democracy. However, there are various aspects of democracy. They may differ in political power centralization, media freedom, judicial independence, corruption rate or the influence of oligarchs on politics. The formal existence of a democracy does not necessarily guarantee economic success; the key is in its application.

According to various authors (see, for example, [here](#)) the basic sources of prosperity are the so-called inclusive institutions, representing such rules of politics and economic functioning preventing abuse of power at the expense of other citizens. It may sound simple but it is a historical challenge that many societies have thus far failed to master. And for those who have, there is no guarantee it is going to stay that way forever. Power goes hand in hand with the great temptation to use such

power for own benefit regardless of others. The theory of the “iron law of oligarchy” even claims that, sooner or later, the powerful ones succeed in their efforts.

A well-operating democracy is the key tool to prevent abuse of power, where political power is distributed between several authorities in such way to control each other and remove power from the hands of a small group of politicians. There should also be fair competition between political parties. Independent regulatory bodies, and independent judiciary and investigative authorities should guarantee the rule of law and protect private ownership. Independent media, civil society and businessmen who are independent from politicians and monopolies are key players that may support the introduction of inclusive institutions. Antimonopoly bodies should play an active role in interfering against monopolies, preventing their creation and expansion. The opposing systems of a functioning democracy are authoritative regimes, dictatorships and “captivation of a country”, where oligarchs control politicians and influence their decisions and legislation for their own benefit.

The trend of the V4 countries shows that the development of democracy is not straight-forward. The rise of authoritative and populist politicians, the influence of oligarchs, wide-spread corruption, weakening of the media, judicial power and regulatory body independence are just some of the features that may be seen in the various V4 countries with growing intensity. **In case the weakening of democracy continues within the V4 region, sooner or later it will be reflected in the slower rate of economic growth and suspension of catching-up with the living standard of developed countries.**

There are no simple solutions available. Democracy should be supported by a strong, informal coalition of independent media and NGOs focused on scrutinizing the government, fighting against corruption and supporting reforms. Private entrepreneurs who are not connected to the ruling politicians and monopolies play a particular role whilst also possessing the financial resources as well as motivation to support pro-democratic efforts in society. It is also important to adopt system changes to reduce the risk of abuse of power. These mainly increase transparency when using public resources as well as in the decision-making process. Making information public enforces public scrutiny. Systematic measures should be focused on distributing centralized power to various authorities controlling each other. For example, control of the judiciary, the police as well as the prosecutor’s office should be separated from executive power personally, financially as well as organizationally, and should not fall under the same person.

2. High-quality Education

The education of citizens is very important for the functioning of democracy and long-term prosperity. Educated people are more resilient to populism, they understand how the world runs and the sources of prosperity, it is easier for them to find work, they create higher added value and they are more open towards different cultures. Paradoxically, we have only limited information regarding the quality of education. Most commonly, the quality is compared at the level of individual

countries, based upon the results of international tests, e.g. PISA tests by OECD. However, we have much less information regarding the quality of individual schools. For universities, there are publically available international charts of top universities. However, they don't provide any information regarding the quality of a particular faculty or even field of study. And there is rarely any comparable information supported with data for secondary and primary schools. Therefore, parents and students have to rely mainly on first impressions or the word-of-mouth personal experience of people who have some kind of experience with a particular school.

If we want high-quality education, schools must be motivated to increase their quality. An important condition for motivation is the regular collection, processing and publishing of information that will provide insight regarding the quality of individual schools and their study programmes (see also [here](#)). Such information may include the results of students in national tests and various competitions or results in accepting students to a higher level of education. Information regarding the wages and unemployment rates of graduates of particular schools and study programmes shows the ability to succeed on the labour market. For primary and secondary schools in particular, the government should measure the added value, i.e. the difference between results when entering and leaving a particular school. The data regarding quality should be regularly published by the government to give students as well as parents the possibility to make well-informed choices and, by doing so, put pressure on increasing the quality of education. The government should use the information regarding the quality of education for interventions into the school network, too, either by providing support for primary schools falling behind in the interest of enabling the same education opportunities, or by suppressing schools proving unsuccessful in the long run. The quality of education should influence financing from public resources to reward better results by providing better financing. The government should support quality by collecting and distributing the best practices of the best schools, too.

The negative impact of the missing motivation of schools to increase their quality of education is characterized by a brain drain as mainly the best students leave to study in other countries. The reason behind this is that schools are not motivated to attract such students; moreover, the best students are not motivated to attend schools where quality is not important or does not matter.

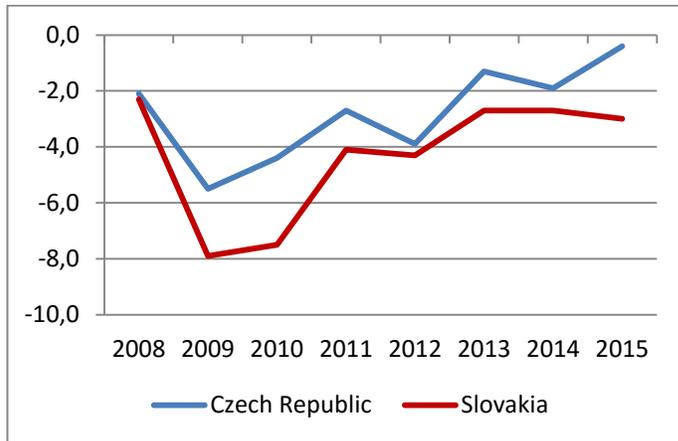
The government should pay special attention to education regarding the meaning of democracy and, in our region, to education on the importance as well as contribution of European integration. The increased popularity of authoritative leaders, extremist, anti-European and anti-democratic political parties in various EU countries, often between young people, serves, among other things, as proof of the failure of the education system in this area.

3. Stable Public Finances

The government debt of Slovakia is above the level of 50% of GDP and government deficit is at 3% of GDP while, in the Czech Republic, the debt has decreased to 40% of GDP and the deficit is getting

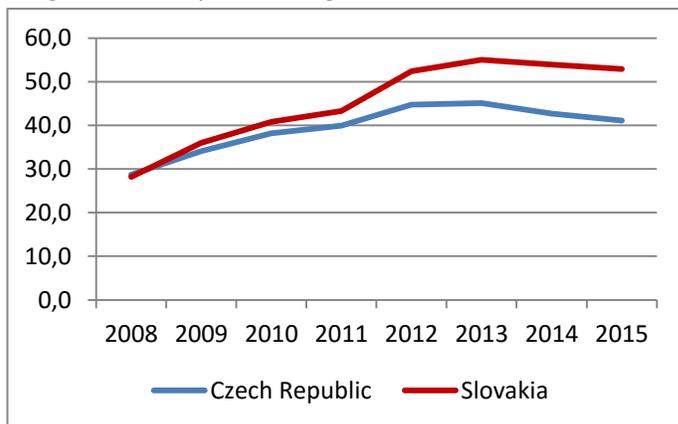
close to zero (see also [here](#)). That's despite the fact that before the economic crisis in 2008 both countries were showing almost identical results in both indicators. The comparison shows that improving public finances is a smaller priority in Slovakia than it is in the Czech Republic.

Diagram 1: Comparison of government deficits of the Czech Republic and Slovakia (% of GDP)



Source: Eurostat

Diagram 2: Comparison of government debts of the Czech Republic and Slovakia (% of GDP)



Source: Eurostat

Disproportionate growth of government debt may lead to macroeconomic instability with a negative impact on living standards. In their efforts to become popular, politicians often increase expenditures and reduce taxes, leading to higher debts. Generally, they should have feedback from financial markets by higher interest rates in case of debt increasing too high. However, following measures by the European Central Bank (low interest rates, OMT, QE), such feedback is significantly lower. Markets perceive that a significant part of credit risk is shared by all the Euro zone members, i.e. the high-risk, less responsible countries do not have to pay the accordingly higher interest rates, which would discourage them from over-indebtedness. The benefit is a considerable relief in interest costs for debt repayment; disadvantages include moral hazards as beneficial conditions reduce governmental motivation to improve government finances. In case of absence of external pressure applied by financial markets, it is necessary for individual governments or the EU to control budgetary discipline.

Debt brakes serve as the key tools for guarding government debt in Slovakia: after exceeding the defined levels, they automatically activate sanctions for the government. Even despite all that, the debt level is not being reduced, or it is being reduced very slowly, even in times of growing incomes. Introduction of expenditure ceilings, which would not be possible for the government to exceed even in case of unexpected incomes, could provide a solution. **The slump of debt level in Slovakia is mainly due to the implications of a debt brake. It appears to be beneficial to have rules for debt guarding laid down in constitutional law, which is not possible to amend by a standard parliamentary majority.**

In the EU, the Stability and Growth Pact (SGP) serves as a key tool for guarding debt levels. Over the last few years, its excessively flexible application has clearly been seen since several countries receive exceptions from meeting the obligations of reducing government deficit or there are no sanctions for failure to meet the obligations respectively. The aforesaid approach represents risk for long-term macro-economic stability in the Euro zone. Continuous indebtedness in the long-term prospect endangers the stability of the Euro currency. Moreover, there is an easier possibility for improvement of government finances during "good times". ECB tools temporarily contributed to the higher growth of Euro zone GDP; such a period should therefore be used for a higher rate of improvement of government finances of member countries. In the mean time, many countries, including Slovakia, fail to capitalize on such an opportunity.

4. Efficient Government

The wasting of public resources, as well as low quality and inefficient public services, lowers the potential for economic growth and worsens the standard of living. In the case of efficient use of public resources, less money is required for the same or even better results public administration results. In other words, the same expenditures may bring better "value for money". People can then get higher-quality services, the government may reduce taxes, invest more in priority public goods or even attract higher-quality employees by offering higher salaries.

An efficient government providing high-quality services to its citizens is an important source of prosperity. Measuring and publishing results to enable a public push for higher quality and efficiency is the key prerequisite for increasing efficiency. For example, the government may measure and publish the results of schools, hospitals, police stations, job centres or courts. It may review the need for large investments and their alternatives, and then compare the benefits in relation to the money used. The regulations should be subject to efficiency analysis, i.e. before their adoption as well as following obtaining information regarding their impact.

Efficiency measurement requires working with data. The government should collect and publish data regularly in a machine-processable form and, optimally, in a user-friendly form, too. "Available public data" may also serve as an impulse for new initiatives in the private sector.

5. Higher Employment Rate

The high unemployment rate, especially the long-term one, is a long-standing problem for Slovakia. In comparison with Germany, all of the V4 countries exhibit a low employment rate. Non-utilized workforce potential slows economic growth and its consequences may have implications during the time of an ageing population, which is unavoidable in the decades to come.

Table 2: Employment, unemployment and long-term unemployment rates (in %, 2015)

	Slovakia	Poland	Hungary	Czech Republic	Germany
Employment Rate	67.7	67.8	68.9	74.8	78.0
Unemployment Rate	11.5	7.5	6.8	5.1	4.6
Long-term Unemployment Rate	7.6	3.0	3.1	2.4	2.0

Source: Eurostat

In Slovakia, the room for an increase in the employment rate is mainly in the utilization of part-time employment and the inclusion of people with low qualifications into the labour market (see also [here](#) and [here](#)). For that, it is required for people to take up employment legally even in case of low incomes. In Germany, this was heavily aided by the creation of so-called “minijobs” and “midijobs”, where people are exempt from paying social contributions up to a certain amount of their wages. **If low incomes are subject to high deductions and net income is much lower than the labour costs that an employer is willing to pay, there is a strong motivation for illicit work. Such motivation gets even stronger if a formally unemployed person receives social benefits and an important part of such benefits would be lost in the case of taking-up legal employment.** Therefore, the solution is to lower the deductions for people with low income as well as introducing a continuous, not too sharp reduction of social benefits depending on income rise from legal employment. Motivation for legal work is even stronger with social benefits available for workers only. The tax bonus in Slovakia may serve as an example, as it is received for each child by working parents only. The increase and expansion of such “employment benefits” serve therefore as a tool to increase employment, too. A high minimum wage may constitute a barrier for the employment of low-qualified persons, mainly in regions. The solution is to introduce a lower minimum wage, e.g. for young persons or people from regions and industries with low average income. The politically most acceptable alternative is the reduction of social and health contributions in such a way as to enable a reduction of costs for employers for employing people at minimum wage.

6. Labour Migration

Human capital is one of the basic sources of growth. If a country is able to attract and integrate citizens of other countries in active working lives, there are many benefits to gain. Migrant workers may establish their own businesses, create new working positions, bring innovations or fill positions that are not attractive for the country’s citizens. Foreign workers may compensate the negative impact of an ageing workforce on government finances as there is increasingly more money needed to pay for pensions or health care. Many developed countries, such as Switzerland, Germany,

Canada, Australia or the USA promote a regulated, yet relatively open approach towards migrants, enabling them to draw economic benefits.

On the other hand, the risk of immigration is difficult integration and a lack of tolerance in case of a collision of various cultures, on the side of immigrants as well as original citizens.

Labour migration within EU countries is relatively open and coordinated by supranational law. National governments control migration from third countries. In Slovakia, the migration process with third-country citizens is excessively prolonged and fails to provide the required flexibility for employers. In an optimal case scenario, it takes 145 days from the moment a foreign citizen applies for a position in Slovakia until the day of their being eligible to start employment, being the longest period out of all OECD countries (see also [here](#)).

The demand for labour migrants by employers in Slovakia is growing, which is evidenced by the increase in foreigners working in Slovakia as well as the increase in available vacancies. **In the interest of long-term growth, it is important to provide greater possibilities for third-country workers. With the goal of risk minimization, such workers should mainly be qualified. In case of lower qualifications, if local citizens are not interested in taking-up certain positions, then also people from countries with a similar culture.** For the selection of immigrants, Slovakia may establish an electronic system of point awarding or other methods utilized by developed countries.

Foreign students studying at universities provide an efficient means of immigration. During their studies, they learn the local language, get to know the local traditions, get contacts and they have time to search for positions, which increases their chances for successful integration. Currently, there are just 6% of foreign students at Slovak universities, which is below the international average (see [here](#), diagrams Nos. 27 and 29).

7. Support of Reforms in Ukraine

Ukraine is currently undergoing historical changes (see also [here](#) and [here](#)). After the Maidan revolution at the beginning of 2014, Viktor Yanukovich, the authoritative president, was overthrown and under pressure applied by public and international institutions, especially the International Monetary Fund, the strengthening of democratic institutions and stabilization of economy got under way. Agencies for fighting against corruption and a parallel police force were established, judges were subject to vetting and an electronic public procurement system began to be established. Gradually, the privatization of state-owned companies has got under way, and, after 10 years of stagnation, energy prices are being liberalized. In the last two years, for example, the basic rate of household gas has increased by almost 1000%, while electricity prices have grown continuously up to 350%. The greatest challenges are the anti-corruption fight and the breaking of the "iron oligarchy law". But that will not be possible without a large coalition of reformist and pro-democratic powers.

Fortunately, with the help of the West, including Slovakia, the third sector is being established, and the activities of free media and members of parliament (Euro-optimists) are noticeable.

Ukraine is a strategic country for the V4, especially for its neighbouring countries. If our Eastern neighbour is successful, we will do better as well. Therefore, the democratization and prosperity of Ukraine should be of a high priority for the V4 countries. Ukraine has a strategic position in regard to further political development in the Russian Federation, i.e. the security, stability and prosperity of the whole of Europe. Providing the retention of democratic institutions, economic reforms and the start-up of economic growth in Ukraine, there is the likelihood that certain processes will be requested by the citizens of the Russian Federation, too. V4 countries and the whole EU should therefore support reforms in Ukraine and, in the case of their successful implementation, speed up the country's integration, e.g. by granting it candidate status. **By providing own experience with transformation and support for the democratization of Ukraine, mainly its neighbouring EU members would ultimately support the stability and growth of their own economies.**

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