

Vysoká škola ekonomická v Praze
Recenzované studie

**Working Papers
Fakulty mezinárodních vztahů**

16/2007

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Tendencies and Implications
for the Economic Governance**

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**Faculty of International Relations
Working Papers**

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October 2007



Vysoká škola ekonomická v Praze
Working Papers Fakulty mezinárodních vztahů
Výzkumný záměr MSM6138439909

Tato studie byla vypracována v rámci Výzkumného záměru Fakulty mezinárodních vztahů Vysoké školy ekonomické v Praze MSM6138439909 „Governance v kontextu globalizované ekonomiky a společnosti“. Studie procházejí recenzním řízením.

Název:	Working Papers Fakulty mezinárodních vztahů
Četnost vydávání:	Vychází minimálně desetkrát ročně
Vydavatel:	Vysoká škola ekonomická v Praze Nakladatelství Oeconomica Náměstí Winstona Churchilla 4, 130 67 Praha 3, IČO: 61 38 43 99 E 17794
Evidenční číslo MK ČR:	1802-6591
ISSN tištěné verze:	1802-6583
ISSN on-line verze:	Prof. Ing. Eva Cihelková, CSc. Vysoká škola ekonomická v Praze, Fakulta mezinárodních vztahů Náměstí Winstona Churchilla 4, 130 67 Praha 3 +420 224 095 270, +420 224 095 248, +420 224 095 230
Vedoucí projektu:	http://vz.fmv.vse.cz/



Economic Growth of the EU: Tendencies and Implications for the Economic Governance

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Summary:

Within the EU environment as well as in the individual member states the issue of economic growth belongs among fiercely discussed topics. A slow growth of GDP in some countries of Western Europe caused a significant slowdown of the dynamics of the entire European Union which led in the year 2000 to the elaboration of so called Lisbon Strategy the fulfilment of which should contribute to the increase in the growth and competitiveness of the European Union. This paper focuses on the explanation of trends and main factors of the economic growth of the EU member base in the last decade and on the recommendations of possible solutions to the execution of the economic governance within the environment of the EU economies.

Keywords: economic growth, EU member states, economic governance

Ekonomický růst EU: Trendy a implikace pro ekonomickou governance

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Abstrakt:

V prostředí Evropské unie i jednotlivých členských zemí patří problematika ekonomického růstu mezi hojně diskutovaná témata. Pomalý růst hrubého domácího některých západoevropských zemí zapříčinil výrazné zpomalení dynamiky celé Evropské unie, což vedlo v roce 2000 vypracováním tzv. Lisabonskou strategii, jejíž plnění by mělo přispět ke zvýšení růstu a konkurenceschopnosti Evropské unie. Tato stat' se zaměřuje na objasnění trendů a hlavních faktorů ekonomického růstu členské základny Evropské unie v poslední dekádě a doporučení možných východisek pro realizaci ekonomické governance v prostředí ekonomik EU.

Klíčová slova: ekonomický růst, členské země EU, ekonomická governance.

JEL: F43, O57

Reviewer: doc. PaedDr. Milan Vošta, Ph.D.

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Introduction

Economic growth as well as economic level belong among the most observed economic variables as they predict both about a rate of the economic activity, performance of a country and the level of economic development at which a given country or region finds itself.

Within the EU environment as well as in the individual member states the issue of economic growth belongs among fiercely discussed topics. A slow growth of GDP in some countries of Western Europe caused a significant slowdown of the dynamics of the entire European Union which led in the year 2000 to the elaboration of so called Lisbon Strategy the fulfilment of which should contribute to the increase in the growth and competitiveness of the European Union.

In the new EU member states the economic growth takes another importance. The increase in living standard together with the convergence to the level of the old EU member states belongs among the major long-term priorities of their macroeconomic policies.

This paper focuses on the explanation of trends and main factors of the economic growth of the EU member base in the last decade and on the recommendations of possible solutions to the execution of the economic governance within the environment of the EU economies.

1. Metodological basis

GDP (Gross Domestic Product), used ordinarily as a basic indicator of monitoring the growth of economies, expresses the value of final products and services produced during a certain period. GDP can be expressed as a real or a nominal one. Nominal GDP is monitored in current prices it means it is measured in the prices of the period when the given output was produced and thus it does not take into account the changes in a price level (it is not adjusted from the inflation rate during the given period.) Real Gross Domestic Product to the contrary is monitored in stable prices, to be more accurate in the prices of a stated year (e.g. the rate of growth during 1995-2000 in the stable prices of the year 1995) (Kadeřábková 2003: 9-11).

Economic growth can be monitored in a short or a long period. In a short period the economic growth is connected with a cyclical development of an economy (short-term fluctuations of a product) and it is measured through indicators of a nominal or a real GDP. In a long term there is meant under the term economic growth the increase in production possibilities of a given

economy, more precisely the increase in a potential product (the output achieved at a full utilization of production factors and at a given technology).

In this paper there will be evaluated the dynamics of the economic growth of the EU member countries on the basis of the indicator of real GDP per capita in the period of the last ten years (1997-2006). For the comparison the data of the Statistical Office of the European Communities (EUROSTAT) are used in order to secure the uniformity of the statistical data for all the economies compared. A statistical file of all 27 EU member countries is examined here.

The analysis of the economic growth both in the short and long periods differs significantly also in respect of its determinants. In the short-term period the dynamism of growth is determined by factors which touch the aggregate demand (household consumption, governmental spending, investments or creation of gross fixed capital respectively and net exports), in the medium-long and long horizons those are the items affecting the aggregate supply. The long-term economic growth is thus determined in part by the number of inputs which stand at the disposal of a given economy and also in part by the efficiency of the utilization of those inputs. Under the term inputs it is understood production factors (labour and capital). The efficiency of the utilization of inputs is characterized by the indicator of a total productivity of factors.

The economic growth is thus influenced by three main factors: growth of labour input; capital deepening and increase in total productivity of factors (technological progress)¹. In order to stipulate the contributions of the individual factors to the dynamism of economic growth it is used so called growth accounting which reports the contributions of individual factors to the economic growth within a given year or a period. On the basis of the size of these contributions it is possible to find out whether the growth was influenced namely due to the contribution of labour or capital accumulation or rather due to the increase in the productivity of the factors (Kadeřábková 2003: 12-16, 29-33).

When searching for the suitable tools of growing policy it is however necessary to advance in the analysis even more deeply and to identify the indicators which influence the level of individual factors of growth and to state procedures of the economic policy that will result in the increase in economic growth. A number of empirical researches have been dealing with this issue and they have come to relatively unambiguous conclusions in the case of determinants of labour and capital. The amount of the labour input is influenced on the basis of the development of selected indicators of a labour market (rate of employment, length of working hours etc.) and governments can influence this factor through

¹ The listed characteristic of the factors of economic growth is based on the assumptions of the neoclassical theory of growth.

their policies promoting employment as well as through a form of various incentives both for employers and employees. The rate of capital accumulation depends on the volume of investments which can be influenced either directly through government expenditures or indirectly through improving the investment activity of private entities.

The determination of the contribution of a total productivity of factors is substantially more difficult as it is defined as a total contribution of the technological progress to the economic growth and it includes all the effects with the exception of growth of labour and capital deepening. In the today's economics there has not been defined an exact method for the calculation the level of total productivity of factors and the contribution to the economic growth is usually calculated to the end as a residual quantity only on the basis of determination of the contributions of labour and capital. Economic theoreticians are not united when determining the exact determinants of a total productivity of factors but one of the main causes they name predominantly the following: level of education and qualifiedness of human capital, intensity of research and development, quality of institutional and entrepreneurial environment, use of modern technologies etc.

Our analysis of the factors of economic growth is based on growth accounting i.e. on the determination of the contributions of individual factors of growth (capital, labour and total productivity of factors) to the economic growth. The quality of the analysis is influenced by a limited access to united statistical data of all the EU member countries and thus two main sources were used: the database of Groningen Growth and Development Centre (the latest data at a disposal are for the period 1995-2004) and the data of the European Commission quoted in a professional publication: *Enlargement, Two Years After – An Economic Success*. Brussels - data for the period 1998-2005 (European Commission 2006: s. 48-50). The database Groningen Growth and Development Centre (available on www.ggdc.net) includes fifteen old member states of the European Union and the analysis of the European Commission ten new member states which entered the EU in 2004.

2. Economic growth of the member base of the EU in 1997-2006

If we examine the economic growth of the European Union in the last decade we find that its dynamics was behind most other centres of the world economy. This, however, does not mean that all the EU countries were characterised by a weak growth performance. We can see from table 1 that the lowest average rates of growth between 1997-2006 were achieved within the framework of the original countries of the European Union, namely by Italy, Germany, Portugal, the Netherlands, Austria, Denmark and France while Germany, France and Italy belong among the biggest economies and thus their dynamics significantly

influences the overall position of the European Union. On the contrary among the most dynamic economies in the period 1997-2006 we can count the Baltic States, Ireland, Luxembourg and Slovakia which belong from the view of their size among the smallest economies of the current European Union and their weight is not big in the union average².

Tab. 1: The EU member countries – GDP growth

EU member countries	Average rate of growth of real GDP during 1997-2006 (in %)
Lithuania	7,5
Estonia	7,3
Ireland	7,1
Latvia	6,2
Luxembourg	5,6
Slovakia	4,5
Poland	4,2
Hungary	4,2
Greece	4,2
Slovenia	4,0
Spain	3,8
Cyprus	3,7
Bulgaria	3,7
Finland	3,6
Sweden	3,0
Czech Republic	2,9
UK	2,8
Romania	2,6
Belgium	2,4
Malta	2,3
France	2,3
Denmark	2,3
Austria	2,3
Netherlands	2,2
Portugal	2,1
Germany	1,6
Italy	1,4

Source: EUROSTAT, own calculations.

The given characteristics could raise a feeling that the economic performance was proportional to the economic extent of a country. This, however, cannot be fully proved as among the stagnant economies belonged e.g. Portugal or

² Calculated on the basis of the indicator of GDP.

Denmark and among the countries growing above the average level can be found Spain, Poland or Great Britain.

However, we can also see a different growth performance among other groups of countries i.e. among the new and the old EU member countries³. This statement is clearly demonstrated in the Table 1 where the average rates of growth of the new EU countries are represented by the black data points and the average rates of growth of the old EU countries are represented by the white data points. From the Table 1 we can see that the comparable dynamics to the dynamics of the most successful new EU members reached in the examined period only Ireland and Luxembourg and a slightly lower Spain, Greece, Finland and Sweden. The other EU countries were behind the majority of the new EU member countries.

The faster growth of the new EU member states cannot be connected only with the period after their accession to the European Union. The rate of growth of the real GDP in the majority of the new member countries very soon after the recovery from the initial transformation drop in the first half of 1990s constantly exceeded the level in the old EU-15 states. To be concrete, in the period 1997-2006 a slower economic growth compared to the average of the EU-15 was registered only in case of Malta and the further countries with a lower growth dynamics were the Czech Republic and Romania which have been achieving, unlike the majority of the new EU member countries, high increases in their GDP only from the beginning of this decade.

3. Factors of the economic growth in the EU member countries

At first we will deal with the sources of economic growth of the old EU member states in the period 1995-2004 while we will try to identify the main differences as well as common features when using growth accounting of two groups of countries: the above average growing economies and stagnant economies⁴. Further we will examine to which extent the contribution of so called ICT capital⁵ was significant to the economic growth.

³ By the term new EU member states are usually meant those countries which accessed in the years 2004 or 2007. Old EU member states are understood the other fifteen members which gradually entered the EC/EU during 1957-1995.

⁴ The rates of growth were analyzed in details in part 2 of this paper, here we only remind that the above average dynamics within the old EU member states were achieved in the last decade only in the following countries: Luxemburg, Ireland, Sweden, Finland, Spain and Greece. On the contrary the lower rates of GDP growth were achieved in the large EU member states (Germany, Italy and France) and also in e.g. Portugal, the Netherlands and Denmark.

⁵ A partial component of capital which includes information and communication technologies – computers, computer equipment, software and communication facilities (based on the definition of Groningen Growth and Development Centre).

Tab. 2: Growth accounting: the old EU member countries (EU-15) with the above average dynamism of growth

Period	GDP growth	Capital growth	Labour growth	TFP growth
		Contributions to GDP growth by		
Finland				
1995-2000	4,9	1,9	1,0	3,0
2000-2004	2,3	0,9	-0,3	1,7
Luxembourg				
1995-2000	6,9	1,3	4,0	1,6
2000-2004	2,7	1,0	2,6	-0,9
Greece				
1995-2000	3,8	1,1	0,9	1,9
2000-2004	4,2	1,1	1,3	1,8
Ireland				
1995-2000	9,7	2,9	2,1	4,4
2000-2004	5,0	2,6	0,5	1,9
Spain				
1995-2000	4,0	1,4	2,8	-0,3
2000-2004	2,5	1,5	1,6	-0,5
Sweden				
1995-2000	3,5	1,2	0,7	1,7
2000-2004	2,1	0,6	-0,4	1,9
UK				
1995-2000	3,3	1,4	0,7	1,2
2000-2004	2,3	0,9	0,2	1,3

Source: Groningen Growth and Development Centre (2007).

If we look at tables 2 (growth accounting of the EU countries with a faster dynamism of economic growth) and 4 (the contribution of so called ICT capital to a total capital deepening) it is not possible to find a united pattern for all successful countries. But we can find common trends for some groups of countries. As for Finland, Sweden and Great Britain there was characteristic a significant role of a technological progress (it shows a high level of a total productivity of factors) as well as a high contribution of ITC capital which was in all countries over the contribution of current capital. Therefore we can state that the listed countries managed to profit most from IT revolution in the second half of the 1990s and their growth accounting in the period 1995-2004 is very similar to the US one. In addition, from table 2 we can find out that in case of the Scandinavian countries in the period 2000-2004 there was typical a negative contribution of labour input. Similar findings were concluded e.g. in

the study European Economic Advisory Group. (European Economic Advisory Group 2006: 73-76.).

Tab. 3: Growth accounting: the old EU member countries (EU-15) with the under average dynamism of growth

Period	GDP growth	Capital growth	Labour growth	TFP growth
		Contributions to GDP growth by		
Austria				
1995-2004	2,7	1,4	-0,4	1,7
2000-2004	1,1	1,1	-0,2	0,2
Belgium				
1995-2004	2,8	1,2	-0,1	1,7
2000-2004	1,3	0,3	0,7	0,3
Denmark				
1995-2000	2,8	1,6	0,6	0,6
2000-2004	1,3	1,1	-0,1	0,3
Italy				
1995-2000	2,0	1,1	0,5	0,4
2000-2004	0,9	1,2	0,8	-1,1
France				
1995-2000	2,7	0,9	0,2	1,6
2000-2004	1,4	1,0	-0,1	0,5
Germany				
1995-2000	1,7	0,6	- 0,4	1,5
2000-2004	0,5	0,4	- 0,5	0,6
Netherlands				
1995-2000	3,8	0,7	2,5	0,6
2000-2004	0,6	0,5	-0,1	0,2
Portugal				
1995-2000	3,9	1,5	1,4	1,0
2000-2004	0,5	0,6	0,0	-0,2

Source: Groningen Growth and Development Centre (2007).

The cause of a high growth of Ireland was the utilization of both the extensive and intensive factors of growth. During the whole period there were significant the contributions of capital as a result of the increased investment activity. The contributions of ICT capital were quite high but the prevailing role was played by current capital. The contributions of technological progress and labour input were abnormally high namely in the first half of the examined period. According to the data from Groningen Growth and Development Centre the total number

of workers in Ireland grew between 1995-2000 by more than 5 % compared to the increase of 1.5% in the period 2000-2004 (available on: www.ggdc.net).

Tab. 4: Contributions of ICT capital and capital without ICT factor to the growth of GDP: selected EU countries and the USA

Country	Period	ICT kapitál	Kapitál bez ICT
Ireland	1995-2000	0,6	2,3
	2000-2004	0,4	2,3
UK	1995-2000	0,8	0,6
	2000-2004	0,4	0,5
Finland	1995-2000	0,7	0,1
	2000-2004	0,6	0,3
Sweden	1995-2000	0,8	0,4
	2000-2004	0,4	0,2
Spain	1995-2000	0,3	1,1
	2000-2004	0,3	1,2
Greece	1995-2000	0,3	0,6
	2000-2004	0,4	0,9
Germany	1995-2000	0,3	0,3
	2000-2004	0,2	0,2
France	1995-2000	0,3	0,7
	2000-2004	0,2	0,8
Italy	1995-2000	0,4	0,7
	2000-2004	0,4	0,8

Narrative: *Capital* – total contribution of capital

ICT capital – a partial component of capital including computers, computer equipment, software and communication facility.

Capital without ICT – a partial component of capital including all parts of capital with the exception of information and communication technologies

Classification is adopted from the methodology by Groningen Growth and Development Centre.

Source: Groningen Growth and Development Centre (2007).

In Spain, Greece and Luxembourg the causes of economic growth differed from those of the Scandinavian ones even more substantially. In case of the Southern countries there were typical the higher contributions of current capital⁶ compared to ICT capital. The high contributions of current capital can be explained through the drop in the interest rates in connection with the entry to the Monetary Union which stimulated the investment activity and through the specifics in case of Greece as well as through the increased activity resulted from giving the Olympic Games in the year 2004 (European Economic Advisory Group 2006: 73-76.). The main source of growth in Spain was

⁶ A partial component of capital which includes all the components of capital with the exception of information and communication technologies (based on the definition of Groningen Growth and Development Centre).

however the contribution of labour force as a consequence of the inertially decreasing unemployment in the course of the whole last decade. The increase in employment was so distinct that it was able to replace also the substantial lessening of the length of working hours. Similarly the Luxembourg economy drew mainly from the increase in labour input which was caused either by the increase in employment and also by a relatively small reduction in the length of working hours. The weight of the components of growth in case of Greece was in this respect different from those of Spain and Luxemburg as the main source was the raise of the total productivity of factors.

The results of the growth accounting of the EU-15 countries with below average growth dynamics can be found in table 3 from which two different groups with a similar development of the factors of growth can be reported. The first group includes Portugal and the Netherlands for which a diametrically different development during the first and the second examined period is characteristic. Between 1995-2000 both countries archive relatively solid rate of GDP growth as well as the individual components of growth and after the year 2000 they are affected by a total economic recession caused by the drop of qualitative as well as quantitative factors of growth.

The second group which includes Germany, France, Italy, Belgium, Denmark and Austria shows different features. For the majority of the economies it is typical a low or even negative increase in labour input and relatively low capital deepening (perhaps with the exception of Italy)⁷ in comparison to more successful countries. For most countries from this group with the exception of Germany, Belgium and Austria there is also clearly seen a substantially lower contribution of the total productivity of factors especially in comparison to the Scandinavian countries. In case of Germany, France and Italy it is possible to make a comparison with the successful economies of the EU-15 in respect of the contribution of ITC capital⁸ and also here it is possible to find out the lagging behind the Scandinavian economies, Great Britain and Ireland. This is not however possible when comparing with the other successfully growing economies e.g. Spain and Greece (see Table 4).

Now we move ahead to the evaluation of the cause of economic growth of the new EU member states within the last decade. Unlike the old EU member countries we can find for the whole group of countries (perhaps with the exception of Malta) some obvious common characteristics. The main factors of economic growth of all ten countries were during the period 1998-2005 capital deepening and growth of a total productivity of factors. These components stimulated a substantial growth of productivity and caused satisfactory dynamics

⁷ The cause of the increased investment activity is like in other countries with high interest rates at the beginning of the 90s was the preparation for the entry to EMU.

⁸ In case of other economies the data are not available.

of economic growth. From table 5 we can see that the noticeably higher contribution of capital versus the growth of technological progress was recorded only in case of Slovenia, Hungary and Malta and for the rest of countries the combination of both factors was typical. Malta was different from the whole group of countries as it showed during 1998-2001 a very low (0.5 %) and during 2001-2005 even a zero contribution of a total productivity of factors and this can be marked as the main cause of the different dynamics of growth. The contribution of labour force to the growth of GDP was within the examined sample of countries (EU-10) a minimal or even a negative one.

The cause of the development of a labour input can be quite clearly extracted from two basic indicators of a labour market, both from the development of a total number of workers as well as the length of working hours. From the mentioned indicators we can identify that the causes affecting the supply of labour input differed in the old and the new EU member countries. The labour markets in the new member countries (EU-10) were in the last decade characterised through a low level of the participation in the labour market and through a permanently high level of structural unemployment. The rate of employment is in all the new EU member states (EU-10) under 70 % frontier stated in the Lisbon Strategy and with the exception of the Czech Republic and Cyprus also under the average level of employment in the old EU member countries (EU-15). In addition, all the new EU member countries recorded throughout 2000-2005 with the exception of Estonia, Slovakia and Slovenia, the drop in total employment.

Unlike the new EU member states, the old EU member states (EU-15) were characterised, with the exception of Denmark and Germany, by the increase in total employment. The drop of labour input or a weak contribution of labour input in some countries was caused by a significant lessening of the length of working hours. Within the EU-15 we can record during 1995-2004 a moderate increase in working hours only in three countries (Denmark, Greece and Belgium) and stagnation in Luxemburg⁹. The double negative effect of working hours and total employment was in the period 2000-2004 clear only in case of Germany where the unemployment grew and moreover the average length of working hours was shortened. The high contributions of labour inputs to the rate of GDP growth can be recorded in case of those countries where a high contribution of employment compensated the fall in working hours (Ireland, Luxemburg, Great Britain, the Netherlands and Spain during 1995-2000).

⁹ Based on the data from Groningen Growth and Development Centre (available on www.ggdc.net).

Tab. 5: Growth accounting: the new EU member countries (EU-10)

Period	Potential product growth	Labour growth	Capital growth	TFP growth
		Contributions to potential growth by		
Czech Republic				
1998-2000	1,5	-1,1	1,4	1,3
2001-2005	2,9	-0,4	1,5	1,9
Estonia				
1998-2000	4,5	-1,8	3,0	3,3
2001-2005	6,9	0,3	3,1	3,3
Cyprus				
1998-2000	3,7	0,8	1,4	1,4
2001-2005	3,6	0,8	1,5	1,3
Latvia				
1998-2000	5,9	-0,4	3,0	3,2
2001-2005	7,3	0,5	3,3	3,3
Lithuania				
1998-2000	3,8	-2,1	2,9	3,0
2001-2005	6,1	0,0	2,8	3,2
Hungary				
1998-2000	4,3	0,6	2,3	1,3
2001-2005	3,8	0,1	2,3	1,4
Malta				
1998-2000	2,9	0,4	2,0	0,5
2001-2005	1,5	0,2	1,3	0,0
Poland				
1998-2000	4,1	-0,9	2,6	2,4
2001-2005	3,0	-0,9	1,5	2,3
Slovenia				
1998-2000	4,2	-0,1	2,7	1,4
2001-2005	3,7	0,1	2,2	1,4
Slovakia				
1998-2000	3,2	-1,6	2,7	2,1
2001-2005	4,7	0,3	1,8	2,6

Source: European Commission (DG ECFIN) (2006: pp. 48).

Conclusions and implications for economic governance

From the analysis done we can deduce that definitely the slow economic growth cannot be perceived as a universal problem of all the countries of the European Union. A number of economies of Western Europe have achieved in the last 10-15 years constantly positive dynamics of their GDP; the new member states are even characterised by highly above-average rates of growth (e.g. the Baltic States rank the leading positions even in worldwide comparison). On the contrary the lowest rates of growth were achieved in the last decade by some old member countries of the European Union, namely by Italy, Germany, Portugal, the Netherlands, Austria, Denmark and France. And Germany, France and Italy belong among the biggest economies thus their dynamics significantly influences the overall position of the European Union. On the contrary the weight of the most dynamic economies (the Baltic States, Ireland, Luxembourg or Slovakia) is not big in the union average which negatively influences the total dynamics of the European Union.

On the basis of a study of growth accounting in the last decade we can state that the main determinants of the economic growth were strongly differentiated. The successful countries can be according to the determinants of the economic growth divided into several groups. Countries like Ireland or Luxembourg took the advantage of the combination of traditional and developed growth factors. Nordic countries and Great Britain took the advantage of the intensive factors like productivity growth and contributions from information technologies. Spain and Greece used more traditional growth components.

For the new member countries there was characterised a high contribution from a technological progress and simultaneously low or negative contribution from a labour input. A number of strongly growing economies were characterised by a low level of qualitative characteristics of their economies (e.g. research and development, potential of innovation and so on). That was especially true in case of the new member countries and Greece and Spain. The mentioned countries are significantly lagging behind the EU average namely in the figures such as the expense on research and development. The share of the expense on research and development to GDP are in all monitored countries with the exception of the Czech Republic and Slovenia lower than 1% of GDP. The process of lagging behind can be also observed in a number of university students or when following the share of expense on education as well as on information and communication technologies. On the contrary the selected old EU member countries (namely Germany and France) rank on the substantially higher positions the new countries when evaluating qualitative indicators of the economic growth.

The mentioned characteristics lead thus to a statement that within the framework of the member base of the EU it is not possible to apply one unified

model of economic policy. Each country has to choose the optimal combination of extensive and intensive factors while it is necessary to take into account namely the phase of the development of a given economy. The most developed economies can hardly compete in the prices of production factors or in a higher quality of their products. Thus they are forced to focus on the production of specific goods. That distinction can be achieved on the basis of their own high innovating know-how. Therefore they must within the framework of their policies develop so called innovation factors – sophistication of the business environment and innovation potential. This means far greater requirements on the business and innovative environment in developed countries of Western Europe compared to their competitors from the new EU member states.

Hereby we do not intend to condemn Lisbon Strategy it is definitely true that the EU economies should in the mid and long term concentrate predominantly on the strengthening of employment and increasing qualitative characteristics of the economy (human potential, research and development, innovations) but it is important to customize the model according to the needs of given economies. In addition it can be recommended at a national level the measures leading to market liberalization as results from the experience of some successful European economies (namely Great Britain, Ireland, Luxembourg and Scandinavian countries and continue in the liberalization in on the inner market of the European Union especially in services. The new countries should specifically emphasize the increase in the proportion of labour input as well as increase in the qualitative indicators the importance of which will grow with the growth of the economic level and the cost characteristics of these countries.

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Vydavatel: Vysoká škola ekonomická v Praze
Nakladatelství Oeconomica

Tisk: Vysoká škola ekonomická v Praze
Nakladatelství Oeconomica

Tato publikace neprošla redakční ani jazykovou úpravou

ISSN 1802-6591