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## LIMITS OF MIDDLE-INCOME TRAP IN THE REGIONAL CONTEXT<sup>2</sup>

### Abstract

The paper aims to analyze the theoretical framework of the middle-income trap concept, depending on the possibilities of eliminating this phenomenon, in the regional context of the Moravian-Silesian Region. The presumption of this issue works with the aim that the issue of the middle income is one of the main features that are currently appearing in modern economies to a greater or lesser extent, all the more urgently in connection with the permanent situation of coronavirus pandemics, which includes all aspects of social life in modern democratic societies within the European Union. The paper addresses the most important issues and analyses the possibilities to reduce the negative effects of the middle-income trap in longer-term periods. The text points out the position of the Moravian-Silesian Region in the Czech Republic, in terms of its powers and evaluates the possibilities that the actors of the Moravian-Silesian Region have.

**Key words:** Middle-income trap, region, regionalism, multi-level governance, self-government

### 1 INTRODUCTION

The theoretical concept of the “Middle-income trap” has been addressed for several decades in various countries about their level of economic development. The basic meaning of this concept expresses investment in infrastructure and education, i.e. in building a high-quality education system, which supports

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creativity, breakthroughs, discoveries, or innovations in science and technology, which can be applied to “return” to the economy. To this day, the Czech Republic belongs among the most centralized EU states in Europe. The current form of the regional and local structure is based on the reforms that took place after 1989, which were part of a more significant process of extensive political, economic, and social transformation of society after the fall of communism in Central and Eastern Europe. Public administration reforms and decentralization processes were also carried out in connection with the Czech Republic’s accession negotiations with the European Union, for which regional policy was one of the most fundamental policies, due to the significance of the implementation of EU aims to reduce economic and social disparities between particular EU regions. During the 1970s, the belief prevailed that “the operation of the common market is not in itself capable of ensuring balanced economic growth throughout the common market, including, for example, geographically specific areas.” (Fiala, Pitrová 2009, 503) as a priority, to outline the possibilities of preventing or minimizing the middle-income trap in advance, through the relationship of the imaginary triangle with the three vertices, namely, small and medium-sized enterprises - education - state. The methods used in this text are based mainly on analysis, comparison, and deduction, which rather fulfill the principles of qualitative research. The text will also analyze the secondary data.

## **2 THEORETICAL DEFINITION OF THE MIDDLE-INCOME TRAP AND ITS RELATIONSHIP TO REGIONAL POLICY**

The European Bank for Reconstruction and Development (EBRD) defines the middle-income trap as a situation where the country has become rich to some extent, which is usually 1-2 / 3 of GDP per capita, but has exhausted its current competitive advantages, usually in particular in the form of cheap labor. Thus the country is in such a situation unable to find a different growth model. European Bank for Reconstruction and Development states that in many countries, several groups are interested in such a situation and are even unwilling to support any changes. Accordingly, EBRD emphasizes that there is no general functioning protection against getting stuck in a middle-income trap, but it published several general recommendations on how to face the middle-income trap more efficiently. These include the following factors: an active role in promoting space for the creation and growth of new companies; avoiding over-regulation of the labor and capital markets; infrastructure investment; emphasis on improving the environment. These recommendations apply in general, but to the Czech Republic, which was removed almost fifteen years ago from the list of countries that the EBRD supports with its loans and consultations, and which are at least a stimulus for further discussion within the group of political and economic elites.

For example, economist Tim Taylor points out that the middle-income trap is talked about mainly in connection with countries that have managed to reach the middle-income economic level but have a problem with further economic development, where they are unable to use their potential more, which follows on the recommendation of the EBRD (Patria. cz). The thesis on the priorities of the Czech Republic 2030 (Teze k prioritám 2030) is very interesting on this issue. This material was submitted to the Government Council for Sustainable Development as the first working output of the Committee for Socio-Economic Development. The material is presented as a pure discussion and we will find in it the definition of the ten most important problems and the possibilities of its solution. The fifth point directly describes the current situation, specifically, it is defined as follows: “The Czech economy is probably in a special version of the middle-income trap and at risk of slow or stopped convergence with advanced economies.” The individual theses are further divided into other subcategories, which are also analyzed. The whole issue is very interesting, and even though thesis number five directly addresses the issue of the middle-income trap, we will also find in the text a reference to theses that are connected with this issue such as in the field of investment, GDP, or innovations. In general, however, the material mentions mainly the following: after 2008, the Czech Republic went through six years of alternating relatively short recessions and insignificant and short periods of economic boom, which was offset by the end of 2014. We can therefore conclude that either the defects of the lost decade appear only in the medium term, or that this is a challenge of long-term low economic growth. Given the above, three hypotheses are offered: 1. The slowdown is temporary, associated with the crisis and strong fiscal consolidation; 2. The slowdown is long-term, but reversible if there is a fundamental reform of the economy; 3. The slowdown is permanent and inevitable, linked to fundamental changes in the global economy. If we lean towards the possibility of long-term stagnation, the question is essential whether we are in some new type of middle-income trap, which has been partially confirmed for some less developed emerging economies. One of the solutions to permanently avert the economic slowdown is, for example, international trade, based on cooperation with today’s fast-growing economies (such as economies in the regions of Southeast Asia, Latin America, or the BRICS group ). However, there is a real possibility that all of the above-mentioned countries, as well as the Czech Republic, will be endangered or even fall into the middle-income trap. The Committee on Socio-Economic Development presents an interesting idea of the middle-income trap of ownership. He further develops this idea as a hypothesis that the Czech Republic did not fall into the middle-income trap because it is one of the results of the economic crisis but on contrary it fall into the middle-income trap as a result of the process of giving up ownership of Czech companies and related rights and instead of this Czech Republic was trying to achieve to

become a successful place for the production of foreign-investment companies with predominant work, which would correspond to reputation and specialization of the Czech Republic (Vize ČR v roce 2030, Výbor pro socioekonomický rozvoj) . This idea fulfills the very definition of the middle-income trap when the short-term thinking of individual economic actors led the Czech Republic to the middle-income trap when the way back seems much more complicated than the way there was. In general, we must think self-critically whether the fact that the Czech Republic is not, for example, a technological leader who, based on domestic research and development, produces top products on a global scale that brings high profits for the domestic economy, well-paid work and high revenues for the state treasury. Is not the fault of the Czech Republic itself and its public policies. The overall situation, therefore, evokes the idea, which is the primary aim of the text, namely to promote the elimination factors of the middle-income trap in a regional context, focusing on issues such as supporting small and medium-sized enterprises and education, which opens up space for innovation and original ideas and solutions. Here it is necessary to point out that the Czech Republic has the opportunity and reserves to work on this issue. Its system of higher education but also apprenticeships is at a very high level, however, the support of entrepreneurship and leadership to it by the state is much less than would be desirable.

As it was mentioned above the submitted text tries to analyze the middle-income trap phenomena from the regional context, which in the above-mentioned factors has an unmistakable and irreplaceable role. Regional development policy is still one of the most funded policies of the current European Union and plays a very important role in the development, especially of the regions of Central and Eastern Europe that joined the EU in 2004, 2007, or 2013. The very concept of region is also accompanied in the literature by several ambiguities and disputes, which stem from the terminological ambiguity of this concept. (Fiala, Říchová et al. 2002, 10) In general, a region refers to “a certain area, a part of the earth’s surface that differs from other areas by specific characteristics. Every region is in a sense a territory, but not every territory is a region” (Siwek 2014, 149), and there are several other definitions where the term “region” can be defined in terms of physical or social geography, demography, infrastructure, environment, or historical, cultural and administrative point of view, etc.” (Čmejrek 2008, 31) The basic definition of the term “region” is twofold. The first is based on the spatial dimension and is understood as “a territory between the nation-state and the locality, which is also the object of the action of actors from different levels.” (Fiala, Říchová, et al. 2002, 11) The second is based on a functional concept for “a space where different types of relations meet between different institutions. Functionally, therefore, the regions are a space of competition.” (Fiala, Říchová et al. 2002, 11) Even this basic definition was a subject of criticism. Some regions meet

both characteristics. Also, some regions are larger in size than the states in which they partially intervene. The presented text is based on the functional definition of the region considered by the Moravian-Silesian Region (Moravskoslezský kraj), which was established on the 1st of January 2000 together with other nowadays regions of the Czech Republic, with the main emphasis on the position of this region within the political system of the Czech Republic. The text also deals with the main problems of the current Moravian-Silesian Region in connection with the emphasis on the phenomena associated with the middle-income trap and the possibilities of its elimination of education and business. Although the Constitution of the Czech Republic of 1993 explicitly stated the existence of so-called “self-governing regions”, these units were not established at the time of the independent Czech Republic and there was no consensus among relevant national political elites a few years later. The discussion on the future regional structure and competencies of regional self-governments lasted for several years, while during the first phases, there were only partial shifts. Before 1993 was the question of decentralization was highly affected by disputes between the Czech and Slovak parts of the federation which issued in the division of Czechoslovakia in 1993. Till the national election in 1996 was this issue rather insignificant, the only parliamentary party, the pro-moralist party of Movement for Self-government Democracy – Society for Moravia and Silesia (Hnutí za samosprávnou demokracii, Společnost pro Moravu a Slezsko) was considering this question as a crucial for further political development. Paradoxically, this question gained higher relevance after the 1996 elections, where the most important propagator of this idea, pro-moralists lost all parliamentary seats. But even till 1997 there were different ideas about the future Czech regional structure among different political parties and most of them were not compatible even among coalition partners in the Czech government. The most discussed issues were not however the question of future competencies and powers of regional authorities and their role in the political system, but the final number of all Czech regions and borders between them. Very crucial became the representation in the Czech Parliament in the upper and especially in the lower chamber and within party leadership of the relevant political party system, such as Civic Democrat Party (Občanská demokratická strana, ODS), Christian democrats (Křesťanskodemokratická strana-Československá strana lidová, KDU-ČSL) and Civic Democrat Alliance (ODA), as well as Czech Social Democrat Party (Česká strana sociálně demokratická) (Vomlela 2014, 28). In 1997 was adopted constitutional law no. 347/1997 which enabled the later establishment of 13 regions as well as strengthened the existing competence of the Capital city of Prague (Hlavní město Praha), which has the same position and powers as Czech regions. (Valeš 2006, 196) The constitutional law also states the borders of particular regions which are consisting of districts. The Moravian-Silesian Region was supposed to consist of the territories of districts of Karviná,

Ostrava-City, Frýdek-Místek, Nový Jičín, Opava and Bruntál (Čl. 1 § 13, Ústavní zákon č. 347/1997 Sb.) This law came into effect after several years on the 1st of January 2000, but new regional authorities started to fully operate during this year. (Říchová 2015, 123) The reason for this was a lack of consensus on future powers and the roles of regions in the political system. During 2000 were adopted several laws and different norms which were crucial for development new regional structure, such as Law on Regions (Zákon o krajích č. 129/2000 Sb.) or Law on the elections to regional chambers (Zákona č. 130/2000 Sb. Zákon o volbách do zastupitelstev krajů a o změně některých zákonů). The adoption of the new lining in 2000 however was not the last step of the reforms of public administration in the Czech Republic. The powers of regional authorities but also municipal authorities at the local level were increased in 2003 due to the abolishment of district offices. Although the reforms took plover ring several years between 1997 and 2003 and were the result of the political compromise of most relevant Czech political parties the reforms did not avoid larger criticism of the way the adopted structure which was considered chaotic. There are significant differences among particular regions in terms of their economic strength power, number of inhabitants, and logic of geographic criteria which were not considered when particular regions were established. The most important limitation was that only a few regions could be NUTS II units, which forced regional authorities of several regions to create a common NUTS II unit, which was the connection of two or even three regions. Most of the problems were issued by the fact, that the decisions resulted in a new structubeingere adopted from “above” and the long-term strategy of their power was lacking. (Vomlela 2014, 29-30) But regions prove to play a significant role in the mediation of conflicts between state and local authorities. (Říchová 2015, 123) The role of Czech regions is also affected by the political competition of political parties. In situations when political representation of the region has also a good strong position in the political parties which are part of the government at the national-state level, the role of regional political elites and regional authorities is increasing. (Ryšavý, Lysek 2018, 3)

### **3 SME AND EDUCATION AS ONE OF THE POSSIBLE WAYS OF PREVENTING THE MIDDLE-INCOME TRAP IN THE REGION?**

The definition and theoretical definition of small and medium-sized enterprises, or entrepreneurship, is essentially reflected in the number of employees and turnover. In general, small and medium-sized enterprises are a category of enterprises with a small number of employees. Different countries and institutions use different criteria to define this category, one of which is, for example, the number of employees. The European Union considers this limit to be 250 employees, while in the United States it is 500 employees. In the literature, the

abbreviation SME (Small and Medium Enterprise) or SMB (Small and Medium Business) is often used for this type of business. In connection with the above, an integral part of the way out of the middle-income trap and its prevention is the creation of an education system that supports innovation and creative thinking. In the Czech Republic, the education system at all levels is inextricably based on the law. There are also a large number of training agencies on the market that offer a number of retraining courses, including active employment policy, which is guaranteed by state policy. However, the education system and the trend of universities, which are currently trying to respond as much as possible to the situation on the labor market, are one of the ways to educate creative individuals with the potential to fill the space for starting small and medium-sized companies. In response to the above, however, it is possible to draw attention to the space that has been developing in recent years in the field of education in the Czech Republic, namely apprenticeships without a high school diploma and apprenticeships with a high school diploma. It is the graduates of this level of education who have the greatest preconditions for establishing small and medium-sized enterprises with innovative elements and opportunities to cooperate with companies that participate in their education. However, it is a matter of discussion to what extent it is necessary to prepare for this level of education so that they can consider themselves confident graduates with a vision, to establish their own company that meets the definition of small and medium-sized enterprises. The above evokes the primary goal, which is the development of conditions for the business environment, which in turn does not create space for a middle-income trap. There is a direct relationship that indicates that the development of the business environment is affected by the quality of the business environment. This is formed by conditions in the field of legislation, institutional infrastructure, state bodies represented by legislatures and ministries, as well as state-established or state-supported institutions and agencies, courts, and public authorities (Council for the Development of the Business Environment, 2007). These conditions can be exhaustively summarized in the following points:

- Finance
- Government policy
- Human resources and education
- Transfers science and research results into practice
- Business partners, services, and law
- Situation in the market
- Entrepreneurial mentality and business support programs

The first two points are directly related, in terms of the material basis for the creation of an SME. Finance is one of the factors that often limit start-ups with the

fear of unfavorable loans and credits, which are often not sufficiently supported by the state. Human resources and education is a debatable factors. A good education and a general overview do not lead human resources to start a business on their own. On the contrary, leading educational institutions to support creativity and create a healthy confident individual who is willing to succeed in the labor market can be one of the ways to support this phenomenon in society. These are followed by the aforementioned transfers of results of science and research into practice (in this respect, not only the results from scientific laboratories of higher education are meant, but also from apprenticeships). The last area influencing the space for the support of small and medium-sized enterprises is the relationship between the business environment and the environment, which is generally created by the state and legal legislation valid throughout the territory. The insufficient definition then leads to concerns about establishing an independent company or trying to maintain it at all.

To analyze the middle-income trap problem and to find possible ways to avoid it in long term, we can define the following problems which are potential threats to the state economy.

- Stagnation of innovations - in this case, it is a problem of the whole state economy. Insufficient support for innovation, which is linked to other aspects such as education at all levels and threatens the middle-income trap.
- Stagnation of education - this threat is related to the entire education system, not only in the Czech Republic. Support for creative thinking in teaching, secondary and higher education in cooperation with practice is desirable. The opposite leads to a threat to the middle-income trap.
- Stagnation of legislation – the threat of insufficient and out-of-date legislative issues that do not respond to current events in society and the market (regional, national and global), but lead to a threat to the middle-income trap.
- Insufficient support and incentives from the state and platforms at the state and regional level - it is clear that without a positive view of SMEs by the government and society, it is not possible to use all the potential offered by individual segments, leading to the trap of middle income.
- Information - on a general scale, sufficient information on this issue is indispensable. This information is important precisely in the relationship between education, government, and regional actors. At this level, it is desirable to cooperate and open up new possibilities for promoting support at all levels, including in particular the prevention of the threat of a middle-income trap.

These risks are just an outline of the issue, which often carries deeper problems, also about the labor market and employment policy in the country or the Czech Republic. But what are the opportunities for individual states, i.e. the Czech Republic, to prevent middle-income traps? This issue was also addressed in the text, from which it is possible to define a few moments of opportunity



to prevent the middle-income trap. The authors of the text consider education, information, legislation, social support, and tradition as these moments. All these moments can be understood in both positive and negative terms. Education is the cornerstone of further business. It is necessary to deepen the general awareness of the current situation, support creativity and translate any educational activities into practice as much as possible. This is also related to the information that should be provided not only at all levels of education but also to citizens and organizations, which could thus be better involved in the economic process. State legislation is inextricably linked to any business, so it can be stated that sufficiently defined legislation facilitates the process of deciding whether to become a small or medium-sized entrepreneur or not to run a business at all. The last two opportunities are social support and the traditions of society.

#### 4 CONCLUSION

The shape reforms that took place after 1989 were marked by extensive changes in the multilevel system of governance. They included a significant reorganization of the system of public administration and self-government, while the regional structures in the form of the then districts and regions were significantly affected. The regional structure was originally abolished in 1990 without compensation, while the final form of the regional establishment was to be decided in the following years. The discussion between the relevant political actors lasted almost until the year 2000 when the regions began to function. Nevertheless, until 1997 no agreement was found on the future delimitation of individual regions. There was even more uncertainty about the future competencies of the regions, which was decided in 2000. In terms of competencies in the field of self-government, the regions were rather weaker actors, which are perceived as intermediaries between municipalities and the central level. Nevertheless, we have seen a change in the position of the regions in recent years. A few years ago, the position of the regions began to change. The regions acted more significantly in the role of mediator between the local and national levels. Political competition has proved to be very important in this regard, with individual national parties strengthening their “regional level” in the past, which has resulted in the strengthening of regional interests. The influence of regions and the influence of regional political elites is stronger in periods when members of government parties are represented on the regional council. This influence is evident in the Moravian-Silesian Region especially after 2016, resp. 2013. The primary level of the text was the introduction of small and medium-sized enterprises and education as one of the limits of creating a middle-income trap at the regional level. The article focused on the above precisely because of the potential that the Czech Republic has from a regional point of view in this regard. Mutual relations are

often quite simple in their complexity, therefore the main goal of all actors should be the effort to support entrepreneurship and education in connection with the regional dispositions of the state

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ÚSTAVNÍ ZÁKON o vytvoření vyšších územních samosprávných celků a o změně ústavního zákona

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