

# Czech Republic

<b>Status Index</b> (Democracy: 9.45 / Market economy: 9.00)		<b>9.23</b>	<b>Management Index</b>		<b>6.95</b>
<b>HDI</b>	0.874		<b>Population</b>	10.2 mn	
<b>GDP per capita (\$, PPP)</b>	16.357		<b>Population growth<sup>1</sup></b>	0.1 %	
<b>Unemployment rate</b>	7.8 %		<b>Women in Parliament</b>	15.7 %	
<b>UN Education Index</b>	0.93		<b>Poverty<sup>2</sup></b>	< 1 %	
			<b>Gini Index</b>	25.4 (1996)	
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. <sup>1</sup> Annual growth between 1975 and 2003. <sup>2</sup> Population living below \$ 1 (1990-2003) World Bank.					

## A. Executive summary

This report focuses primarily on the years 2003 – 2004, when the Czech Republic completed its preparation for EU accession. Signing the accession treaty in April 2003, the referendum on accession held in June 2003, accession to the EU in May 2004 and the Czech Republic's first European Parliament elections in November 2004 mark milestones in the country's development. These processes significantly shaped the political-legal framework for the functioning of society.

Political leaders were successful in consolidating the rule of law and democracy, but achieved only partial success in economic and social reforms. Several economic indicators showed improvement; GDP grew continuously; per-capita income increased to \$15,700 and inflation remained low. The inflow of foreign investments was also satisfactory and reflected confidence in the business environment. However, it was not possible to reduce the high unemployment rate, although it remains below the EU average. The increase in the state budget deficit jeopardizes the fulfillment of the Maastricht criteria for the Czech Republic's accession to the Eurozone. In addition to reducing the state budget deficit, the Czech Republic will also have to carry out several structural reforms needed for the expected accession to the EMU by the end of the decade.

Improvements to the legal environment, law enforcement and courts are still needed. Citizens have begun to appeal to the European Court of Justice due to long delays in national Czech courts. Despite having declared the fight against corruption a priority, the government has not yet found an efficient antidote to corruption in the state apparatus, police and political elite.

The Czech political party system is consolidated and party representation in parliament is stable. Constitutional checks-and-balances function well. The government's marginal parliamentary majority hampers the adoption of important reform decisions with long-term effects. Representational democracy in the Czech Republic faces the challenges of an increasing gap between parties and citizens, a lack of interest in political party membership, and a declining interest in public matters generally, as evidenced by low electoral turnouts. While the public strongly approves of democracy and democratic procedures, citizens show dissatisfaction with development in the country. There are no large-scale potential opponents to political and social reforms.

Currently, there are no serious ethnic, religious or political conflicts in the country. To the contrary, there are tendencies to seek reconciliation with the communist past and vital attempts to solve issues such as the political and social inclusion of minorities within the majority society.

During the period under investigation, political extremism and related crime or violence declined. There are no intransigent religious groups or new religious movements. There are no relevant activities of Islamic extremists. The main risk associated with right-wing extremist groups is their continued effort to improve their networks and strengthen foreign cooperation. During the period monitored, politically motivated extremist activities stagnated. Extremists currently pose no significant danger to Czech democracy.

## **B. History and characteristics of transformation**

During the last fifteen years, the Czech Republic underwent three major transformations. Political transformation built a democratic system; economic transformation entailed the shift from a state-planned to market economy; and an unexpected redefinition of the nation-state resulted from the disintegration of the Czechoslovakian federation into two separate successor states, the Czech and Slovak Republics on January 1, 1993.

The formation of the basic pillars of a legal democratic environment was based upon a new constitution. The constitution was first radically reformed in 1990 and gradually amended through 1992. Upon the dissolution of the Czech-Slovak Federal Republic, a new democratic constitution was prepared for the new successor state. The Czech Republic continues to be criticized by the European Commission for its slow transposition of European directives and legislation. By the end of 2004, 9.6% of the total number of regulations remained to be transposed into national law.

The Czech party system stabilized quickly. The structures of political parties in parliament have been consolidated since the 1992 elections. The beginning of political transformation in the first half of the 1990s was managed by politically inexperienced elites and socialist reformers of the Prague Spring period (1968) who had returned to lead the government. However, the shift from “political amateurs” to “professional politicians” soon ensued. Recruitment patterns typical of liberal party democracies gained significance later. In 2002, 58% of the members of parliament were re-elected. This development is related to the process of party system stabilization and consolidation (number of effective parties: 3.89).

Transformation toward a market economy began in 1990 with the introduction of fundamental economic reforms. The shift away from an egalitarian distribution of wealth and income proved to be a key step. As communist Czechoslovakia was the most “socialized” of all the Central and Eastern European economies, with 97% of its assets owned by the state, the government thus implemented its speedy privatization program. This program included a controversial voucher privatization, which proved problematic and resulted in significant financial losses. The legal foundation for the country’s economic transformation was created between 1990 and 1992. Basic legislation governing privatization and the restitution of property was adopted, and a large portion of the privatization process was completed by the mid-1990s. The state still owns or holds large shares of certain large enterprises.

Since the beginning of the transformation process, the country has striven for inclusion in international structures. This was especially true of the Czech Republic’s entry into the International Monetary Fund in 1993, as the IMF (like the World Bank) offered credit that the country urgently needed at the beginning of its economic reforms. The country’s economic and social development took place in four phases. The first was characterized by a considerable decline in the Gross Domestic Product (GDP). The next phase (1994-96) saw considerable economic growth, followed by a two-year recession (1997-99). Since 2000, a new phase of economic growth has been observed. However, not all of the economic indicators are performing well.

Formulated at the beginning of the 1990s, the target of “a return to Europe” and integration into European structures has been achieved. In March 1999, the Czech Republic became a member of NATO and in May 2004 a member of the EU. Rapid progress has been made on the way toward democracy and the rule of law. Democracy was consolidated by the mid-1990s. Citizens’ relationship with the democratic system is relatively good, although the level of satisfaction with the political performance of the country is rather low. In the course of the monitored period, the percentage of satisfied citizens in public opinion polls hovered around

15%. Dissatisfaction comes primarily from Communist Party sympathizers, the elderly and socially and economically disadvantaged groups. However, there are also dissatisfied intellectuals, entrepreneurs and individuals from the middle class.

## **C. Assessment**

### **1. Democracy**

#### **1.1. Stateness**

The Czech Republic is a consolidated representative democracy. Communication between the two chambers of the bicameral parliament has improved, although it is still not legally regulated.

Current President Václav Klaus, long-time chairman of Civic Democratic Party and prime minister from 1992-97, replaced Václav Havel in 2003. The election of the new president reflected the internal fragmentation of the ruling coalition and political parties, as evidenced by the fact that the president was elected only on the third ballot and the third vote on February 28, 2003. Klaus is far more actively involved in the legislative process than Havel was. From 2003 to 2004, he vetoed 11 bills, though in all of these cases he was subsequently overruled by the required absolute majority in the Parliament.

All citizens are equal before the law and their rights are guaranteed by the constitution. Historically, the Czech Republic has been a country characterized by emigration and transition. As such, migration policy has been rather passive and ad hoc until the end of the 1990s. The prospect of the EU accession and an increasing influx of immigrants have resulted in the government taking a more active position and enforcing proactive measures in the realm of migration control to compensate for shortage of skilled labor and the poor mobility of the Czech labor force.

The Czech Republic, defined by the Constitution as a unitary state, has a highly homogenous ethnic structure. More than 90% of the population declare themselves to be of Czech nationality. The Roma are the largest ethnic minority. With the exception of the Roma population, the government relationship toward minorities is generally unproblematic, as is their social and economic integration into the society. Thus far, not enough attention has been paid to guaranteeing the Roma population access to education and assistance in overcoming cultural and social barriers within Czech society.

The Czech Republic is one of the most secularized countries in Europe. Religion has no influence on politics or law. In the 2001 census, 32.1% of the population claimed to belong to a church or religion (predominantly to the Roman Catholic church). There were 25 state-recognized churches in 2003, all of which receive direct state funding, depending on the number of clergy they have. Religious organizations receive approximately \$106 million annually. The restitution of church property and the ratification of the treaty with the Vatican are two unresolved problems.

The state has a differentiated administrative structure throughout the country. The local government structure is highly fragmented. In 2001, there were 6,251 municipalities in the Czech Republic of which nearly 80% had a population of less than 1,000. Decentralization progressed significantly during the period under consideration: in January 2003, the government carried out unprecedented decentralization, transferring a significant number of powers in education, healthcare, territorial planning, and environmental policies to regional governments. At the same time, the former state administrative units – counties and county offices – were abolished, their powers were transferred to regional authorities and 194 selected municipalities endowed with extended powers. Regional and local authorities receive their funding through national taxes, which the national parliament determines annually. The law defining the degree of decentralization in financing is always subject to heated debates between the national and regional authorities.

## **1.2. Political Participation**

Free and fair elections have been held in the Czech Republic since its establishment. During the monitored period, the first elections to the European Parliament (EP) were held in addition to by-elections for two seats, parliamentary elections for 1/3 of the Senate seats, and district elections. The electoral turnout in all types of elections has been low – between 19% (in the case of the second round of the Senate elections) and 29.6% (for district elections). There were no elections to the national parliament in 2003 and 2004. Little attention has been paid to the EP elections – the electoral turnout was 28.32%. An explanation for the low turnout compared to the participation in the referendum on the accession of the Czech Republic to the EU can be found in the public's skepticism vis-à-vis the EU, the role of the EP, and the thin European identity of the Czech citizens. Political parties and the media in the Czech Republic ascribed much less importance to the EP elections than to the parliamentary elections. The strongest ruling party, the social democratic ČSSD, secured only two seats and suffered a great electoral defeat that resulted in the resignation of the social democratic Prime Minister Špidla and his cabinet.

Czech law on political parties and movements regulates the formation and registration of political entities. Today, 126 political parties and movements are registered, 92 of which are active. Thus far, 13 entities have been barred from registration and the activities of 21 entities have been halted.

Non-governmental nonprofit organizations are legally regulated. At present, more than 85,000 NGOs are registered in the Czech Republic. Because post-Communist citizens tend not to be inclined toward self-organization, NGOs are not sufficiently accepted as an important partner in providing social services and policy formulation. This constitutes the greatest weakness of the nonprofit sector, as does the continued strong dependence on funding from public and foreign sources.

Freedoms of speech and the press in the Czech Republic have been guaranteed since the country was founded, and the country has a wide range of independent electronic and printed media. During the period under consideration, the influence of political parties on the media has decreased. Investigative journalism is not sufficiently developed, and there are debates about the independence of some media. Gradually, Internet accessibility has been growing; today approximately 17% of the population has Internet access.

### **1.3. Rule of Law**

The president of the republic and other democratically elected representatives rule within the scope of their defined powers. Political tensions between the newly-elected president and the left-of-center coalition cabinet and between the president and the parliament in proposing candidates for constitutional judges were dealt with using democratic mechanisms as part of the constitutional division of powers. There is no visible tendency toward the collusion of powers among the democratic institutions. Nevertheless, there are disagreements on certain policies originating from different political standpoints of the major political actors – the president, the government and the parliament.

In addition to the separation of powers between the legislative and executive branches, the judicial branch has maintained its independence. The main criticism of the judicial branch is the time it takes to adjudicate a case. The European Commission frequently criticizes this issue in reports, and Czech citizens often turn to the European Court of Justice with their cases. Of the total number of six cases filed against the Czech Republic, four were concerned with the duration and/or the course of a legal case. Individual courts are able to interpret all legal norms within their powers independent of political pressure.

In the light of current cases involving an attempt to corrupt an MP and documented economic criminal behavior of a regional judge, the cabinet has intensified its fight against corruption. In spite of these efforts, as well as the gradual evolution of legal and procedural mechanisms, growing political will and the work of judges, it remains difficult to punish corruption. According to the Transparency International Corruption Perception Index (CPI), the Czech Republic dropped from a ranking of 51st of 146 in 2003 to 54th 2004.

Civic rights are anchored in the Declaration of Basic Rights and Freedoms, the observance of which is supervised by the constitutional court, the country's Highest Administrative Court, and the office of the ombudsman (public defender of rights). During 2003 and 2004, the Highest Administrative Court dealt with, respectively, approximately 4,000 and 7,000 submissions. During the same period, the office of the ombudsman addressed approximately 4,500 submissions per year, of which 60% were within its defined powers. Two issues attracted significant media coverage – the issue of sterilization of several Roma women in whose cases, based on the investigation of the office, the requirement of a qualified consent with the procedure was disputed, and the amount of financial compensation in cases of land expropriation by the state for public purposes.

Restitutions remained among the most watched cases heard by the constitutional court. In 2003, one representative of the nobility attempted to create a precedent in a case of property restitution. In 2004, there several cases, initiated both by state bodies and those seeking restitution.

#### **1.4. Stability of democratic institutions**

A predominant majority of political elites and citizens do not see any alternative to democracy. There is a strong approval of democracy as well as democratic norms and procedures among the public. Democracy is most often associated with freedom and participation. High socioeconomic status and education correlate positively with a positive evaluation of democracy. Positive attitudes are also adopted on practical grounds: proponents of democracy tend to participate more in political and civic life.

Critical attitudes toward democratic institutions represent the expression of an assessment of institutional performance. Trust can be divided into institutional trust (which is generally lower) and interpersonal trust (which is significantly higher). While only a small portion of the population has trust in the parliament and cabinet (20% and 30% respectively), municipal councils and assemblies and the president enjoy greater support (62% and 70% respectively). The low trust in parliament and the cabinet can be seen as the result of relative dissatisfaction with the political situation in the country and its political representation, rather than

with the political regime as such. Ninety-three percent of Czech citizens report having confidence in their acquaintances, while 85% trust their fellow citizens, and 68% feel this way about other citizens of the European Union.

The state's administrative system is stable. The degree of information provided by the public administration to citizens has improved considerably since Information and Communications Technology (ICT) has been employed increasingly, especially at the level of central state administration. The implementation of legislation regarding the service of the employees in public administration as well as that dealing with officials of territorial self-administration could improve the services in this area further. To date, however, the implementation of this legislation has been delayed.

In general, the functioning of institutions reflects both division of political powers and the will of different branches to come to consensus. Some offices do function poorly, however: the Supreme Audit Office is one such example. The office is responsible for auditing the management of state property and the implementation of the state budget. Following the demise of its president in 2003, no successor was appointed (this position is appointed by the president, following a proposal by the Chamber of Deputies), as the political parties have not yet been able to reach an agreement.

### **1.5. Political and social integration**

Fifteen years after the country's transition to democracy, the Czech Republic is still in the process of building cohesion, empathy, and solidarity, both among socioeconomic groups as well as between generations. The social functions of the family, community, and neighborhood have been weakened. To build social capital and cohesion such "bottom-up" structures of activity must supplement the "top-down" activities of the welfare state. Social exclusion is primarily widespread within the Roma minority. This is a clear case of "ethnicization of poverty."

The party system is relatively stable; fragmentation and polarization are fairly weak. While volatility remains above the European average, it does not endanger political stability. The Civic Democratic Party (ODS) and the Communist Party of Bohemia and Moravia (KSČM) are the two political parties with the most stable electorates. Protest voting played an increasing role in recent elections. One weakness of the process of interest mediation is the low degree of coordination among social organizations and interest groups at national, regional and sectoral levels. None of the interest groups dominates the process of interest representation, which reflects competing social interests. Thus, a relative social consensus has been established and the risk of social protest lies within the limits of consolidated democracies.

## **2. Market economy**

### **2.1. Level of socioeconomic development**

The Czech Republic is a functioning market economy that has been gradually converging with the economies of the EU Member-states. In general, there is no massive exclusion due to poverty, education, or sex-specific discrimination. Again, the Roma are the exception to this rule. The average monthly income in the Czech Republic was €580 in 2004, a 6.8% increase compared to 2003. There are great differences between the capital Prague and the remaining regions of the country. In Prague, the average salary reached 124% of the national average while income in the western Karlovy Vary region averaged only 85% of the national average. According to Eurostat, the region surrounding Prague is the wealthiest of all the new EU member states. Income differences between men and women persist. The HDI index was at 0.857 in 2001. The speed of wage increases exceeds the growth of labor productivity (4.1%, 2004). While income inequality has gradually increased, the GINI index rose only marginally between 1996 and 2002, from 26 in to 27.3.

Unemployment has not fallen; on the contrary, it has increased slightly and was nearly ten 10% in 2004, albeit with great regional and gender-related differences. Women suffer higher levels of unemployment than men do, with a rate of 10.9% in 2004, as compared to 8.3% for men in the same years. It has become more difficult for women with children to access the labor market. The biggest problem is long-term unemployment, which constitutes approximately 40% of overall unemployment. The unemployment of Roma is estimated at 80-90%. Again, this figure shows the massive social exclusion suffered by this minority population. The labor market is still characterized by relatively low mobility between jobs and between regions. Families—especially one-parent households—have been the main losers of transition.

### **2.2. Organization of the market and competition**

The fundamental aspects of free-market competition are stable, although specific problems have appeared during the period under consideration. In 1996, the Office for Protection of Competition (which replaced the Ministry for Economic Competition in 1999) was set up to create conditions conducive to the support and protection of economic competition and to oversee public procurement. The office is completely independent, as interference in decision-making from the cabinet or other political leaders is illegal. In connection with the harmonization of the Czech legislation with European norms, the law on economic competition protection was amended in August 2004. The new legislation resulted in an intensification of the office's activities. This is reflected in a growing number of

solved cases as well as in the increase in of sanctions and fines imposed. The office dealt with 12 cases in 2002, 30 in 2003 and as many as 53 in 2004. In the cases handled in 2004, the office imposed a fine for a breach of the law on the economic competition protection. The largest fine imposed by the office (€10 million) was imposed in 2004 on distributors of petrol for forming a cartel on the sales price of petrol. The second-largest fine (€2.7 million) was imposed on Český Telecom for abusing its dominant position in the telecommunications market.

Problems with the protection of foreign investments continue. A dispute between the Czech government and a U.S.-based company, Central European Media Enterprises (CME), ended with the government being ordered to pay the petitioner more than CZK 10 billion (\$350 million). The firm's owner, Ronald Lauder, filed a lawsuit against the Czech Republic for not protecting his investments in the country's largest private television station, TV Nova.

Foreign trade has been fully liberalized. Domestic price liberalization continues, albeit slowly. Some prices (in particular those of energy and housing) have been gradually deregulated in a process controlled by the government. The continued rent control was the subject of constant debate, as it prevents the liberalization of the housing market and supports speculation with state flats. More than one quarter of households live in rent-controlled flats.

Economic competition continues to be hindered by the fact that the government owns large segments of some sectors. In telecommunications, the previously state-run Český Telecom has retained its dominant position. This has resulted in higher-than-average fees for telecommunications services – including internet service provision – in comparison to most neighboring countries. The electricity sector has not been fully liberalized either. A state-owned company still controls most of the production, distribution, and sale of electricity. Administrative requirements pose barriers to setting up a business, heightening inefficiency. Registration in the Commercial Register is the most criticized aspect of the administrative process. Administrative barriers and corrupt practices hamper the development of a dynamic entrepreneurial spirit and environment in the Czech Republic. The privatization of the banking sector was completed; it now complies with international standards. Its stability and performance improved considerably.

### **2.3. Currency and price stability**

The evaluated period was characterized by a relatively stable currency. The exchange rate fell from 33 Czech crowns per dollar in 2002 to 28 in 2003 and 26 in 2004. In 2004, both currencies saw a dramatic drop, and despite the strengthening of the Czech crown's increasing strength, annual figures grew. The Czech Republic's inflation rate remained low, having moved from 1.8% in 2002 to 0.1% in 2003 then to 2.8% in 2004.

The country faces two major problems: a rapidly growing budget deficit and an increase in its total debt. A relative weakness lies in a large budget deficit (4.28% of GDP in 2003 and 4.9% of GDP in 2004), which could hinder the country's acceptance in the Eurozone. The government has recorded budget deficits every year since 1996. These high deficits present the imminent challenge to meet the Maastricht criteria, as the deficit must fall below 3% to meet European Monetary Union (EMU) entrance criteria.

### **2.4. Private property**

Property rights are respected and government authorities regulate the acquisition of property. Property rights are regulated by basic liberal rights in terms of acquisition, benefits, use and sale. Upon the country's accession to the EU, the country entered a seven-year transition period in which non-Czech citizens are banned from owning both property and land in the Czech Republic. Nevertheless, businesses with foreign co-ownership can already acquire and own property in the country.

During the period under consideration, the office of the ombudsman examined the law on property expropriation in the public interest. After an agreement with Ministry of Finance, the coefficients for the calculation of land prices were increased so that the price paid for land now reflects the development of market prices.

### **2.5. Welfare regime**

The social safety net in the Czech Republic is based on three main pillars: social security, state social support and social assistance. The first provides contribution-based benefits replacing a citizen's income in case of old age, sickness or unemployment. Tax revenues fund the second pillar, which provides support to citizens in specific life situations (e.g. maternity). Tax revenues also fund the third pillar, which provides means-tested support to citizens in the event of unforeseen circumstances.

The most pressing issues include: abuse of the social benefit system; the system's administrative requirements toward citizens; improvement of the compatibility between work and family; and social exclusion based on ethnic and other considerations. A public debate on these matters would significantly contribute to the implementation of equal opportunities among disadvantaged social groups and individuals, such as the Roma, disabled citizens and women.

Social discrimination of marginalized groups is the primary obstacle to their access to social services and education. Compared to the majority population, a large portion of Roma children are almost automatically placed in "special needs" schools. During the monitored period, state institutions became more inclined to work on eliminating existing inequalities because of external pressures from the international community and internal pressures exercised by public debate.

## **2.6. Economic performance**

Since 2000, the country has experienced continuous economic growth. GDP increased by 1.5% in 2002, 3.1% in 2003 and 3.8% in 2004, as did per capita GDP. Considerable growth was recorded in exports, which rose from 7.3% in 2003 to 24.2% in 2004, and in foreign direct investment. The crown appreciated in relation to both the dollar and the euro. Exports increased and inflation remained low, below 3%. The unemployment rate remains high, around 10%. Rising levels of long-term unemployment as well as massive unemployment in certain regions constitute increasing problems. However, the Czech Republic is becoming one of the most prominent target countries in Central and Eastern Europe for the allocation of foreign direct investment (FDI). Yet, foreign investors' restructuring and rationalization does not tend to significantly increase the number of jobs.

Fiscal policy remained unbalanced, with the government budget deficit skyrocketing from 1.89% of GDP in 2002 to 4.28% in 2003 and 4.9% in 2004. Predictions of continued growth in the government budget deficit have given rise to a fiscal reform program, which should bring about a change in 2006. The country's negative trade balance was reduced during the last two years.

The Czech Republic's relatively stable political and economic environment and well-qualified labor force make it attractive for foreign investors. The influx of foreign capital was one of the distinct factors contributing to growing prosperity. The most efficient form of this is FDI, which recorded a steady increase during the period under consideration, which also confirms the trust in the investment climate. FDI inflow totaled \$2.5 billion in 2003, and more than doubled between 2003 and 2004. German enterprises have invested the most in Czech industry.

Projects in the fields of research, development and shared services are rapidly increasing. The Czech Republic has continuously managed to attract investments from a number of multinational companies.

## **2.7. Sustainability**

Within the framework of the country's accession to the EU, environmental protection became a high political priority on the micro- and the macro- levels. The State Environmental Fund, established in 1991, is the key instrument used to meet obligations arising from international conventions on environmental protection and the implementation of the State Environmental Policy. In 2001, the fund became an agency responsible for implementation within the EU pre-accession framework.

Government spending on environmental protection in the Czech Republic is comparable to the EU average. In the mid-1990s, it was above average, having peaked in 1997, accounting for 2.4% of GDP. Today, it corresponds to the European average of approximately 1%. The volume, structure and dynamism of the growth in spending reflect the goals and intentions of the State Environmental Policy. The positive trend of investments in environmental protection and legislation that have either already been implemented or are expected to soon be implemented should have a positive impact both on the gradual improvement of the environment as well as on creating a sustainable business environment and conditions conducive to the further economic growth of individual regions.

In the Czech Republic, all public institutions of higher education are free of charge. In addition, there are also private schools at all levels and parochial schools at primary and secondary levels. Approximately 85% of all children attend pre-school childcare facilities and only 2% of pupils fail to complete elementary education. The Czech Republic has one of the highest proportions of people who obtain secondary education among OECD countries. The situation is significantly worse in tertiary education, which only about 13% of the population achieves.

One of education's main social objectives is to enable upward social mobility for individuals based on individual abilities and merits and limit the influence of inherited privileges. However, surveys have shown that the reproduction of inequalities in inter-generational education is higher in the Czech Republic than in most EU countries.

There is a need to increase public expenditures for education, as government spending on education - at approximately 5% of GDP - is currently below EU average. At the time this report was written, the government had pledged to

increase spending on education to 6% of GDP by 2005. Spending for research and development (R&D) declined swiftly in the first half of the 1990s, but rebounded in the second half of the decade, increasing significantly until 2000. A decrease in the past years reflects the government's decision to reset its budget priorities in favor of short-term measures. The obligation to increase spending on R&D to 0.6% of GDP by 2000, 0.65% by 2001 and 0.7% by 2002, as negotiated with the EU, has not been carried out. The negative trend is likely to continue until at least 2004, owing to the planned budget cuts.

The major bodies of the state administration involved in the education and development of R&D policies are the Ministry of Education, the Ministry of Youth and Sports (MSMT), the research and development council (R&D Council), and, until the 2004 reorganization of the cabinet, the deputy prime minister for research and development, human rights, and human resources.

Governmental R&D policy is developed in cooperation with experts and R&D institutions from non-state institutions such as the Academy of Sciences, the Science Foundation of the Czech Republic, the Council of Czech Universities, the Czech Rectors' Conference, the Association of Research Organizations, and the Confederation of Industry of the Czech Republic. There is a wide-ranging debate within the scientific community and among the public concerning these policies. The problem of "brain-drain" became salient during the period under observation, and policies were adopted to maintain and increase human capital in R&D, including possibilities of additional funding for junior researchers returning from abroad.

### **3. Management**

#### **3.1. Level of difficulty**

There are no constitutional constraints on democratic governance in the Czech Republic. When the Czech Republic joined the European Union on May 1, 2004, an additional external "stabilizer" of Czech democracy came into play. From a historical perspective, it was also important that Slovakia, with which the Czech Republic formed a state for more than 40 years and maintains a special relationship after the countries' "velvet divorce," also became a member of the EU.

In terms of civic engagement, the Czech Republic's post-Communist civil society is facing the negative legacy of the Communist past. Czech society has never been a set of atomized individuals. To the contrary, today a portion of citizens still considers social networks important. However, these networks are not automatically part of a participatory civil society. People tend to rely on social

networks very much, which points toward a strong division between the private and public spheres. Networks of friends and acquaintances are perceived as part of the private sphere. These networks are resistant to more general public mobilization. Their activity, however, is also an important source of legitimacy for democracy, since it builds interpersonal trust, which in turn enforces trust in institutions and increases participation in the public sphere in the long term.

In 1989, civil society in the Czech Republic had a long historical tradition. Its roots date as far back as the Habsburg Empire and the country's national revival movement, which created various cultural, artistic and educational societies and associations that became prominent actors in Czech civic life. The embryonic origins of many of today's associations can be seen in several officially recognized organizations in areas such as ecology, tourism, and sports that existed during the Communist regime. In addition to these organizations, there were a wide range of important nonprofit organizations and other civic activities that developed after 1989.

### Profile of the Political System

	Regime type: Democracy System of government: Parliamentary
	1. Head of State: Václav Havel Head of Government: Vladimír Špidla Type of government: coalition majority
	2. Head of State: Václav Klaus Head of Government: Stanislav Gross Type of government: coalition majority
	3. Head of Government: Jiří Paroubek Type of government: single party minority
Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional of votes gained by party $i$ ; $p_i$ is the share of parliamentary mandates controlled by party $i$ . Effective number of parties reflects the political weight of parties (L	

At present, there is no major ethnic, religious or social conflict in the Czech Republic. To the contrary, there are tendencies toward reconciliation with the Communist past and vital attempts to tackle issues such as the political and social inclusion of the Roma into the majority society.

### 3.2. Steering capability

During the period under review, fulfilling the requisite conditions for EU

accession and actual accession itself were strategic priorities. The signature of the Treaty of Accession in April 2003 and the completion of several reforms, including a referendum to secure public support for this step, were thus key. Competition between political parties was subordinated to this long-term goal. The strongest ruling party was in power for its second term, and 2003 and 2004 passed without any major governmental crisis. Accession to the EMU remains a long-term goal, which—despite election promises—requires cuts in welfare benefits. The cabinet has begun implementing these cuts without facing major protest or social unrest.

However, the postponement of the highly unpopular reforms of the healthcare and pension system may create future problems in view of the country's aging population and negative demographic development. Regarding this pressing problem, the government avoided initiating the first steps toward reform, failing to show political leadership and take responsibility for the country's future.

The planned pension system reform—from the previous pay-as-you-go system to a contribution-defined system—was thus postponed. It was not possible to make any progress in the healthcare reform. The fact that three ministers of healthcare held the office during the assessed two-year period shows how difficult and politically sensitive reforms in this area are.

### **3.3. Resource efficiency**

The cabinet changed once during the period under consideration. After the failure in the EP elections, Prime Minister Špidla resigned, and left fellow party member Stanislav Gross to take over leadership of the ČSSD and set up a coalition cabinet. Both governments endeavored to make efficient use of available resources, with important aid from the EU in terms of both pre-accession funds and ongoing twinning projects with “old” member-states to increase “know-how” and both national and sub-national levels.

In 2003, the government approved a three-year consolidation program aimed at reducing the growing budget deficit to no more than 4% of GDP by 2006. In 2004, a public finance reform was launched. It is to be carried out in several steps. The reform brought, among other things, an increase in consumer taxes on tobacco, alcohol and gas. The VAT on a number of services increased, including telecommunications and Internet, from a reduced rate of 5% to the standard rate of 22% (this would later be lowered to 19%). Measures such as alcohol stamps, the introduction of cash registers, and a ban on selling alcohol and cigarettes at markets were adopted to fight the growth of the informal economy. The corporate tax was reduced from 31% to 28%, and a further reduction to 24% is scheduled

for 2006. The contribution to social and healthcare benefits of the self-employed increased. In terms of spending, the reform plan includes: reduction of the paid-out sickness contribution and state welfare support allowances, a reduction of the state contribution for construction savings plans, a 6% reduction in the number of state employees by 2006, a reduction of the number of central bodies of the state administration, and radicalization of the legally-defined increases in retirement pensions, the minimum wage, and salaries of public sector employees.

The government (a coalition of the ČSSD, KDU-ČSL, US-DEU) was only moderately successful in coordinating conflicting interests into a coherent policy scheme, due primarily to the government's slim majority and the relatively weak ties among coalition partners. The coalition partners tend to focus more on singular party programs than on common governmental policy tasks. Major conflicts in 2003 and 2004 included continuous tensions between the efforts of the Ministry of Finance to achieve a balanced state budget and to observe the Maastricht convergence criteria and the efforts of the Ministry of Labor and Social Affairs to support socially disadvantaged groups of the population. Another issue in this context is the introduction of regional governments to decentralize governance. The current parliamentary opposition (ODS) occupies most of the seats in the regional governments. Consequently, there are annual tensions over regional budgets.

Although one of its priorities, the government has not yet been able to efficiently fight corruption in the state apparatus, police and political leadership. The best-known corruption affair in politics came in 2003 when an MP of one coalition party reported a corruption attempt on the part of representatives of the opposition ODS. For a bribe of 10 million crowns (\$400,000), he was asked to vote against his party during the vote of confidence in the cabinet. While the ruling coalition condemned these unfair practices, ODS and the president considered the case to be, first and foremost, a matter of democratic order and civil liberties, as the police had tapped the telephones of top representatives of the opposition and checked their bank accounts. According to the office of the chief public prosecutor, the charges were illegal, and in October 2004, the proceedings were put on halt, due to the police's illegal methods of investigation.

The cabinet and several ministries intensified their fight against corruption. As of September 2004, an anti-corruption telephone line was established in the Ministry of Labor and Social Affairs, which coordinates the anti-corruption program. At the same time, the European Anti-Fraud Office (OLAF) established a free line for citizens of the Czech Republic. Notwithstanding these efforts, the implementation of penalties is difficult despite gradual progress in legal and procedural mechanisms, political will and the work of judges. Indeed, the anti-corruption campaign was not very successful according to Transparency International's Corruption Perception Index, in which the country dropped from a ranking of 51st of 146 in 2003 to 54th 2004.

### **3.4. Consensus-building**

There is a long-term broad consensus among major political actors as well as among the public on democracy and market economy. The extent of this consensus was demonstrated by the country's aim to join the EU. After two successive failures to elect the president of the republic by the electoral assembly in January and February 2003, the debate on the direct popular election of the president was reinitiated. In this debate, the ruling coalition favors preserving the status quo, while the opposition favors a direct vote for the president. The public, which tends to look favorably upon the president (the current president enjoys the greatest approval rating of all institutions) also favors the direct vote, but only marginally supports an expansion of presidential powers.

The country has witnessed the gradual inclusion of the Communist party KSČM into the political mainstream. This is a result of not only a stable party preference for KSČM and its success in EP elections, but also of the party's growing appeal as a potential coalition partner. Another phenomenon on the Czech political scene is the growing support for smaller non-partisan associations in regional and Senate elections. In the election to the EP, two independent groups managed to secure five of the twenty-four seats. Together these groups created the Open Democracy Caucus, which today forms the second-largest parliamentary group in the Senate with 17 members of 81 Senators.

There are no large-scale potential opponents to political and social reforms. Throughout the transition process, discussions have focused on the speed and scope of transition rather than its direction. Although the evolution of cleavages and consensus in the Czech Republic—like those in central Europe more generally—does not entirely follow western European patterns, evidence of persistent cleavages is observed: in the Czech Republic, there is neither a clear fault-line dividing those favoring communism and liberal democracy nor an important societal division between winners and losers of transformation. Instead, discussion centers on questions of deepening European integration. The EU referendum evidenced that a considerable number (23%) of Czechs disagreed with the country's accession to the EU. This could become a divisive issue in the future, particularly in the referendum on the EU constitution. Voting against the constitution in the European Parliament, Euro-skeptic parties such as the ODS signaled that they may endeavor to bring the issue back to the national public debate.

The issue of coming to terms with the past remains open in the Czech Republic. At stake are not only the country's communist past but also World War II and the immediate post-war period. A process of compensating victims of forced labor

was completed but some cases related to restitution of property to churches have not been closed. After a decade-and-a-half, the political and social climate is gradually beginning to change and the country is showing the first signs of willingness to face its history.

### **3.5. International cooperation**

The Czech Republic has continued to build international cooperation at bilateral and multilateral levels. In recent years, the government has focused primarily on multilateral cooperation by meeting the criteria for EU accession, adopting the *acquis communautaire* and organizing the first elections to the European Parliament. In comparison to previous years, less attention was paid to cooperation within Central Europe, as in the framework of the Central European Initiative, the Visegrad Group. The Czech Republic's EU accession on May 1, 2004 changed the Czech Republic's position within Europe and in relation to its immediate neighbors. By joining the EU club of developed countries, the Czech Republic acquired greater credibility from foreign partners but also lost some of its previous advantages. External funding from multilateral organizations and foundations has stopped or significantly declined. However, there are new opportunities for cooperation in economics and R&D, and the growing influx of foreign direct investment is a testament to investors' trust in the country's reliability. Relations with Austria remain strained due to the Temelin nuclear power plant, however, and the relationship of the government with the organization representing Sudeten Germans is tense.

## **4. Trend of development**

### **4.1. Democratic development**

Democracy in the Czech Republic can be considered consolidated: the country maintains democratic structures, the functioning of institutions continues to improve, and the processes of government decentralization and professionalization of the armed forces have been completed. The country's new membership in the EU functions as an additional stabilizing factor.

The hierarchical functioning of political parties and the party-centered nature of politics negatively influences the public's degree of satisfaction with the functioning of current government, though not the perception and support for democracy itself. This is also reflected in declining electoral turnouts, though this is compensated to some extent by civic engagement.

A relatively large turnout in the referendum on EU accession indicates room for the political mobilization of citizens, which political parties do not sufficiently realize. However, a strong link between political parties and voters' interests is absent. One striking example: while the country's strongest political party, the ODS, represents a Euro-skeptic opinion, its electorate is pro-European. Political parties are thus neither fully responsive to their voters nor are they sufficiently rooted in society.

#### 4.2. Market economy development

The market economy was functioning fairly well between 2001 and 2004, and a number of macroeconomic indicators improved: GDP and GDP per capita grew; inflation remained low; and the crown strengthened against the dollar and the euro. That said, it was not possible to reverse or slow down the country's budget deficit or growing debt. Moreover, current high unemployment levels could not be reduced. The large proportion of long-term unemployment and considerable regional disparity in unemployment rates should be taken into account. The gradual increase in households registered by social offices as households in social need is also alarming.

The country's socioeconomic level, as measured by the United Nations Human Development Report (HDI) increased steadily—albeit gradually—over the last years, moving from 0.843 in 1995 to 0.868 in 2002. While the institutional framework of the market economy improved quantitatively and qualitatively, anti-corruption measures, the access to economically relevant information, and R&D must still be improved.

**Table: Development of macroeconomic fundamentals (2000-2004)**

	2000	2001	2002	2003	2004
Growth of GDP in %	3.9	2.6	1.5	3.1	3.8?

Export growth in %	16.5	11.5	2.1	7.3	24.2
Import growth in %	16.3	13.0	4.9	7.9	20.5
Inflation in % (CPI)	3.9	4.7	1.8	0.1	2.8
Investment in % of GDP	28.8	28.9	27.9	27.3	26.0
Tax Revenue in % of GDP	26.02	25.87	26.01	26.2	?
Unemployment in %	9.02	8.54	9.15	9.9	9.5?
Budget deficit in % of GDP	2.14	2.92	1.89	4.28	4.9?
Current account balance in billion US\$	-2.72	-3.27	-4.17	-5.57	-5.57 (est.)

Source: Czech Statistical Office, Ministry of Finance CR, Ministry of Labor and Social Affairs CR, Ministry of Industry and Trade CR, data 2004 – exp. – CIA, The World Factbook, GINI – World Bank, 2003.

#### D. Strategic perspective

During the period under review, the Czech Republic overcame the negative trends observed at the end of the 1990s and several of the country's political and economic indicators gradually improved. EU accession marked a turning point in the country's development and showed that the Czech Republic was efficient in adopting the *acquis communautaire*. In the upcoming years, the transposition of European directives and legislation and their implementation will test whether administrative efficiency and compliance with EU norms will continue. A more credible strategy needs to be established for the Czech Republic's integration into the European Monetary Union by 2010. Reducing the budget deficit and increasing expenditures on R&D and education must be on the agenda.

There is room for improvement both politically and economically. Attention must focus on the fight against organized crime and corruption in the state administration and judiciary. Slow, sluggish courts constitute another urgent issue to be addressed. Several reforms to the Czech Republic's welfare regime are needed, particularly regarding health care, pensions and social assistance. More invigorating measures must be introduced into labor market policy; labor mobility must improve and the Czech Republic opened further to foreign labor. This will require solid consensus among political parties on long-term goals, something that has proven impossible so far.

Representatives of the political elite have thus far failed to secure greater support among citizens and strengthen their participation in political life and civil society. Doing so requires coordination between civic organizations and interest groups at national, regional and sectoral levels.