

# BTI 2008 | Czech Republic Country Report

<b>Status Index</b>	1-10	<b>9.56</b>	# 1 of 125	
Democracy	1-10	9.55	# 3 of 125	➔
Market Economy	1-10	9.57	# 1 of 125	↗
<b>Management Index</b>	1-10	<b>6.62</b>	# 20 of 125	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	10.2	HDI	0.89	GDP p.c.	\$	18,272
Pop. growth <sup>1</sup>	% p.a.	0.3	HDI rank of 177	30	Gini Index		25.4
Life expectancy	years	76	UN Education Index	0.93	Poverty <sup>3</sup>	%	<2
Urban population	%	73.5	Gender equality <sup>2</sup>	0.62	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

During the review period, the Czech Republic gained experience as a member of the European Union and saw its economic development improve, but it also suffered growing popular disillusionment with political parties and the government's performance. The year 2006 was an important election year, with elections to the Chamber of Deputies and Senate in June, and local elections following in the fall. The Chamber election results highlighted the cleavages within Czech society, and the division resulted in drawn-out government formation negotiations that lasted 230 days. The political system, however, is fully consolidated. The party system's degree of fragmentation continues to decline. There are no serious ethnic, religious or social conflicts within the country. Most polarization is related to socioeconomic matters. Although there is wide societal consensus on the merits of a market economy, the scope of economic reform has been a divisive issue. In this respect, the distribution of power in the parliament hampers the adoption of important long-term reforms. Apart from these difficulties, the Czech constitutional system of checks and balances functions quite well. Today the Czech Republic is fully integrated into international structures and has been partly successful in boosting its economic development. GDP has grown continuously, per-capita income has increased, and inflation has remained low. The unemployment rate has declined and is now below the EU average. However, according to the Czech National and European Central Banks, the growing state budget deficit undermines Czech aspirations to meet the Maastricht criteria for joining the euro zone. An additional concern is the fact that the Czech government has not been successful in reforming the health and pension systems. Further improvements are required in the realms of law enforcement and the judicial system. Although these issues are a priority, the government has failed to deal effectively with specific types of corruption to date, including the influence of organized crime within the state administration, the police and among political elites.

## History and Characteristics of Transformation

The transformation of Czechoslovakia was an integral part of the political changes that took place in Central and Eastern Europe in 1988 and 1989. The fall of the Iron Curtain caught the economically relatively stable but politically very rigid communist regime off guard. The climax of the political changes came on 17 November 1989 in Prague, when police brutally intervened in a peaceful student demonstration. Students and artists traveled throughout the country to relay information about the events, thus overcoming the regime's monopoly of the media. In the days that followed, there was a general strike in which more than half a million people protested against the police intervention and the communist regime in Prague. By using force against students, the communist regime lost the working class' remaining tolerance for its policies. Generally speaking, the regime was never broadly supported, but rather tolerated by the majority. Most Czech citizens abhorred the state's use of violence against students.

Students, artists and representatives of the opposition movement formed the revolutionary "Civic Forum." After the Communist Party government renounced its monopoly on power on November 28, the Civic Forum negotiated with the government and became a government partner. Two of the most important and immediate results of these negotiations was the reconstruction of parliament and the inclusion of members of the Civic Forum into the National and Federal Assemblies. The parliament elected dissident Vaclav Havel to be president and Alexander Dubcek, a symbolic figure of the Prague Spring (1968), to be speaker of the Federal Assembly.

Transformation in the Czech Republic since 1990 has included major political and economic changes as well as a redefinition of the nation-state. There have been two major actors shaping the country during this period. The first is former dissident and key representative of the opposition movement Charter 77, Vaclav Havel, the second is the economist Vaclav Klaus. Havel became president of the Czechoslovak Federative Republic (1990 – 1992) and later the Czech Republic (1993 – 2003). Klaus became a Civic Forum leader and later chairman of the Civic Democratic Party (ODS), holding the offices of prime minister, speaker of the parliament and, since 2003, president. These two figures represent strong, and in some respects, opposing streams within Czech politics. They have often clashed in public for ideological and personal reasons. Their differences have shaped the nature of Czech politics significantly, resulting in a highly polarized system interlaced with ideological and personal animosities, which pose a major obstacle to effective governance in many respects.

Despite these difficulties, the Czech party system stabilized quickly in the 1990s. Politically inexperienced elites and socialist reformers from the Prague Spring period managed the initial phase of the political transformation process. In the mid-nineties,

however, there was a shift away from a system characterized by “political amateurs” to one dominated by professional politicians. This was evident in the evolution of political recruitment patterns, which became increasingly similar to those common in other liberal multiparty democracies.

Since the beginning of the transformation process, the country has strived for inclusion in international structures such as the IMF, which the Czech Republic joined in 1993. Membership in the IMF and World Bank offered guaranteed credit necessary for economic and social reforms as part of a process that exhibited four main phases. The first was characterized by a considerable decline in major economic indicators, especially in GDP. The next phase (1994 – 96), was characterized by considerable economic growth, followed by a third phase of recession (1997 – 99). Since 2000, a new phase of economic growth has been observed. This trend in economic indicators, however, suggests that the success of Czech reforms has been limited.

The Czech Republic has attained its key goal of “a return to Europe” and integration into European structures. In March 1999, the Czech Republic became a member of NATO, and in May 2004, it became a member of the European Union. Rapid progress has been made in (re-)establishing democracy and the rule of law. While the public’s relationship with the democratic system is relatively good, the level of satisfaction with its political performance is rather low. In the course of the period under review, public opinion polls recorded the percentage of satisfied citizens as hovering around 15%. It is primarily Communist Party sympathizers, the elderly, and socially and economically disadvantaged groups who are dissatisfied. Moreover, a large portion of the population believes that members of the former communist regime effectively exchanged their political capital for economic power. There is some merit in such suspicions, as many experts and middle-cadre members of the communist hierarchy now hold prominent positions in business.

# Transformation Status

## I. Democracy

### 1 | Stateness

The Czech Republic has no major problems related to stateness.

Monopoly on the  
use of force  
State identity

The Czech Republic is a largely homogenous society, with the Roma constituting its largest ethnic minority. The Roma have traditionally faced problems in overcoming cultural and social barriers in the majority society and high unemployment rates, which often stem from low education levels. The government relationship toward minorities has improved over time, and the policy aim is to increase social and economic integration into the majority society. The Czech Republic was for a long time characterized by emigration and transition. Since the 1990s, and especially following EU membership, it has experienced increasing levels of immigration. The largest immigrant groups are Ukrainians, Slovaks and Vietnamese.

The Czech Republic is one of the most secular countries in Europe. Religious dogmas have no influence on politics or law. However, the church has not been separated from the state and in fact receives funding from the state budget. Unresolved issues from the last two years include the restitution of church property and the ratification of a treaty with the Vatican. In the summer of 2006, a long-lasting dispute between church and state over St. Vitus's Cathedral, a national symbol, had been resolved. An action lodged in 1992 by the Religious Matrix and with the support of other religious entities ended in June 2006, when the Catholic Church finally succeeded in acquiring the cathedral and some adjacent buildings next to the Prague castle. In February 2007, however, the constitutional court cancelled this decision, and litigation is beginning again.

No interference  
of religious  
dogmas

The state has a differentiated administrative structure throughout the country, making it possible to extract and allocate state resources on a broad basis.

Basic  
administration

## 2 | Political Participation

There are no significant restraints on free and fair elections. Elections to the Chamber of Deputies took place in July 2006, followed by elections to the Senate (every two years, 1/3 of Senate mandates are up for election) and local elections in the autumn. Electoral turnout in these contests marked an improvement on previous elections. This pattern may be attributed to the mobilizing effect the polarization between the two major parties has on the public as well as campaign effects. The electoral campaigns were characterized by personal animosities between the main party leaders.

Free and fair elections

The democratically elected parliament and government of the Czech Republic have the effective power to govern and are not constrained by any non-democratic veto powers.

Effective power to govern

The freedom of association and assembly is unrestricted within the basic democratic order. The law on political parties and movements regulates the formation and registration of political entities. One hundred and forty political parties and movements are registered currently, of which 118 are active.

Association / assembly rights

Freedoms of speech and the press are guaranteed under Czech law, and there is currently a strong independent media. During the review period, the influence of political parties on the media has decreased. Investigative journalism has uncovered important criminal and corruption cases that suggest a connection between organized crime and senior politicians and bureaucrats. The liberalization of the media market has benefited Internet use. Approximately 27% of households have Internet access, and 41% of the adult population use the Internet regularly.

Freedom of expression

## 3 | Rule of Law

Collusion among democratic institutions has not been a serious problem in the Czech Republic. During the review period, there has been tension between the president and the government, as the government was destabilized by a mid-term change of prime minister. This was exacerbated by the fragile majority in the parliament. This situation also affected the legislative process, as the Chamber of Deputies was able to exert considerable influence over the government. There was also some tension between the Senate and the president over appointments to the Constitutional Court that reflected differences in interpretations of the Court's role. The resulting delay in appointments meant there were not enough members for the Court to convene. Consequently, two and a half years were needed to appoint judges.

Separation of powers

The judiciary is free from unconstitutional interventions by other state institutions. Two examples from the period under review illustrate this judicial independence. First, the Constitutional Court deemed the president's recall of the chief justice of the Supreme Court to be unconstitutional. In the second example, the Supreme Administrative Court ruled against the president, who had refused to appoint some new judges due to their age (below 30). The long waiting period for hearing court cases remains problematic. More than half of the cases heard at regional courts involve a wait of more than two years. The number of complaints lodged with the European Court for Human Rights increased between 2003 and 2004, but this number stabilized between 2005 and 2006 (1369 submissions in 2005). Nevertheless, the judiciary is not completely free from corruption. According to Transparency International's Global Corruption Barometer, the Czech legal system now ranks third from the bottom in comparison with EU and other Western European countries in terms of corruption.

Independent  
judiciary

The Conflict of Interest Act (2006) now regulates the simultaneous holding of different positions of power. Moreover, there are now sanctions against the abuse of power. Unfortunately, however, there are loopholes within the legislation. This was evident in the privatization of Unipetrol, in which Zdeněk Doležal, the chief of the prime minister's office, played a dubious role. Corruption was suspected in the distribution of EU funds and in the manner in which a serving prime minister, Stanislav Gross, purchased an apartment. In the latter controversy, the prime minister eventually resigned. The court dismissed accusations made against Gross, but his political authority was compromised, and he is currently not pursuing elected political office.

Prosecution of  
office abuse

The Constitutional Court, the Supreme Administrative Court and the Office of the Ombudsman (public defender of rights) supervise the observance of civic rights. From 1 January 2003, the Czech Republic implemented greater protection to all forms of legal personality against (illegal) interference by public administrative bodies. Moreover, since early 2006, new administrative rules have solidified citizens' rights vis-à-vis the state. During 2005 and 2006, the Office of the Ombudsman received about 5,000 submissions annually, of which around 57% fell within its defined powers. Compared to the preceding period, this represents an increase of more than 10%. This increase is partly a result of media attention given to some cases and the Office's activities. A large portion of the complaints relate to protracted court proceedings. In 2005, a significant number of submissions related to the completion of restitution processes. The Chamber of Deputies re-elected Ombudsman Otakar Motejl to a second term in December 2006.

Civil rights

#### 4 | Stability of Democratic Institutions

Over the past two years, a lack of political will to reach consensus influenced the functioning of some institutions. This is exemplified in the Constitutional Court's chronic understaffing and the failure to appoint a president of the Supreme Audit Office for almost two years. This lack of decision-making prevented these bodies from working in the legally stipulated manner. The system of state administration is stable and characterized by limited fragmentation and polarization. The amount of information provided by the public administration to citizens has improved at the regional and local levels. So far, the state administration has not become more transparent. For example, there is still no legal distinction made between political appointees and professional bureaucrats. The elections to the Chamber of Deputies in July 2006 led to a tie in the distribution of parliamentary mandates among the major parties and their potential coalition partners. Although the Civic Democrats won 35% of the votes, both the left and the center-right ended up with 100 seats. This was due mainly to the electoral formula used in the Czech Republic. Seven months of negotiations were resolved only in January 2007, when the second government proposed by Civic Democrat Chairman Mirek Topolanek won a vote of confidence with the support of the Greens, Christian Democrats and two Social Democratic "defectors." As a consequence, politicians and experts have been debating a reform of the electoral system to avoid an evenly divided parliament in the future.

Performance of democratic institutions

Most citizens accept democratic institutions and their development, and there are no important groups seeking to change the political system. The president has been recording the highest levels of popular support; around three out of four citizens currently have confidence in the president. In contrast, Czechs have least confidence in political parties and both chambers of the parliament (between 20 and 30%). Confidence in the government fell in late 2006 as a result of the post-electoral stalemate. Despite the continued support for democratic development at a general level, dissatisfaction with the current political situation is growing. At the end of 2004, some 15% of those polled expressed satisfaction with the current political situation, while 54% were dissatisfied. In late 2006, just 10% were satisfied and 64% dissatisfied.

Commitment to democratic institutions

#### 5 | Political and Social Integration

The most important trend is the continuing consolidation of Czech parliamentarism. The results of the 2006 elections demonstrate that the degree of fragmentation and the effective number of parties (3.1) continues to decline. Currently, there are five parties represented in the Czech parliament. This pattern primarily stems from the ability of the two largest political parties to secure more

Party system



than two thirds of the popular vote in 2006 – a record since the fall of communism. However, the dramatic election campaign of 2006, which mobilized and polarized society, also increased the (left-right) polarization of the party system. The decline of the right-wing US-DEU and its replacement by the Green Party was one of the major changes within parliament following the 2006 chamber elections. However, the Green Party is not well anchored in regional politics, and its position along the left-right axis remains relatively unclear.

There is a dense network of interest groups that tend to share basic cooperative orientations, reflect competing social interests and provide a largely balanced representation of societal interests. Civil society in the Czech Republic has been successful in creating space for itself between the spheres of private interests and state.

Interest groups

There is a clear disparity between a stable and high degree of general support for democracy and poor satisfaction with the current political situation in the Czech Republic. The population links democracy specifically to freedom, participation and socioeconomic security. Citizens demonstrating the greatest dissatisfaction with the political and economic situation in the Czech Republic also have the least confidence in political institutions. Public confidence in institutions is based primarily on evaluations of the state's performance.

Consent to democratic norms

More than 85,000 NGOs are currently registered in the Czech Republic – a number that has increased markedly following EU accession. The status of NGOs is legally regulated. The greatest weakness of the Czech non-profit sector, apart from continued dependence on public and foreign funding, is the fact that NGOs are often not accepted as an important partner in the provision of social services and formulation of new policies. The structures of political representation in the Czech Republic are relatively stable. One clear example of the post-communist legacy is the fact that some citizens continue to consider social networks very important and do not consider them to be part of, but rather an alternative to, civil society. This trend is enhanced by factors such as the high degree of secularization and urbanization. After seventeen years of democratic transformation, the Czech Republic is still building social cohesion, social empathy and solidarity among social groups as well as between generations. The social function of the community and neighborhood has not yet been fully restored. An interesting example is the Association of Voluntary Firefighters, which has one of the largest memberships of any organization in the Czech Republic. Membership fell after 1989 but gradually stabilized, and since 2000 there has been an increase in membership. The links between voluntary firefighters and local politics, especially in small municipalities, is strong, and this linkage represents an important source of mobilization within Czech civil society.

Associational activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

The Czech Republic has a stable and functioning market economy. With the exception of the Roma population, there is no apparent social exclusion due to poverty, education, ethnicity or sex, which demonstrates a clear case of the ethnization of poverty in the Czech Republic. Average income increased by 5.8% between 2005 and 2006. Income inequalities have also gradually increased, especially at the regional level and between the capital, Prague, and the rest of the country. Income disparities between men and women persist; nonetheless, the gender disparity index did improve between 2001 and 2004. Unemployment fell by 2.2% between 2004 and 2006, though gender and regional differences continue. Long-term unemployment remains a serious problem and affects approximately 4.3% of the labor force.

Socioeconomic  
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	75,282	91,299	108,208	<b>124,365</b>
Growth of GDP	%	1.9	3.6	4.2	<b>6.1</b>
Inflation (CPI)	%	1.8	0.1	2.8	<b>1.8</b>
Unemployment	%	7.3	7.8	8.3	-
Foreign direct investment	% of GDP	11.3	2.2	4.1	-
Export growth	%	2.1	7.2	21.1	<b>10.6</b>
Import growth	%	5	8	18.2	<b>4.9</b>
Current account balance	\$ mn.	-4264.8	-5785.5	-6537.6	<b>-2494.9</b>
Public debt	\$ mn.	7,090.3	8,735.3	12,020.1	<b>9,735.2</b>
External debt	\$ mn.	27,663.9	34,807.1	45,560.9	<b>39,718.8</b>
External debt service	% of GNI	6.2	6.3	8.1	<b>5</b>
Cash surplus or deficit	% of GDP	-6.0	-4.9	-3.2	<b>-3.5</b>

		2002	2003	2004	2005
Tax Revenue	% of GDP	15.8	16.1	15.9	<b>15.6</b>
Government consumption	% of GDP	22.3	23.4	22.4	<b>22.3</b>
Public expnd. on edu.	% of GDP	4.4	4.6	-	-
Public expnd. on health	% of GDP	6.3	6.7	6.5	-
R&D expenditure	% of GDP	1.2	1.3	1.3	-
Military expenditure	% of GDP	2.0	2.0	1.8	<b>1.8</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

Though the fundamentals of free-market competition are firmly rooted in the Czech Republic, problems did surface during the review period. The transformation to a market economy began in 1990 with the introduction of fundamental economic reforms. The legal basis for the country's economic transformation was created between 1990 and 1992, and a large portion of the privatization process was completed by the mid-1990s. The state still owns or holds majority stakes in some large enterprises.

Market-based competition

The Office for the Protection of Competition was established in 1996. The law protecting economic competition was amended in August 2004 in connection with the harmonization of Czech legislation with the EU's *acquis communautaire*. This new legislation has expanded the Office's activities, and the number of cases processed, and sanctions and fines imposed have increased.

Anti-monopoly policy

Foreign trade is fully liberalized, with uniform, low tariffs and no fundamental state intervention in free trade.

Liberalization of foreign trade

In contrast to the problems of the late 1990s with the Czech banks' excessive debts and problematic credit policy, the banking sector is stable today. On the recommendation of the World Bank, the state places more emphasis on consumer protection within financial markets. During the period under review, the anti-monopoly authority dealt with the issue of bank fees, which are very high compared to the rest of the European Union. The authority decreed that some fees should be canceled, such as those for closing a bank account. In 2005, a proposal was put forth to establish an office of a financial ombudsman. This represents an important step in efforts to increase the transparency and competitiveness of Czech financial markets and in promoting financial education, which is sponsored

Banking system

by the Ministry of Finance. Also in 2005, the Code of Conduct in Relations between Banks and Clients was drafted with the support of the Czech National Bank and the Czech Banking Association. The Czech capital market shows continued growth. The volume of trade on the stock market more than doubled between 2000 and 2005. Since the Czech Republic's accession to the EU, capital markets have witnessed major changes, with Czech entities now able to offer their services and products in all EU member states, and the Czech capital market opening up fully to foreign companies. In this context, the number of service providers increased dramatically, both in terms of securities and investment services. The number of foreign banks and companies today is more than double than that of domestic Czech firms. An amendment to the legislation on majority ownership also brought a major change, allowing owners holding more than 90% of shares to displace minority shareholders.

## 8 | Currency and Price Stability

The Czech currency has been stable over the last two years and has in fact strengthened against the U.S. dollar and euro without any significant exchange rate fluctuations. Monetary stability was not affected by the political stalemate following the 2006 general election. Despite an increase in the price of some products following accession, inflation has remained low (1.9% in 2005, 2.5% in 2006). This situation is also undoubtedly due to the slow liberalization of price regulations for rent and utilities. The government set inflation rate targets at 3% from mid-2004 to early 2006 to ensure compliance with EMU convergence criteria.

Anti-inflation /  
forex policy

The other convergence targets for the EMU, such as a public budget deficit of no more than 3% of GDP, have not been met in recent years. Expenditures continue to grow and their structure remains largely unchanged, meaning that there is a high degree of mandatory social expenditure. In view of the distribution of political forces and the stalemate after the 2006 elections, it was impossible to impose greater budgetary discipline. While the state budget deficit fell in 2006, it increased again in the budget approved for 2007. The government has moved the target year for joining the euro zone beyond 2010.

Macrostability

## 9 | Private Property

Private property rights are respected in the Czech Republic, and government authorities regulate the acquisition, use and sale of property. A seven-year transition period began upon accession to the European Union that bans non-Czech citizens from owning both property and land in the Czech Republic.

Property rights

Nevertheless, foreign-owned businesses can already acquire and own property in the country.

The Czech Republic has a functioning but rather complex legal framework for operating the private sector. Communist Czechoslovakia was the most “socialized” of all the Central and Eastern European economies, with 97% of its assets owned by the state. This was one of the reasons why Czech governments in the early to mid-1990s implemented a fast privatization program, which included the so-called voucher privatization scheme. Controversial and resulting in serious financial losses, this scheme was criticized by both domestic political elites and the IMF in 2005. The government has continued to privatize large state enterprises. The most salient privatization projects in the last two years have been Prague Airport, the Czech Energy Company (CEZ) and most recently, the Czech postal service. While there is a political consensus about privatizing Prague Airport, there are large disagreements regarding the privatization of the state-owned portion of CEZ assets.

Private  
enterprise

## 10 | Welfare Regime

During the period under review, the system of social benefits and its administration have not, as hoped, been simplified, and problems with social welfare fraud persist. Laws adopted in 2006 by the Social Democrat government doubled parental allowances to 40% of the average monthly salary in the non-commercial sector. Simultaneously, childbirth allowances have increased significantly. The newly introduced “Crayon allowance,” representing a single sum of 1000 CZK (approx. 36 euro) given to parents at the beginning of their child’s first school year, does not represent a significant increase in children’s well being, but it nevertheless contributed to increased expenditures and could be seen as an example of a non-systematic reform. These new laws, which contribute to budget deficit increases, were criticized by the Civic Democrat opposition in early 2006 as a pre-election tactic to garner more votes.

Social safety nets

Czech law guarantees equal opportunities at work, in education and in access to social services. Implementation of EU directives has underpinned such guarantees. A legal and institutional system for the protection of people against gender-based discrimination has been implemented, though it is not always enforced in practice. A support system to help marginalized groups overcome their initial disadvantage is often insufficient. This is primarily a problem for the Roma school age population, as more than half of Roma children are educated at separate schools. Their chances of progressing to higher education or securing good jobs are poor. This is primarily a problem for the Roma school age population, as more than half of Roma children are segregated and educated at separate schools. Their chances of progressing to higher education or securing

Equal opportunity

good jobs are poor. Members of the Roma community are also among the most problematic groups on the labor market. Their situation is aggravated by overt and covert forms of xenophobia and ethnic discrimination exercised in mainstream society.

## 11 | Economic Performance

Macroeconomic development did not exhibit significant volatility in 2005 and 2006, and it was characterized by accelerating economic growth and low inflation. GDP per capita is relatively high, having increased from \$16,013 in 2004 to \$19,408 in 2006. Despite these positive economic trends, the persistence of a high state budget deficit remains a problem. The strengthening of the Czech crown (CZK) against the U.S. dollar and euro contributed to a slowdown in export growth. Nonetheless, there is a positive balance of trade. The Czech economy is very open to foreign trade, which increases the dependence of domestic economic activities on partner countries' economies. Germany is the main export market. The orientation of the Czech economy toward exports is enhanced by the flow of foreign investments because a large amount of production from foreign-owned enterprises is exported. These trends stem from increased free trade following EU accession and increased capacity in many manufacturing sectors, such as the automotive industry. Labor productivity grew faster than wages, but the fast growth in wages presents a threat to the Czech Republic's competitiveness on the global market. According to the public business-promotion agency Czechinvest (2005), the Czech Republic is the seventh most attractive country in the world for investors. State incentives play a large role in attracting foreign investments. Investment incentives have often been criticized by domestic small- and medium-sized enterprises. Thanks to foreign investment, more than 16,000 jobs have been created in the last few years. Investments with a higher added value, such as services and IT, are increasingly common. Some of the most important developments have been the transfer of DHL's Central and Eastern European headquarters to Prague and the opening of a new motor company, TPCA (Toyota-Peugeot-Citroen), in Kolín.

Output strength

## 12 | Sustainability

The Czech Republic is battling its own legacy in environmental protection in two senses. Firstly, the communist era was characterized by an emphasis on heavy industry, while environmental protection was a marginalized topic. Secondly, environmental protection played second fiddle to economic reform during the period of transformation. Things started to change with the EU accession process; environmental protection became a high political priority, both at the micro- and macro-levels. The amount of expenditures for environmental protection in the

Environmental policy

Czech Republic is comparable to the EU average of approximately 1% (in 2004 1.4%) of GDP. The Czech Republic's policy goal is to transfer responsibility to the private sector and municipalities. The volume, structure and dynamic growth of these expenditures reflect the goals and intentions of the state's environmental policy. The positive investment trend in environmental protection, combined with already implemented or expected legal changes, 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.

Among OECD countries, the Czech Republic has one of the highest proportions of people with secondary education. The situation is significantly worse in tertiary education; only about 13% obtain tertiary education. Therefore, one governmental priority is to increase the percentage of the population with tertiary education, thus improving the Czech Republic's competitiveness. Education expenditures equal approximately 5% of GDP, below the EU average. The Czech Republic had pledged but failed to increase these expenditures to 6% of GDP by 2005. Several continuing education programs, which are a necessary precondition for the EU labor market, were launched during the period under review. Public R&D expenditures in the Czech Republic have been slowly but continually growing over the last decade, but they nonetheless failed to meet the obligatory 0.65% by 2001 as negotiated with the EU. Expenditures were still only 0.46% in 2004 (35,083 million CZK). Business R&D expenditures have been continually growing. The main weakness in Czech R&D is the lack of private funding. As in other areas, the Czech Republic is battling the legacy of the past and strong financial dependence on the state.

Education policy  
/ R&D

## Transformation Management

### I. Level of Difficulty

During the period under review, the Czech Republic did not battle any structural problems. In the 2004 assessment of the Human Development Index, it was ranked 30th (0.885). GDP and Purchasing Power Parity (PPP) have been growing. The number of HIV/AIDS cases is less than 0.2% of the population (15 - 69 years). Thanks to the effective programs of non-profit organizations, the number of newly infected drug users has been falling continuously since 2000. In contrast, the number of newly infected prostitutes has risen sharply. A large portion of these newly infected women (with long-term residence in the Czech Republic) come from Ukraine and other former Soviet states. The educational structure in the Czech Republic has a high reputation, having a UN education index score of 0.93. After completing elementary school, a large portion of the population continues on to secondary education. Discussions continue about increasing the number of college graduates.

Structural  
constraints

A tradition of civic organizations in the Czech Republic dates back to the 19th century. Civil society was revived following the 1989 revolution. Initially, there was an increase in the number and membership of organizations, followed by a dramatic drop in the first half of the 1990s. This was then followed by a process of stabilization and subsequent growth in some organizations. The 2004 ISSP survey also shows that aside from socio-demographic characteristics such as sex, age, educational level, subjective class (self-positioning of a respondent in a class structure) and size of municipality, membership in political and civic organizations has an influence on electoral participation. Some people still consider social networks to be important not as a part of, but as an alternative to, civil society. This feature represents a potential base for further development within Czech civil society. However, social networks have remained resistant to more general displays of public mobilization so far.

Civil society  
traditions

At present, there are no major ethnic, religious, or social conflicts in the Czech Republic. Key issues include reconciliation with the communist past and the political and social inclusion of the Roma into the majority society.

Conflict intensity



## II. Management Performance

### 14 | Steering Capability

During the period under review, the Czech Republic saw a change in prime ministers and thus in ruling cabinets, held parliamentary elections, and suffered a seven-month period of political uncertainty without a regular government. Although the political direction has not changed fundamentally, the need for power broking between left and right within an evenly divided parliament has served as an obstacle to implementing important reforms such as reducing welfare spending. Postponing unpopular pension and health care system reforms while increasing welfare benefits is likely to exacerbate budgetary deficit problems, especially in light of the country's aging population. Although the current Civic Democratic government entered office having won a confidence vote in January 2006, its parliamentary support of just 50% does not evoke great hopes for rapid progress on a reform program. In the end, positive economic developments may not coincide with structural reforms or policies geared toward achieving long-term strategic priorities, such as joining the EMU.

Prioritization

Government actions related to democratic and economic reforms are primarily a product of Czech membership in the European Union. If EU accession served as an incentive for basic democratic reforms, current reforms deal primarily with improving the legal environment, rationalizing the administration and creating a favorable business environment. The constant amending of basic legal regulations and adoption of new regulatory measures, combined with poor coordination, have created numerous implementation problems and increased the transaction costs for society. Nonetheless, some progress has been made, for example with the trade licensing law amendment. The goal of the amendment was to allow complete registration for tax, social and health care insurance of businesspersons at a trade license office. The amendment to the Czech National Bank (CNB) Act in 2006 resulted in the merging of financial markets supervision within the CNB. This should help to further strengthen the Czech Republic's financial stability. In the economic sphere, the government made poor progress in implementing reforms and did not implement any major structural reforms. Communication between the two parliamentary chambers has improved. In the last two years thanks to EU accession and the growing role played by committees associated with European integration. President Klaus (March 2003 – ) is more active than his predecessor in the legislative process. He

Implementation

has used his veto power primarily for legislation dealing with economic and social issues. In 2005 and 2006, President Klaus vetoed 17 bills, but qualified parliamentary majorities subsequently overruled a majority of these vetoes.

During the review period, the government has not taken advantage of stable conditions and high economic growth to gradually reduce expenditures. On the contrary, it increased state debt and oversaw the sale of large companies, thereby increasing state revenues in the short term. Rather than resulting in redoubled efforts for remedial action, the errors made by political leaders were criticized but not acted upon. This situation is exemplified by a failure to deal with non-transparent or suspicious state tenders and an unsuccessful battle with organized crime. The central bank is an important critic of the economic situation and is concerned that an early accession into the euro zone is being jeopardized.

Policy learning

## 15 | Resource Efficiency

The Czech Republic successfully reformed administrative structures following the 1989 revolution, especially in terms of territorial public administration. The establishment of self-administrative regions constituted successful fulfillment of one of the European Commission's requirements for EU accession. The merging of a number of administrative and self-administrative functions has strengthened the self-administrative segment of state administration significantly. However, the process has not been an unqualified success. Reforming the central state administration has been hindered by a high degree of politicization and discretionary power among political elites. Personnel changes among deputy ministers, directors of departments or unit heads are customary after a change of political leadership, a practice that should have ended with the Service Act. Unfortunately, implementation of the Service Act has been postponed for several years. The government is committed to bringing the Czech economy on par with the most advanced EU member states. It drafted and approved the Economic Growth Strategy (2005), the goal of which is to set targets for the period 2005 – 2013. This strategy has two main objectives, namely to set priorities for coordinating economic policies and directing EU funds, and to communicate these priorities to the public and the business sphere. The strategy focuses on five priority areas: the institutional environment, sources of funding, infrastructure, human resources development, and research, development and innovation. This strategy concentrates particularly on the economy but makes reference to the social and environmental pillars of sustainable development. Critics have reproached this strategy for its inadequate social dimension. The main strategic governance problem in the Czech Republic is the absence of actors implementing the concepts and strategies outlined in this decade-long blueprint in the form of concrete policies. Moreover, there is no coordinated effort between the national and regional governments to achieve key priorities.

Efficient use of assets

The Gross and Paroubek governments, both Social Democrat, tried to coordinate conflicting objectives and interests. Their success was rather limited, however, due to the government's slim majority and the relatively weak ties among coalition partners. The situation was complicated by the election campaign in the first half of 2006; one member of the coalition stood no chance of being re-elected to parliament, and two other parties differed in their program orientation at the end of the election term. Cooperation with the Social Democrats damaged both center-right political parties in the eyes of voters. In 2006, the Social Democrats demonstrated an increasing interest in cooperating openly with the Communist Party in order to pass some concrete laws, above all the new labor code. This move was unpopular among Social Democrat party members, and it was absolutely unacceptable to their Christian Democrat (KDU-CSL) coalition partners.

Policy coordination

The Czech Republic has been battling corruption for a long time. However, the political leadership has failed to fight corruption efficiently within the bureaucracy, the police and high-level politics. This is further substantiated by the efforts of the government to influence the work of bodies investigating organized crime and by suspicions that organized crime has influence in the state administration. The so-called "Kubice Affair" is one example; directly before the 2006 election, the Ministry of Interior's department for combating organized crime leaked a report on the alleged connections of civil servants and Social Democrat politicians with organized crime. While no convincing evidence was provided to underpin the allegations raised by the report until March 2007, Civic Democrat and Social Democrat politicians used the report to accuse each other. The Czech Republic regularly has one of the worst rankings within the EU in Transparency International's Corruption Perceptions Index. In 2006, it improved by half a point, moving from 47th to 46th. This poor result is also a consequence of ignoring the issue of corruption and its manifestations in almost all walks of life, such as sports (corruption scandals in the Czech Soccer League in 2005 and 2006), for so long. One fear is that corruption may become a tolerated evil. According to the Corruption Perceptions Index, 17 - 18% (2005/6) of respondents or members of their households have given bribes in the Czech Republic. According to Transparency International, corruption appears to have greatest influence on political parties and the police, with the legal system and judiciary ranking third. The most critical areas appear to be public fund allocation, distribution of state and municipal property, and penetration of organized crime into the state administration. Thus far, no efficient countermeasures have been implemented, which in part seems to stem from a lack of interest on the part of the ruling elites to reduce the degree of corruption opportunities. The most pressing problems among the integrity mechanisms are an absence of codes of conduct and low efficiency in prosecuting corruption.

Anti-corruption  
policy

## 16 | Consensus-Building

There is a long-standing general consensus among major political actors as well as among the public on the merits of democracy and a market economy. This follows from the nature of the transition process, where discussions centered on the speed and scope of transition rather than on its direction. The 2006 parliamentary elections revitalized socioeconomic cleavages and the polarization of society. Some of the main election issues involved the ruling Social Democrats defending the social welfare state against the main opposition Civic Democrats, who stressed the need for major health and pension system reforms and proposed a new flat tax. Simultaneously, the past became a vehicle on the route to power once again, as the Civic Democrats stressed the possibility that Social Democrats would be able and willing to form a government with the Communist Party, even though an official coalition with the Communist Party remains a key political taboo. In the end, it was both political polarization and political scandals relating to corruption as well as Mr. Paroubek's political style that proved to be a significant source of voter mobilization.

Consensus on goals

In principle, there are no significant anti-democratic veto players in the Czech Republic. The only critic of the market economy, but not democracy as such, is the Communist Party, which represents 12% of voters. Major political actors recognize the necessity of reforms. However, small governing majorities do not allow the implementation of far-reaching long-term reform plans.

Anti-democratic veto actors

The political management of social cleavages is rather poor, as political actors contribute greatly to the further exacerbation of socioeconomic divisions. The Communist Party, which unlike communist parties in most other Central and Eastern European countries did not undergo a reform process, enjoys some potential due mainly to the fact that it attracts protest votes from losers in the transition process. A sharply polarized electoral campaign hindered and delayed the formation of a government in 2006. The Civic Democrat's general election victory was confirmed in both Senate and local elections. The election results were tarnished somewhat by the actions of party leaders after the polls closed. For example, incumbent Prime Minister Jiri Paroubek, in his first speech, initially refused to acknowledge the results of the elections and later controversially compared the victory of Civic Democrats to the communist coup d'état in 1948. In the following electoral stalemate, President Klaus, in an act of non-partisanship, invited all of the political parties to negotiations, including, for the first time, the Czech Communist Party. The negotiations resulted in the election of the leadership of the Chamber of Deputies and for the first time since 1989, a member of the Communist Party became vice chairman of parliament. President Klaus sought to establish a stable government by favoring either a

Cleavage / conflict management

grand coalition of the two main parties (the Civic Democrats and the Social Democrats) or early elections. Many media commentators suggested that while acting appropriately, Klaus had ulterior motives as a grand coalition would be the most effective means of securing his re-election as president in 2008. The chairman of the Senate also participated in the government formation process, thereby boosting the second chamber's reputation.

Political representatives in the Czech Republic tend to ignore civil society as an important partner in policy formulation, though things have improved since the Czech Republic's accession to the European Union. Moreover, the EU's structural fund's "Partnership Principle" stipulates the involvement of civil society in projects aimed at resolving important issues. Non-profit organizations were treated as equal partners by public authorities in developing the Sustainable Development Strategy for the Czech Republic, which was passed in 2004. Non-profit associations effectively influenced the preparation of the new Act on Social Services that entered into force on 1 January, 2007. At the regional and local levels, civil society is increasingly recognized and involved. For example, the regional government of Vysocina conducted a large-scale survey to map the needs of civil society in 2005 and is planning to provide assistance in the form of training in the acquisition and management of European funds. However, this level of involvement does not apply to all policy areas. The discussion of the European Constitutional Treaty between 2004 and 2006, for example, was completely dominated by the government, and civil society was only marginally involved.

Civil society  
participation

In contrast to the previous review period, there are positive signs regarding reconciliation of past injustices. There are emergent signs of the government's willingness to discuss the country's forty years of communist history without labels and prejudices. For example, it is now recognized that the first phase of communist rule involved the imprisonment of political opponents and forced labor. Individual victims are publishing their narratives, their cases are debated and some have begun to receive partial compensation. Increasingly, the narratives of victims include those who suffered in the Roma Holocaust and the transfer/expulsion of the Sudeten Germans, issues which were ignored or misinterpreted under communism. Social debate was launched on the issue of compensating ethnic Germans who fought against the Nazis. Although the debate is still rather marginal, it is considered to be an important step toward reconciliation of past injustices. There are educational programs that facilitate working through the past. One such example teaches modern Czech history (1945 – 1989) to elementary and secondary schoolchildren with the help of documentaries and discussions with eyewitnesses. Addressing political issues, the program presents everyday life in the recent past and serves as an important forum for inter-generational communication.

Reconciliation

## 17 | International Cooperation

Since EU accession, the government's activities have adapted to, and are strongly influenced by, the EU legislative framework. In view of the fact that most EU legislation was implemented before Czech accession to the EU, and that a leftist government "tempered" by rightist opposition was in office between 1998 and 2006, no major reforms have taken been implemented under the influence of the European Union during the review period. Cooperation with the World Bank and the IMF continues. However, much of this is analytical and consultative in nature. In 2005, the Czech Republic was elected to the UN Human Rights Council. Governmental bodies and non-profit organizations continue to be involved in human rights issues in Cuba and Belarus.

Effective use of support

In general, the government acts as a trustworthy and reliable partner in its relations with the international community. By joining the European Union, the Czech Republic acquired greater credibility. This was manifested in the decision to have the Czech Republic hold the EU Presidency in the first half of 2009. Such is the importance of this decision that the Prime Minister Topolánek established a new cabinet portfolio, the vice prime minister responsible for European affairs, who will coordinate preparatory activities. Multilateral cooperation has developed primarily within the EU framework. Attention is also paid to cooperation within the framework of the Central European Initiative and especially to the Visegrad Group (V4), which in 2006 celebrated its fifteenth anniversary. Relations with Austria remain strained due to disagreement over the Temelin nuclear power plant. The war in Iraq confronted the Czech Republic government with a difficult decision-making process as it had to decide whether to support the United States or to share the reserved attitude of a large number of EU member states. The government decision to send a military police contingent to Iraq was approved by both chambers of parliament in 2003. The Czech army has also sent a special forces battalion to Afghanistan as part of the Enduring Freedom mission. This battalion contributed in the past to the UN mission in former Yugoslavia.

Credibility

The Czech government favors intensifying Visegrad regional cooperation. According to the European Commission, regional groupings like the Visegrad Group are clearly very appropriate for delivering a valuable and effective regional response to issues and policies debated in the European Union. Efforts to define common interests within the EU have strengthened regional cooperation further. The ministers of foreign affairs of the V4 (Czech Republic, Hungary, Poland, Slovakia) and B3 countries (Estonia, Latvia, Lithuania) expressed their firm interest in joining the Schengen area in October 2007. The V4 and B3 countries also expressed their readiness to work within the "Coalition

Regional cooperation

for Visa Equality,” with the aim of reaching visa reciprocity with the United States, meaning visa-free travel to the United States for their citizens. In the Convention on the Future of Europe, the Czech Republic – together with Austria – submitted an initiative on behalf of a group of fifteen small countries criticizing the Draft Constitutional Treaty. This group argued that the Draft Constitutional Treaty strengthens the position of the larger member states to the detriment of small ones.

## Strategic Outlook

The period examined here represents the first years of the Czech Republic's EU membership in which the legislative framework of the European Union and a majority of directives have been successfully implemented. The main objectives for the future remain increasing the state administration's effectiveness and de-politicizing the executive branch. The successful implementation of the law on the civil service constitutes an important step in this direction. In 2006, the Czech Republic began to disburse EU funds more successfully. However, it was the intervention of the new government in the fall of 2006 which led to the final successful disbursement. Whereas 18% of the funds were distributed by March 2006, 80% were distributed by November and 100% by December 2006. The Czech Republic needs to be more efficient with regard to EU funds, as it is still lagging behind in comparison to the pre-accession period. Crisis management measures are needed to improve communication with final beneficiaries and accelerate the administration of the projects and payments demands. For the forthcoming period, major improvements are necessary in programs targeting human resources development, regional development and development activities in Prague. Generally speaking, there is room for further improvement both politically and economically. In terms of political reforms, an electoral law reform that would prevent post-electoral stalemates is the primary goal. This requires political consensus among the major political parties. Attention must also be focused on the fight against organized crime and corruption in the state administration, judiciary and police. Sluggish courts are another urgent issue to be addressed. Resolving these issues is important, especially if the Czech Republic is to join the Schengen states in the fall of 2007. With regard to economic reform, primary targets include reducing the budget deficit and mandatory expenditures, and fulfilling the criteria for EMU accession. Long-term policies aimed at sustainable growth are also needed and require that the position of the Ministry of Environment be strengthened in comparison to the Ministry of Industry and Trade. Increased investment in sustainable growth is also required. The Czech Republic's welfare regime needs to be reformed, particularly regarding health care, pensions and social assistance. It is necessary to face up to long-term low fertility rates and a growing proportion of seniors in Czech society. Past ad hoc reforms, such as increases in grants for births, need to be replaced by structural reforms aimed at improving the situation of young families as well as single parents. Negative demographic trends can also be partially compensated through immigration. More generally, demographic trends will have profound consequences on economic development in the medium and long term. Despite declines in unemployment, there is an



identifiable set of structural problems within the labor market, including problems associated with the employment of older workers and adapting the educational system to changing labor market demands.