2000 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, March 2001

CZECH REPUBLIC

Key Economic Indicators

(Millions of U.S. dollars unless otherwise indicated)

	1998	1999	2000 1/
Income, Production and Employment:			
Nominal GDP (US$ billion) 2/	55.0	53.06	51.04
Real GDP Growth (pct)	-2.3	-0.2	2.7
GDP by Sector (pct): 2/			
Agriculture	5.0	5.3	5.0
Manufacturing	31.3	30.5	31.0
Services	51.6	53.3	53.3
Government 3/	31.2	32.5	32.8
Per Capita GDP (US$) 2/	5,500	5,405	5,004
Labor Force (000s)	5,170	5,203	5,213
Unemployment (pct)	7.5	9.4	9.2
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	5.2	8.1	7.7
Consumer Price Inflation	10.7	2.1	4.0
Exchange Rate (CKR/US$)			
Official	32.27	34.60	40.00
Balance of Payments and Trade: 4/			
Total Exports FOB (US$ bill)	26.3	26.8	18.3
Exports to U.S.	441	650	507
Total imports CIF (US$ bill)	28.9	28.9	20.8
Imports from U.S.	786	1,180	918
Trade Balance (US$ bill)	-2.6	-2.06	-1.9
Balance with U.S.	-345	-530	-412
Current Account Deficit/GDP (pct)	-1.9	-1.5	-3.5
External Debt 5/	24.3	24.3	22.0
Debt Service Payments/GDP (pct)	10.0	7.5	10.0
Fiscal Deficit (Central)/GDP (pct)	1.6	1.6	1.8
Gold and Foreign Exchange Reserves	15.9	13.2	12.3
Aid from U.S. 6/	N/A	N/A	N/A
Aid from All Other Sources	N/A	N/A	N/A

1/ Unless stated otherwise, 2000 figures are based on the latest estimates of the Czech Statistical Office (CSO) dated October 3, 2000, of the Ministry of Finance and/or unofficial estimates from the Czech National Bank.
2/ GDP at factor cost; percentage changes calculated in local currency.
3/ Central government spending as pct of GDP.
4/ January through August 2000 data. Czech imports do not include re-exports of U.S. goods through other countries.
5/ In absolute numbers, the figure for external debt does not change, the growth reflects shifts in DEM vs. US$ exchange rates.
6/ U.S. assistance was phased out by September 30, 1997.

1. General Policy Framework

The Czech Republic is a small and generally open economy. Having largely created a free and competitive market, it is currently struggling with problems stemming from unfinished structural reforms mainly in the field of bank privatization, industrial restructuring, legal reform and financial market transparency. The Czech Republic is currently emerging from a deep recession, which can be attributed largely to these unfinished structural reforms. Record levels of foreign investment and stronger growth in the Czech Republic's principal export markets have led the way to the recent recovery, with the economy expected to grow by over two percent this year.

Until 1998 the Czech Republic pursued balanced budgets, incurring only small deficits on the way. Economic recession, inadequate tax collection and the Social Democratic government's pledge to support a wide range of social welfare and investment programs led to a 1999 government budget deficit of 1.6 percent of GDP. The 2000 budget deficit is targeted at 1.8 percent of GDP. The 2001 budget, under discussion now, will also be in deficit. These figures represent only the state budget deficit as a percentage of GDP, not the wider government deficit, which includes local government budgets and several off-budget institutions. The broader figures have ranged between 1.5 and 0.6 percent of GDP. While local government surpluses in the past two years moderated this broader statistic, in 2000 the general government deficit is expected to reach 5.1 percent of GDP. Budget deficits incurred have traditionally been financed through the issuance of government bonds.

The Czech Republic saw strong inflows of foreign direct investment in 1999 ($4.9 billion), a trend expected to continue in 2000 (as of June 30, FDI measured $1.9 billion). While helping to fuel the current economic turnaround, the strong foreign investment flows have also placed upward pressure on the Czech crown, leading the Czech National Bank (CNB) to voice concerns about a loss of overall economic competitiveness. To minimize this possibility, the CNB introduced a new account for foreign investment inflows, hoping to ease upward pressure on the Czech crown.

One of the reasons for the strong inflows of FDI is the package of incentives the Czech government offers to attract investments. The incentives are available to foreign and domestic firms that invest $10 million in a new manufacturing facility. The package also includes tax breaks of up to 10 years offered in two five-year periods; duty-free imports of high-tech equipment and a 90-day deferral of value-added tax payments (VAT); potential for creation of special customs zones; job creation benefits; training grants; opportunities to obtain low-cost land; and the possibility of additional incentives for secondary investment and production expansion. The threshold is $5 million in regions where unemployment measures at least 25 percent more than the national average.

The CNB is responsible for monetary policy. The primary instrument used by the bank to influence monetary policy is the two-week repo rate. Following growing current account imbalances in 1997, the CNB sharply restricted monetary policy, a pattern which held until 1999. Then, a deepening recession combined with lower than anticipated price levels, improved current account and a relatively strong crown, led the CNB to cut interest rates several times. The CNB has kept the repo rate stable for the last 12 months but is maintaining a careful eye on the recently expanding current account deficit.

2. Exchange Rate Policy

The Czech crown is a freely floating currency. The crown is fully convertible for most business transactions. The Foreign Exchange Act provides a legislative framework for full current account convertibility. As of January 1999 all capital account restrictions have been lifted with two exceptions. First, until the end of 2000 Czech citizens may not open bank accounts abroad without a permit from the central bank. As of 2001, citizens will no longer need a permit, but will still need to notify the CNB. Secondly, foreigners are still barred from the purchase of real estate in the Czech Republic. Foreign company branches will be permitted to own real estate as of 2002, in accordance with the Czech Republic's commitments in the Organization for Economic Cooperation and Development (OECD).

3. Structural Policies

The government sees full membership in the European Union (EU) as one of its highest foreign policy priorities. An EU association agreement signed in 1991 currently governs relations between the Czech Republic and the EU. Detailed accession negotiations began in November 1998. The Czech government has set itself a target date of 2003 to be prepared for EU accession. By then also the gradual deregulation of government controlled prices of energies, rents, some pharmaceuticals, telecommunications, passenger train and coach transportation, postal services and water rate and sewage charges should be complete (liberalization of all other prices took place in 1991). The actual date of accession will depend on the outcome of current negotiations with the EU. As part of the EU accession process, many of the Czech Republic's regulatory policies and practices are evolving toward EU norms. Through membership in OECD, the Czech Republic agreed to meet, with relatively few exceptions, OECD standards for equal treatment of foreign and domestic investors and restrictions on special investment incentives. The United States has succeeded in using the OECD membership process to encourage the Czech Republic to make several improvements to the business climate for U.S. firms.

Czech tax codes are generally in line with European Union tax policies. In 2000 the government reduced taxes on corporate profits from 35 to 31 percent. The tax rate for the highest tax bracket for personal income tax was lowered to 32 percent. Employer and employees social insurance contributions are respectively 35 percent and 12.5 percent. The government permits tax write-offs of bad debts, although with less generous treatment of pre-1995 debts. Firms are allowed to write-off the first year's share of a bad debt without filing suit against the debtor, though subsequent write-offs must document unsuccessful efforts to collect past due amounts. U.S. firms have complained that Czech tax legislation effectively penalizes use of holding company structures by leveling both corporate tax and dividends withholding tax on profit flows between group companies, thus creating double taxation on such profits. Czech law does not permit intra-group use of losses (i.e., offsetting losses in one group entity against profits in another), and imposes corporate tax on dividends received from foreign holding without allowing use of a foreign tax credit for the underlying tax suffered in the subsidiary's home jurisdiction.

The need for an improved bankruptcy law remains an important structural impediment. Most observers believe the slow and uneven courts and weakness of creditors' legal standing has hampered the current bankruptcy law from acting as an effective vehicle for corporate restructuring. Members of Parliament and others have called for a bankruptcy law closer to the U. S. Chapter Eleven provisions or "London Rules" for out-of-court settlements to encourage resuscitation of troubled firms. Several amendments, the latest in force as of May 1, 2000, have sought to address these concerns. Presently, there is a three to four-year backlog in the bankruptcy courts and only a small secondary market for the liquidation of seized assets.

4. Debt Management Policies

The Czech Republic maintains a moderate foreign debt and has received investment grade ratings from the major international credit agencies. In 1999 gross foreign debt measured $24.3 billion. To June 30, 2000 gross foreign debt measured $20.9 billion, most of the amount being the debt of companies ($11.5 billion) and commercial banks ($8 billion). Debt service as a percentage of GDP and debt service to exports stand at 9 percent and 9.6 percent, respectively. The Czech Republic repaid its entire debt with the International Monetary Fund (IMF) ahead of schedule.

5. Aid

The Czech Republic graduated from USAID assistance on September 30, 1997. The Czech Republic continues to receive assistance from the European Union's PHARE program and individual EU member states to assist its transformation during the accession period for EU membership. According to the European Commission Delegation in Prague, since 1990 the Czech Republic has received 660 million ECU in PHARE assistance.

6. Significant Barriers to U.S. Exports

The Czech Republic is committed to a free market and maintains a generally open economy with few barriers to trade and investment. It is a founding member of the World Trade Organization (WTO). The Czech Republic maintains relatively low tariff rates, with a trade-weighted average tariff of 4.5 percent, which is gradually reduced to 3.5 percent in accordance its Uruguay Round commitments. The Czech Republic is a signatory to the WTO Information Technology Agreement and has announced its intention to join the General Agreement on Tariffs and Trade (GATT) Agreement on Trade in Civil Aircraft.

The Czech Republic's EU association agreement established preferential tariffs for EU-origin products to the Czech markets, while maintaining higher most-favored-nation rates for U.S. and other non-EU products. The preferential tariffs for EU goods are declining on an annual basis and by 2001 most EU industrial products will enjoy duty-free status. Since 1992, when the trade-related provisions of the EU association agreement first came into force, a number of U.S. companies within many industry sectors have complained that tariff preferences given the EU under the agreement have diminished their business prospects and ability to compete against EU-origin products. Products most affected include aircraft and automobiles, among others. In July 2000 the Czech Republic signed the Protocol to the Europe Agreement on Conformity Assessment and Acceptance of Products (PECA) with the EU which as of January 1, 2001 will enable imports of EU industrial products without any additional testing. European companies have sought on occasion to use the Czech Republic's interest in EU membership to gain advantage in commercial competition.

Trade in agricultural/food products is generally free of major trade barriers, although technical barriers continue to hamper imports of certain products. In 2000 the EU and the Czech Republic have agreed to eliminate most tariffs on the other's agriculture products as a part of so-called "Zero-for-Zero Agreements." In anticipation of EU membership, the Czech Republic is rewriting much of its legislation related to standards and trade in agricultural/food products. During this transition phase, it is not always clear which rules apply, a situation which has led to some delays in approval. The harmonization of standards with the EU should ease the paperwork burden for those exporters already exporting to the EU. However, the alignment of Czech food legislation with the EU also means that certain products currently prohibited in the EU will also be prohibited in the Czech Republic in the future.

A law implementing EU directives to regulate Genetically Modified Organisms (GMOs) will enter into force on January 1, 2001. The government is in the process of drafting decrees regulating new, approved GMO varieties for field-testing. U.S. exporters of beef, poultry, pork and horse meat are not yet able to ship to the Czech Republic due to problems with export certification. USDA's Food Safety Inspection Service (FSIS) is currently reviewing certification documents proposed by the Czech State Veterinary Administration.

The government is required by law to hold tenders for major procurement. The law, introduced in 1994, proved unsatisfactory, and attempts at its revision have failed. A new procurement law will be introduced to Parliament in 2001 to fully harmonize Czech practice with EU legislation. It will also remove the current ten percent price advantage for domestic firms. The Czech Republic is not a member of the WTO Government Procurement Agreement.

The Czech Ministry of Industry and Trade issues import licenses to those seeking to import selected goods into the Czech Republic. While most products and services are exempt from licensing, oil, natural gas, pyrotechnical products, sporting guns and ammunition require an import license.

Legally, foreign and domestic investors are treated identically and both are subject to the same tax codes and other laws. The government does not screen foreign investment projects other than for a few sensitive industries, e.g., in the defense sector. The government evaluates all investment offers for the few state enterprises still undergoing privatization. As part of OECD membership, the Czech Republic committed not to discriminate against foreign investors in privatization sales, with only a few excepted sectors. The government has overcome political resistance to foreign investment in certain sensitive sectors, such as petrochemical, telecommunications and breweries. The ban on foreign ownership of real estate remains another important exception, although foreign-owned Czech firms may purchase real estate freely.

U.S. investors interested in starting joint ventures with or acquiring Czech firms have experienced problems with unclear ownership and lack of information on company finances. Investors have complained about the difficulty of protecting their rights through legal means such as a secured interest. In particular, investors have been frustrated by the lack of effective recourse to the court system. The slow pace of court procedures is often compounded by judges' limited understanding of complex commercial cases. The Czech Republic also imposes a Czech language requirement for trade licenses for most forms of business. This requirement can be fulfilled by a Czech partner, but this can be burdensome and involves additional risks. Moreover, some businessmen cite a convoluted, or in some cases corrupt, bureaucratic system, both at national and local levels, which can act as an impediment to market access. Often considerable time is spent by a potential investor to finalize a deal, or enforce the terms of a contract.

The opaque nature of the stock market puts U.S. investors and financial services providers at a competitive disadvantage. While stock market reforms were enacted in 1996 to help protect small shareholders and increase transparency of transactions, enforcement has been uneven. A Czech Securities Commission opened in 1998 with a mission of improving the regulatory framework of the capital market, increasing capital market transparency, and restoring investor confidence. To date, the Commission has issued some 3,284 authorized rulings, and in the re-licensing process, which is complete, has revoked 240 licenses. It has been hampered, however, by budgetary constraints and a lack of rule-making authority. A new law on the Securities Commission is being prepared to strengthen its status.

U.S. firms also complain about the lack of consistency in the application of customs norms. These problems are primarily due to the newness of recent regulatory changes and rapid expansion of customs personnel. Training efforts are underway to correct the situation and address these concerns.

7. Export Subsidies Policy

The Czech Export Bank provides export guarantees and credits to Czech exporters. The bank follows OECD consensus on export credits. Additionally, the government maintains a fund through which it purchases domestic agricultural surpluses for resale on international markets. For some commodities, pricing is established at a level that includes a subsidy to local producers.

8. Protection of U.S. Intellectual Property

The Czech Republic is a member of the Bern and Universal Copyright Conventions and the Paris Convention on Industrial Property. Czech laws for the protection of intellectual property rights (IPR) are generally good, but enforcement has lagged. Existing legislation guarantees protection of all forms of property rights, including patents, copyrights, trademarks and semiconductor chip layout design. The Czech Republic met most of its outstanding obligations under the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement with the passage of an amendment to the copyright law providing 70 years of copyright protection for literary works, up from the present 50 years, which will enter into force on December 1, 2000. Czech law does not clearly provide for civil *ex parte* search procedures as required by the WTO Agreement on Trade-related Aspects of Intellectual Property Rights, which would enable right holders to better protect their interests. The ability of rights holders to make use of existing ex parte search and seizure provisions remains an area of concern.

As a result of enforcement weaknesses and delays in indictments and prosecutions, the U.S. government retained the Czech Republic on the Watch List during the 2000 Special 301 cycle. The U.S. Embassy continues to work with U.S. industry and Czech government officials to improve enforcement of IPR norms. Two recent legislative amendments should expand tools of enforcement of IPR. One, entered into force as of December 1, 1999, boosts the powers of the customs service to seize counterfeit goods, and the other, in effect as of September 1, 2000, allows the Czech Commercial Inspection (CCI) to act directly in IPR cases.

9. Worker Rights

a. *The Right of Association:* The law provides workers with the right to form and join unions of their own choice without prior authorization, and the government respects this right in practice. Most workers are members of unions affiliated with the Czech-Moravian Chamber of Trade Unions (CMKOS), a democratically oriented, republic-wide umbrella organization for branch unions. The unions are not affiliated with political parties and exercise independence. Workers have the right to strike, except for those whose role in public order or public safety is deemed crucial. By law, strikes may take place only after mediation efforts fail. Unions are free to form or join federations and confederations and affiliate with and participate in international bodies. Union membership is on the decline.

b. *The Right to Organize and Bargain Collectively:* The law provides for collective bargaining, which is generally carried out by unions and employers on a company basis. The scope for collective bargaining is more limited in the government sector, where wages depend on the budget.

c. *Prohibition of Forced or Compulsory Labor:* The law prohibits forced or compulsory labor, including that performed by children, and it is not practiced.

d. *Minimum Age for Employment of Children:* The Labor Code stipulates a minimum working age of 15 years, although children who have completed courses at special schools (schools for the mentally disabled and socially maladjusted) may work at age 14. These prohibitions are enforced in practice.

e. *Acceptable Conditions of Work:* The government sets minimum wage standards. The minimum wage is 4,500 Czech Crowns per month (approximately $113), although the monthly average is 13,473 Czech Crowns (approximately $337) per month. Average net wages are 2.8 times as high as official sustenance costs. The minimum wage provides a sparse standard of living for an individual worker or family, although allowances are available to families with children. The law mandates a standard workweek of 40 hours. It also requires paid rest of at least 30 minutes during the standard 8-hour workday, as well as annual leave from four weeks up to eight weeks depending on the profession. Overtime ordered by the employer may not exceed 150 hours per year or 8 hours per week as a standard practice. Industrial accident rates are not unusually high. Workers have the right to refuse work endangering their life or health without risk of loss of employment.

f. *Rights in Sectors with U.S. Investment:* All of the above observations on worker rights apply to firms with foreign investment. Rights in these sectors do not differ from those in other sectors of the economy. Conditions in sectors with U.S. investment do not differ from those outlined above.

Extent of U.S. Investment in Selected Industries—U.S. Direct Investment Position Abroad on an Historical Cost Basis—1999

(Millions of U.S. dollars)

Category		Amount
Petroleum		(1)
Total Manufacturing		71
Food & Kindred Products	5	
Chemicals & Allied Products	35	
Primary & Fabricated Metals	5	
Industrial Machinery and Equipment	21	
Electric & Electronic Equipment	-86	
Transportation Equipment	79	
Other Manufacturing	13	
Wholesale Trade		58
Banking		(1)

Finance/Insurance/Real Estate	81
Services	33
Other Industries	61
TOTAL ALL INDUSTRIES	501

(1) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.