

NATIONAL LISBON PROGRAMME

2005 – 2008

(National Reform Programme of the Czech Republic)

October 2005

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EUROPEAN CONTEXT AND NATIONAL REFLECTION

With the aim to co-ordinate measures for stimulating economic growth, employment and competitiveness of EU Member States, whilst maintaining the quality of life and the level of environmental protection in the context of global economic competition and unfavourable demographic development in Europe, the EU during the Spring European Council meeting in 2000 adopted the Lisbon strategy. Though it is evident that so far the fulfilling of Lisbon strategy has not brought the expected outcomes, arguments justifying its existence are still convincing. Despite critical voices the Lisbon strategy remains a meaningful concept for developing European potential with the aim to improve economic output of the EU. However, it should not be taken only as a means of changing the European economy with the effort to catch up with the most developed world economies. More likely it is an attempt to fulfil the European vision of future, based on modernisation of EU economy while maintaining the particularities of its social model.

Following the recommendations based on the report prepared by so-called Kok expert group, the European Commission submitted to the Spring European Council in 2005 a Mid-term Review of the Lisbon strategy. This document became a starting point for fundamental change in understanding this agenda. The “new” Lisbon strategy is primarily oriented at higher economic growth and employment, while respecting the principles of sustainable development. At the same time a proposal for improved governance of the whole process was adopted. The new governance of Lisbon agenda should simplify and streamline the present system of co-ordinating economic policies both at EU and Member State level. It should also strengthen the ownership of Lisbon goals by Member States. Emphasis is put on a permanent dialogue between the key actors in national political systems (government, parliament, local and regional authorities, social and economic partners, non-government non-profit organisations) with the aim to increase their participation on the reform process.

Since the first days of its EU membership the Czech Republic took its part in discussions about revision of the Lisbon strategy. In connection with the declared claim to put more stress at economic growth and employment in EU Member States the Czech Republic welcomed the proposal to submit single national documents – National Reform Programmes. Their aim is to strengthen the political accountability for fulfilling the content of Lisbon strategy and to allow for assessment of the reform measures taken at the level of Member States. The National Reform Programmes are three-year programmes, which however can be revised in case of political changes.

Elaborating the National Reform Programme is a priority of the Czech government, which is reflected in its Policy statement of May 10, 2005. National Reform Programme represents the opportunity to clarify economic and employment policy priorities to general public and to explain the necessity of taking those reform steps to which the Czech Republic commits by submitting this document.

A report will be elaborated annually by European commission, in which the chosen priorities and progress reached by each Member State will be assessed. The annual report on progress will be a basis for multilateral surveillance of fulfilling the Lisbon goals and it will also serve as a source of information for the Spring European Council. The Commission will submit its first annual report on progress in January 2006.

The National Reform Programme of the Czech Republic was elaborated on the basis of Integrated Guidelines for Growth and Jobs (2005–2008), adopted by the European Council in June 2005. These merge the Broad Economic Policy Guidelines and Employment Guidelines of the EU into a single document, which is an important part of the process of re-orientation and new understanding of Lisbon strategy. Decrease in the number of guidelines and their better interconnection will allow Member States to concentrate on a limited number of goals and thus achieve higher effectiveness in meeting them. The substance of the Integrated Guidelines reflects efforts to focus more on reforms aimed at increasing growth potential and employment in the EU, whilst maintaining sound macroeconomic framework. At the same time the measures proposed in this document

address the most important barriers curbing the growth of European economies, i.e. low labour market flexibility, insufficient use of firms' innovation potential and excessive regulation of enterprises.

The Sustainable Development Strategy of the Czech Republic and the Economic Growth Strategy were among the information sources used for the National Reform Programme. The measures to increase growth and employment presented in Economic Growth Strategy correspond to those in National Reform Programme. It must be noted, however, that the Economic Growth Strategy is a plan for the period 2006 – 2013, while the National Reform Programme, in accordance with the Commission's request, includes only measures to be implemented within the next three years. Some other documents are also reflected in the National Reform Programme, i.e. the Implementation Report on the 2003-2005 Broad Economic Policy Guidelines, the prepared update of the Convergence Programme of the CR and inputs into the National Strategic Reference Framework and the National Development Plan. When choosing priorities, the following criteria were taken into account: possible accomplishment within the next three years, expenditure frameworks of the Czech budget, measurability and synergic effect.

In order to achieve broad consensus on the reform priorities, this Programme was consulted with economic and social partners and also with the Chamber of Deputies and the Senate of the Parliament of the CR. The social and economic partners will also play an active role in fulfilling the goals following from this document, notably via the Council of Economic and Social Agreement and its working teams. With the aim to promote solidarity of citizens with this project, whose main purpose is to decrease the difference between growth potential of Europe and its economic partners, issues closely connected to the Czech National Reform Programme will be actively discussed with public.

The National Reform Programme of the Czech Republic represents an integrated and cohesive approach to macroeconomic and microeconomic and employment policies.

The most important priority of CR in the **macroeconomic area** is continuing in public finances reform. The reform focuses on gradual reduction of the share of Maastricht general government deficit on GDP in such a way that in 2008 the deficit should not exceed 3% of GDP. Monetary policy based on inflation targeting should help maintaining a low and stable growth of price level. The Czech Republic strives for eurozone membership. The aim of implemented reforms therefore is to meet the Maastricht criteria so that the euro could be introduced before 2010.

The reforms in **microeconomic area** are interconnected and focused on measures to strengthen and increase the competitive advantages of Czech and European industrial base, while respecting the need of sustainable use of resources. At the same time, owing to faster growth of macroeconomic labour productivity, the gap between Czech economy and EU average will be closing gradually. The most important reform measures will be to create a stimulating environment for research, development and innovations, including their commercial utilization, modernisation and development of means of transport, information and communication networks and creation of a favourable business environment that would facilitate setting up of new companies and would prove a low administrative burden on entrepreneurs.

Since the wage growth at present follows the growth of labour productivity and therefore does not undermine macroeconomic stability of the Czech Republic, reforms in the area of **labour market** will focus mainly on labour market flexibility. Extending the freedom of contract, reduction of statutory non-wage labour cost and promoting regional mobility of labour force are the key elements to increase motivation of people to work. As concerns labour market inclusion, focus is on those at the beginning or at the end of professional career. Reforms in the area of education will increase the quality of labour force, extend the education opportunities and help to cope with the demanding conditions on a changing labour market.

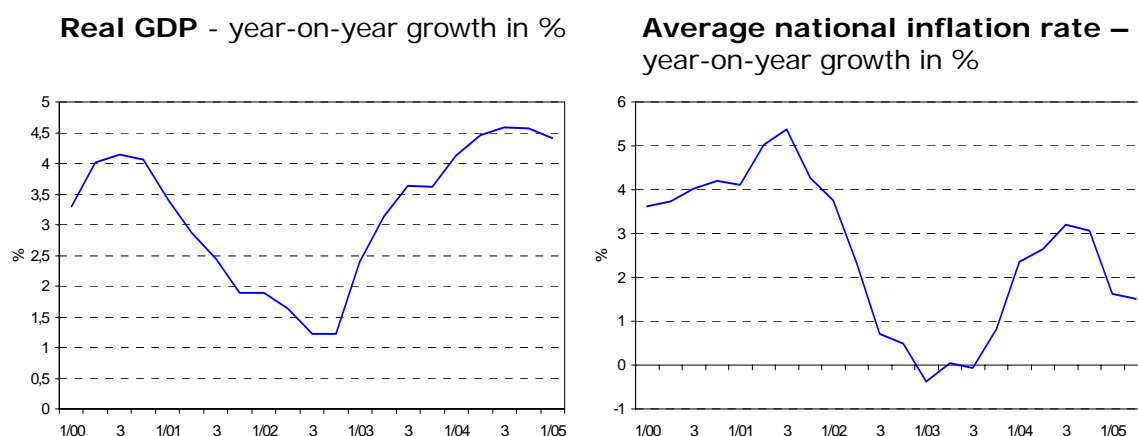
National Reform Programme of the Czech Republic however should not be taken as a list of all priorities, problems or weaknesses, supplemented with detailed schedule of remedies and instruments to be used.¹

Success of the proposed reform measures will affect functioning of the EU Internal Market based on the four economic freedoms, and vice versa. A fully functioning Internal Market will facilitate the trade exchange of goods both in the EU and outside and thus will contribute to promoting competitiveness of the CR on foreign markets. On the other hand, persistent difficulties with placing products on other Member States' markets or problems with recognition of qualifications and labour permission requirements in case of providing cross border services are a common cause of discontent. In this context it must be mentioned that introduction of the transition period on free movement of workers was a very delicate issue in the CR. Although these problems affect only a limited number of entities or citizens, generally they are perceived negatively.

Transposition of Internal Market directives into legal systems of Member states is key for ensuring its good functioning. Only a timely and proper transposition will allow citizens and entrepreneurs to benefit fully from their rights and economic advantages of a functioning Internal Market. During the last year the Czech Republic substantially reduced its transposition deficit, which originated in the period of EU accession, to present 3.6%². Further deficit reduction and timely transposition in the future is one of the principal priorities. Many measures aimed at increasing the speed and improving the quality of meeting legislative obligations are being implemented, in order to reach the EU limits in this area in the first half of 2006.

PRESENT STATE OF THE CZECH ECONOMY³

Current macroeconomic developments of the CR can be summed up as positive. For the last five quarters the year-on-year growth of the Czech Republic exceeds 4% and the structure of this growth, which is pulled by investment activity and improving export performance, is favourable from a long-term perspective. The fastening growth has both structural and cyclical nature. The potential product growth rate accelerates persistently, notably owing to a robust increase in total factor productivity. In the first quarter of 2005 it reached 3.9%, according to our calculations. At the same time the negative output gap is probably closing.



¹ During the process of elaborating National Reform Programme, given the priorities for the nearest future, it was decided not to elaborate fully guidelines No. 6, 10, 12, 13 and 21. With regard to synergies between the measures proposed by Integrated guidelines the expectation is that implementation of reforms presented in this programme will have positive impact even on guidelines which are not explicitly covered by it.

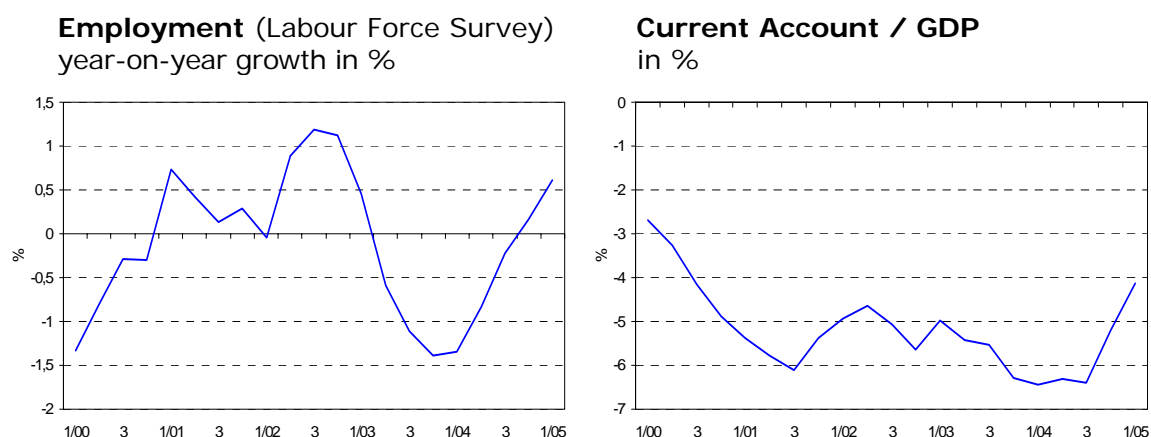
² Internal Market Scoreboard 2005.

³ The source of the data is the Czech Statistical Office database as to July 18, 2005.

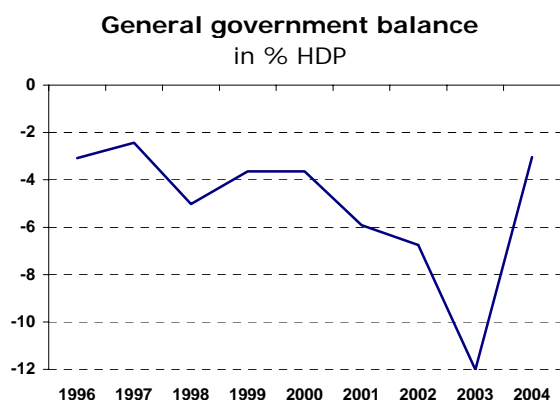
Since the end of nineties the Czech economy can be considered a low-inflation economy. Since the beginning of 2005 the year-on-year growth of consumer prices is below 2%; in June 2005 it reached 1.8%. The effects of exceptionally high prices of raw materials on world markets are partly compensated by strengthening of the Czech koruna exchange rate. High level of competition on the consumer market also plays an important role.

Positive developments also emerged on the labour market. After a few years of decrease, the employment (according to the Labour Force Survey) in the fourth quarter of 2004 started increasing in a year-on-year comparison. The growth in the first quarter of 2005 reached 0.6%, while it was most significant in construction and manufacturing. Dynamic growth of labour productivity around 4% persists. Seasonally adjusted unemployment rate reached its peak at 8.4% in the first quarter of 2004 and is slowly decreasing since then. The fall of employment and participation rates also ceased. It is an open question to what extent this is a cyclical development resulting from delayed effects of the closing negative output gap and to what extent it reflects improvements in the structural labour market characteristics and active labour market policy measures.

External economic balance, expressed by the ratio of current account to GDP twelve-months moving sums, has been improving since the third quarter of 2004. In the first quarter of 2005 the current account deficit reached 4.1% GDP. The main factor is a sharp improvement of the trade balance, a result of simplified foreign trade procedures after EU entry and in particular of the effects of important mainly export-oriented investments which were accomplished. Despite high oil prices, the twelve-months moving trade balance, which in December 2003 recorded a deficit of 2.7% of GDP, reached a moderate surplus.



At present the Czech Republic shows excessive general government deficits. **Budgetary deficits** were caused by expenditures on transformation and modernisation of the economy, expensive social system and by increase in expenditures at times when fiscal policy was used for stimulating demand. The institutional framework of fiscal policy also

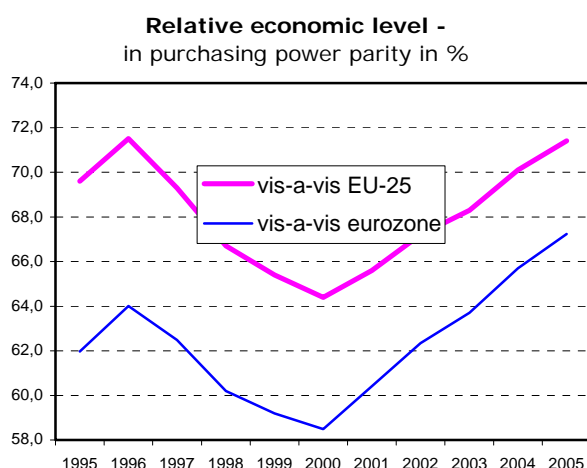


contributed to ineffectiveness in fiscal policy. Public budgets were fragmented with a lot of expenditure centres, which were to a certain degree autonomous. This resulted in expenditures increasing outside the narrowly defined state budget and disturbed the allocation effectiveness. Furthermore, the planning horizon was inadequately short with stress being put on a one-year budgetary cycle. Owing to this, it was impossible to curb the increase of mandatory expenditures and often resulted in pro-cyclical fiscal policy.

Since 2003 the annual GDP growth rate exceeds 3% and the economic development creates a favourable environment for a fiscal consolidation. The consolidation is built on expenditure cuts, restructuring of the revenue side and on binding medium-term expenditure frameworks, which extend the planning horizon and help to eliminate pro-cyclical fiscal policy. A successful fiscal consolidation will allow for a stable economic environment with low interest rates and stable exchange rate. With the medium-term expenditure frameworks in place, the savings on expenditures can, via the effect of expectations and confidence, increase private consumption and investment and thus boost the economic growth.

In the long term public finances will be significantly influenced by demographic development. Though at present the share of people over 65 years on total population is lower than in EU-15 countries, should the demographic situation not change, the process of population ageing might accelerate and the CR could become a country with one of the eldest populations in Europe. In that case the pension system and the systems of health and long-term care would be exposed to enormous pressures on expenditure. Without effective reforms in these areas the public finances quality will deteriorate. Expenditures acting as an economic growth catalyst (infrastructure, research and development, education) would be further forced out by social transfers and expenditures on consumption. Without additional adjustments and reforms concerning the pension system, system of social security benefits and labour market, the unfavourable demographic development would lead to a substantial decrease in employment with a negative impact on potential growth rate.

Reforms presented in this National Reform Programme should help to **accelerate the process of real convergence⁴ of the Czech economy to EU-25 average**. Recently, after overcoming the recession in the second half of nineties, the growth rate of the Czech economy markedly exceeds the EU average. During the period 2000 – 2005 the average



growth rate of the Czech economy should reach 3.3% compared to 2.0% in EU-25 and 1.8% in eurozone. The convergence process in the period 1995 – 2004 proved considerable irregularities due to strong cyclical fluctuations and weak synchronisation of economic cycle with the EU. In 1995 the relative level of economic output per capita of the Czech economy expressed in purchasing power parity compared with EU-25 average reached 70%. It then dropped to 64% in 2000 and in 2005 it is expected to reach 71%. The relative level towards eurozone is expected to exceed two thirds.

These data, however, are not conclusive for the convergence process, since they are substantially affected by cyclical position of the economy. While at the beginning of the surveyed period the output gap was strongly positive (according to our calculations it peaked in 1996 at 3.4%), in 2000 the recession of the end of nineties was still fading away and only since then the potential output⁵ growth rate started accelerating, which is a precondition for sustainable nature of the convergence process.

As in all new member states' economies, in the Czech economy there is a huge difference in hourly labour productivity compared to "old" EU countries. Apparently this is a result of

⁴ The data comparing the relative level of Czech economy with the EU come from Eurostat database valid as to July 18, 2005. Where the data are available, the Czech economy is compared to EU-25 average. In other cases it is compared to eurozone countries.

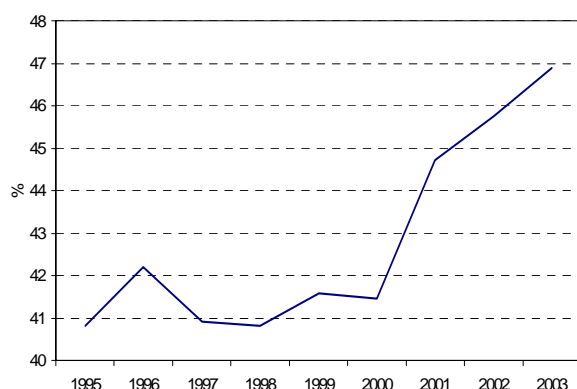
⁵ The potential output is defined as a real output level assuming average use of production factors. Potential output growth can be accelerated by increasing the stock of capital (i.e. higher investment), by increasing the hours worked and by boosting productivity.

technological underdevelopment in the period of centrally planned economy, which was caused by ineffective allocation of production factors. Transformation, privatisation and restructuring of the economy, introduction of new market economy institutions, transfer of technologies and adaptation of economic subjects to new conditions created environment allowing for **gradual reduction of the differences in productivity levels**. Hourly productivity in the Czech economy thus increased from 41% of the EU average both in 1995 and 2000 to 47% in 2003.

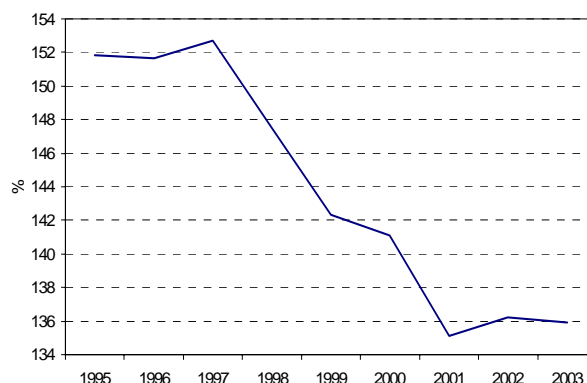
Proposed reforms, notably at microeconomic level, should help to maintain or even accelerate this positive tendency. Labour productivity growth should be stimulated by investment in research, development and innovation, by modernisation and development of transport, information and communication infrastructure and by improving business environment.

As concerns **labour utilisation**, compared to EU the CR still scores high above average, though this relation deteriorates fast. If we decompose the relative economic level to the effect of hourly labour productivity and the effect of hours worked per capita, the average amount of hours worked compared to EU-12 in 2003 was approximately by 36% higher (as compared to 52% in 1997).

Hourly labour productivity –
relative level in purchasing power parity
compared with eurozone in %

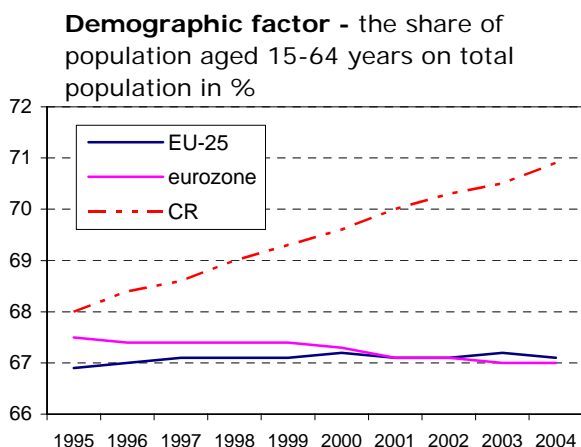


Labour utilisation -
relative level of hours worked per capita
compared with eurozone in %



Favourable **demographic structure** is an important, though only temporary, factor, which contributed to higher labour utilisation. While in the EU average for many years the share of population aged 15 – 64 oscillates around 67%, the share of people in productive age in the CR increased from 68% in 1995 to 71% in 2004.

When considering the future impact on economy, it is however necessary to take into account that this situation is an outcome of high natality in the seventies and eighties of last century. As a result of the drop in birth rate in the nineties, when total fertility rate fell from 1.94 in 1988 to 1.13 in 1999 (at present it is somewhere around 1.20) and gradually growing life expectation, the positive effect of demographic factor will culminate probably in 2008 (according to Eurostat methodology). Since then the impact of population ageing will take place. Overcoming the foreseeable effects of this phenomenon is a challenge for both present and future fiscal and structural policymakers.

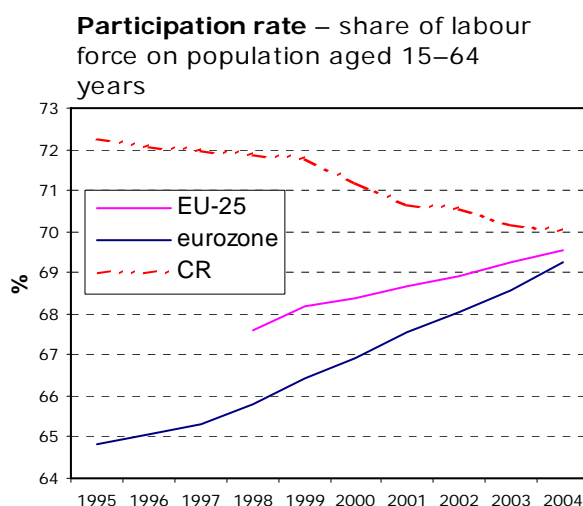
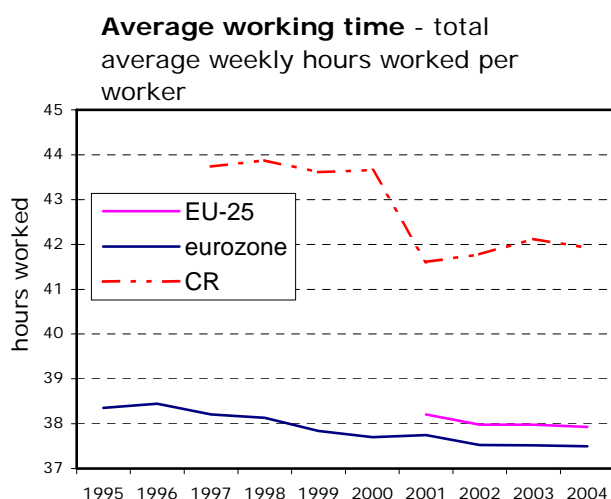


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Another source of the above-average

labour utilisation in the CR is a high **amount of hour worked per worker**. The average working time in the Czech economy is traditionally long. Moreover, the effective working time of newly established entrepreneurs (mostly with no employees) is on average significantly longer compared to that of employees. The amount of part-time jobs in the Czech economy is markedly lower than in the “old” EU Member States. Also the length of holiday leave and the number of bank holidays are below EU average.

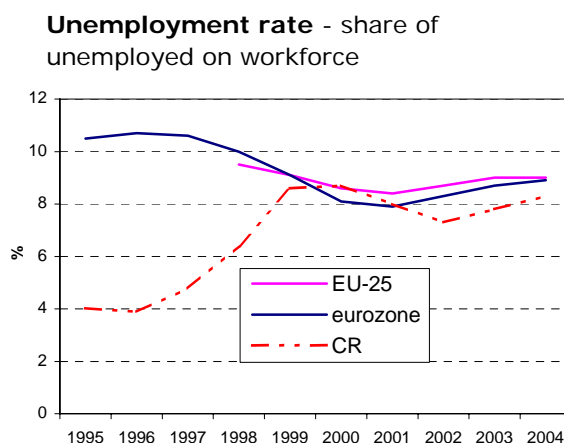
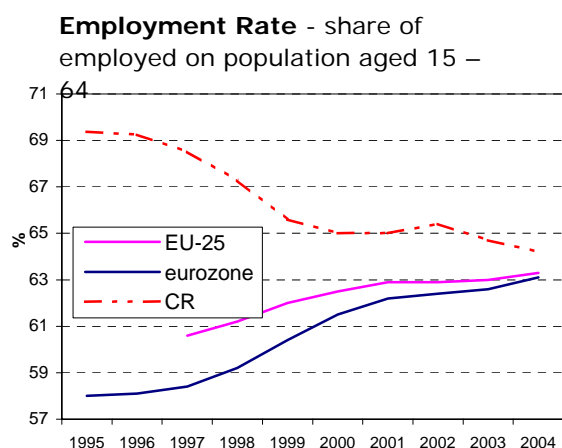
Future increase in the length of working time in the Czech economy cannot be expected. Like in other developed countries, with improving economic situation individual preferences will probably shift from consumption of material goods to increase in the value of free time for self-development.



The drop in relative labour utilisation compared with EU countries is to a large part a result of **labour participation** development. In the EU, notably in eurozone countries, the participation rate (share of workforce on population aged 15 – 64) is growing constantly, owing to policies promoting labour market flexibility, and aiming at inclusion of marginal groups into the labour force. The development in the CR is however the opposite. Apart from positive signs, like increased share of young people participating on secondary and tertiary education, also some negative effects are coming to light, e.g. a still large proportion of early retirements or dependence of certain population groups on social security benefits.

To change the trend of participation rate and in particular of employment rate is a task for labour market policy. Increase in labour market flexibility, developed education system and social inclusion of disadvantaged population groups into the labour market are preconditions.

The drop in relative labour utilisation, notably after 1995, was due to an abrupt growth of



unemployment. In the second half of nineties, in the period of substantial structural changes of the economy, unemployment reached the level comparable with both EU-25 and eurozone averages. The difference from eurozone, 0.6 percentage points in 2004, can be attributed to a better position of the Czech economy in economic cycle.

Measures aimed at increasing labour market flexibility and strengthening the stimulation effect of direct taxes and benefits can contribute to a decrease in structural unemployment.

MACROECONOMIC PART

Macroeconomic stability and sustainable growth

Stable macroeconomic environment, including both external and internal equilibrium, is an important factor contributing to economic growth. It can be supported by appropriate monetary and fiscal policy. Before introduction of euro, the price stability will be secured by means of inflation targeting. This strategy is compatible with a rather liberalised and global environment of current world economy.

In the coming years the Czech Republic will be dealing with a specific task to take part in decision on the timing of entry into ERM II and on setting the central exchange rate parity. The analysis of benefits and costs of ERM II membership⁶ concludes that the participation in ERM II should be viewed merely as the gateway to joining the eurozone, i.e. participation in the mechanism should not exceed the minimum required period of two years.

The Czech Republic is aware of the scope of fiscal problems and long-term challenges. The public finances reform is under way since 2003, the debates about pension and healthcare system reforms gained on intensity. The reason in both cases is an effort to remove excessive general government deficits, to meet the criteria for Economic and Monetary Union (EMU) entry in 2010 and gradually to head towards long-term sustainability of public finances (deficit below 1% of GDP).

As concerns fiscal policy, the CR has set up a medium-term target to decrease the so-called Maastricht deficit below 3% before 2008 and to keep the government sector gross debt below 60% of GDP. More details on the measures to achieve this goal – both on expenditure and revenue side – are described in the 2004 Convergence Programme of the CR and will also be included in the 2005 Convergence Programme⁷. The main principles are emphasis on **medium term orientation of public budgets and respecting the medium term expenditure frameworks of the state budget and of extrabudgetary funds.**

Recent introduction of medium term budgeting by means of medium term budgetary frameworks and binding expenditure ceilings⁸ based on three year rolling basis is an important step in the area of public finances. Thus the fiscal impacts are more transparent and the automatic stabilisers can work freely without disturbances.

Strengthening the role of binding medium term expenditure frameworks on the level of budgetary chapters and state funds will facilitate the enforcement of obligations and application of sanctions. The medium term expenditure frameworks however cover only the state budget and state funds, which are controlled directly by central fiscal authority. Local governments are not covered. It is therefore important to promote communication between central and local governments in order to involve them more closely in the

⁶ A report "ERM II and the Exchange-rate Convergence Criterion" of July 15, 2003.

⁷ In 2005 the works on Convergence Programme and on National Reform Programme are carried out simultaneously. The Convergence Programme will not be finished before the Draft State Budget for 2006 and Medium Term Budgetary Framework for 2007 – 2008 are submitted to Parliament in October 2005.

⁸ For more information see Act No. 218/2000 Coll. on Budgetary Rules.

budgeting process. With this aim the Committee for Public Finances⁹ was set up as an advisory body to the minister of finances. The rules defining local government management must ensure effective treatment of entrusted funds and sustainable debt position of local governments. The degree of autonomy in management must be reflected in the scope of responsibility for this management. Similar conclusions can be made for the system of public health insurance.

Successful consolidation of public budgets cannot be realised without **systematic restructuring of expenditure side of the budget**. The Czech Republic struggles with a high share of quasi-mandatory and mandatory expenditures on public expenditures, which limits the scope for budgetary management. Systemic reform of pension security and healthcare financing together with correction in the system of state social support and social benefits is a necessity. Social benefits have to be more closely connected to active participation in the labour market. Though savings in non-mandatory expenditures (notably investment expenditures, R&D expenditures) are easier to achieve in the short term, such a policy would hamper economic growth. Therefore the public expenditure programmes have to concentrate on priority areas specified in the Economic Growth Strategy (infrastructure, education, research, development and innovations, development of the institutional environment for business), which on the other hand boost economic growth. To support these priorities, the Czech Republic will adopt measures to maximise the utilisation of Structural Funds and Cohesion Fund, to increase the absorption capacity and to ensure effective use of these funds. To ensure effective spending of public funds and to facilitate the choice of priority programmes it is however necessary to advance with public expenditure programming and to introduce output and outcome oriented budgeting in the state administration, accompanied by control and assessment mechanisms. This concerns in particular interconnection between programming of European and national funds, including the incorporation of Structural Funds and Cohesion Fund resources into national budgetary process. The degree of autonomy in management must be reflected in the scope of responsibility. Despite some particularities of public finances management, market approaches to management and assessment of projects (benchmarking, etc.) have to be introduced whenever possible.

The **restructuring of the revenue side** is already in progress. Both the implemented and planned measures in the area of taxes also aim at promoting economic growth and employment. Tax burden is gradually shifting from direct to indirect taxes. An example is an increase in VAT and excises, compensated for by a cut in personal and corporate income tax, which has already been approved and implemented (see Convergence Programme of the CR, 2004). Since 2006 further decrease in taxes for low-income families is planned, which will strengthen the motivation to participate actively on the labour market. Tax incentives for R&D projects were also implemented.

The Czech Republic has to proceed in implementation of the main principles of environmental tax reform, which will lead to further restructuring of tax burden. The concept of the reform will be elaborated before the end of 2005.

Excessive fragmentation of public budgets with more than one centre (state budget, state funds, local governments and public healthcare insurance system) can also be a source of risk. An overall consolidation of public finances is under way and for future it will be necessary to **continue in increasing transparency**, including consistent monitoring of indirect and contingent liabilities. The existence of state funds with autonomous plans on spending, often having the opportunity for ineffective spending, complicates their public control. Further and much deeper integration of these funds will be a step towards better transparency and stability of public finances. Local governments, which are part of public finances, have to be **properly integrated into**

⁹ The Committee associates Association of Regions of the CR and Union of Towns and municipalities of the CR. The central body of the Association of Regions of the CR is the council of the Association of Regions of the CR, which consists of regional governors, who, after consulting their assembly, can adopt strategic decisions which are binding.

the medium term budgetary process. Closer coordination of fiscal policy between central and local governments, including introduction of proper monitoring and assessment of indebtedness and debt service, with the possibility of penalization of municipalities with excessive indebtedness, will help to reduce the risk of missing the given fiscal targets. Caution is also necessary in case of state guarantees and implicit public liabilities (e.g. public-private partnerships). In case of their incorrect evaluation in the past they can turn out to be problematic.

To ensure long-term sustainability of public finances despite unavoidable process of population ageing, a coordinated approach in the area of public finance consolidation, pension system reform, healthcare financing and labour market reform, aiming to increase employment rate, is necessary.

It is important to **decrease the sensitivity of public finances to demographic development and to create effective mechanisms for pension and healthcare system financing.** An Executive team, whose aim was to prepare the background for a decision about pension reform, was established in 2004. This group analysed in detail the present pension system and also the reform proposals of all parliamentary political parties. Its analysis concludes¹⁰ that the current pension system is financially unsustainable in the long term and ineffective from microeconomic point of view. Without parametric changes, around 2050 this system would generate deficits between 4 – 5% of GDP. A long term strategy is to maintain the overall replacement rate of pre-pension income from the pension systems. The replacement rate of state pension insurance will probably decrease, increasing replacement rate from private systems will however compensate for it. From individuals' point of view, the present system is actuarially imbalanced. Since the pension does not fully reflect the years worked after reaching the statutory retirement age, it does not motivate citizens to work beyond the statutory retirement age. The Czech pension system is also considerably re-distributive. This on the one hand ensures that only a very small proportion of pensioners is below the poverty level. On the other hand, the absence of tight linkage between the contributions paid into the system and the pension received may discourage from economic activity and/or from paying contributions. In the short term it is therefore crucial to define the basic principals of pension reform, consisting mainly of increase in the statutory retirement age to reflect the prolonging life expectancy, new sources of financing, strengthening the relation to earnings and actuarial neutrality. In the next election term, when the basic principles are defined, the preparation, adoption and implementation of the pension system reform will take place.

The system of public healthcare insurance is coping with difficulties in financing. For the last few years the costs have been growing faster than the amount of financial resources. This trend leads to an increase in the public healthcare insurance deficit and prolongation of maturity dates concerning the payments from insurance companies to healthcare providers. The healthcare in the CR is generally accessible in an overlarge network of healthcare providers, which offers a relatively high standard. It is however almost entirely financed from public resources. Such a system leads to an excessive supply, whose structure is not always suitable. "Free" healthcare also motivates to immoderate consumption (of medicaments, healthcare services and aid). In the longer term the pressure on expenditure will become even stronger as a result of population ageing and expected faster growth of wage costs in the healthcare sector.

The government has approved some short-term stabilisation measures to balance the financial situation of healthcare insurance. These measures, which will be implemented within the next months, focus notably on strengthening of the revenue side (assignment of part of health insurance companies' claims after maturity dates to Ceska konsolidacni agentura, increase of insurance premiums paid from state budget for so-called state policyholders, complete redistribution of insurance premium) and cost regulation

¹⁰ Final report of the Executive team for preparation of materials relating to the pension system reform.

(changes in legislation concerning the conciliation procedure and the role of state in determining the payments for healthcare, medications and medical devices, rational pharmacotherapy, optimisation of healthcare services network, development of instruments for measuring and assessing the quality of provided healthcare services). Implementation of these short-term measures will only partly contribute to healthcare system stabilisation. So will do partial amendments to acts and secondary legislation in the area of healthcare. These steps however will not contribute to long-term fiscal sustainability, since they only lead to redistribution of the limited resources and transfer the problems to other segments of general government. To ensure financial sustainability and long-term stabilisation of the healthcare system, a consistent reform is necessary. Its concept should deal with sources of the problems, i.e. excessive and unregulated demand for healthcare and excessive supply of healthcare, notably the overlarge network of healthcare providers. Unlike the so far prevailing consumption of health care services, in future the stress should be put on prevention and stronger responsibility of citizens for their health.

Compared to EU countries, the participation rate and employment in the Czech Republic are slightly above average. The CR however falls behind countries with high employment (Denmark, Sweden, United Kingdom) because of low participation rate of older workers (55 - 64). The process of population ageing will result in absolute decrease in the number of employed and thus will have negative impact on economic growth. It is therefore necessary to **draw on the reserves in older workers' participation rate and decrease inactivity and unemployment of low-income groups**. In the last five years the participation rate of people aged 55 - 64 increased as a result of tightened early retirement schemes (abolition of early retirement schemes with only temporarily reduced pension benefits) and continuing rise in the statutory retirement age. The measures to increase participation rate of elderly people should be accompanied with pension system reform. Further increase of retirement age, unification of the retirement age of males and females, moderation in the redistribution of pension system and strengthening of actuarial neutrality would all contribute to higher rate of economic activity. The proposed changes in personal income tax strengthen motivation of low-income groups to more active labour market participation. In order to increase the employment rate significantly, further modifications in the tax and benefit system will be necessary. The system must neither discourage from taking up a low-paid job nor encourage dependence on the state.

Macroeconomic stability and sustainable growth - priorities

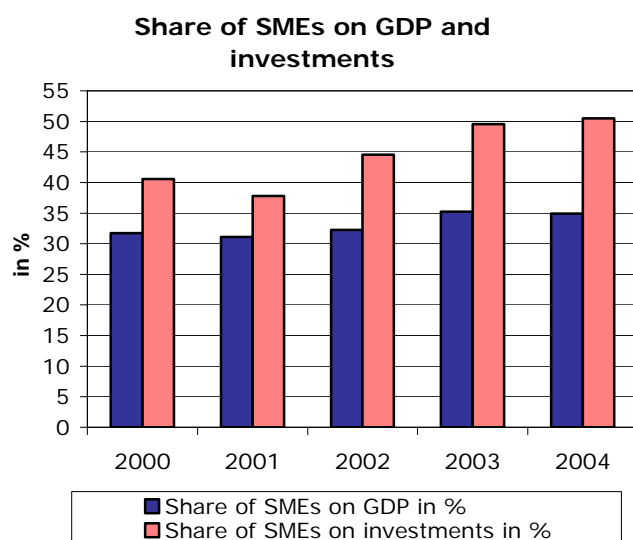
- **Respect the principles of fiscal targeting and strengthen the binding character of medium term expenditure ceilings of the state budget and extrabudgetary funds.**
- **Restructure the expenditure side of public budgets**
- **Continue in restructuring of tax burden**
- **Prevent indirect indebtedness in the form of extrabudgetary fiscal risks**
- **Adopt strategic decisions necessary for financial stabilisation of pension and healthcare system**
- **Increase the participation rate of population in productive age**

MICROECONOMIC PART

The position of the Czech economy compared to the EU proves that in recent years the living standards increased. It must be noted however that the convergence still lacks dynamism and a range of mostly economic and institutional difficulties originated previous years negatively influences the development. Further economic development of the Czech Republic depends on how entrepreneurs cope with competition pressures, resulting from the world economy globalisation. With regard to strengthening competition of countries with cheap labour force it is clear that the existing comparative advantages, i.e. low labour costs and low exchange rate, will be lost in the long run. To face this challenge it is necessary to develop a knowledge society, to promote research and development, to encourage the innovation potential of enterprises, to improve the quality of business environment and to develop human resources. Modern and developed infrastructure, encouragements of environmental technologies and rational utilisation of human resources are also among the main pillars of a well functioning economy. Quality regulation framework together with good legal enforceability is precondition for a sound competitive environment.

Business Environment

Small and medium sized enterprises (SMEs) are generally considered to be an engine of economic growth. According to data from December 2004 SMEs represent 99.85% of all enterprises in the Czech Republic and 61.5% of employees work in SMEs. In the last year SMEs produced 35% of GDP, they participated on total investments in the CR by 50.5% and their share on total exports of goods and services reached 34.3%¹¹.



At present there are 7 national programmes aimed at promotion of small and medium sized entrepreneurship financed from the state budget. For implementation of these programmes in the period 2005 – 2006 an amount of 550 mil. CZK was designated. Apart from this there are 9 programmes co-financed from Structural Funds as part of the Operational Programme Industry and Enterprise (OPIE). 25% of deductible expenses are co-financed from state budget. National programmes for support of SMEs, which are financed from the state budget, should be used primarily on activities that cannot be covered by Structural Funds. In future

the CR will therefore focus on ensuring effective operation of programmes, whose structure and drawing requirements will gradually adapt to the needs of small and medium-sized entrepreneurs. As concerns the Community level, at present notably the Multiannual Programme for enterprises and entrepreneurship is addressed to SMEs. After 2007 it will be replaced by the Competitiveness and Innovation Framework Programme.

One of the common goals of small and medium-sized enterprise promotion is to increase the export performance and competitiveness of SMEs and to create conditions that will help SMEs to operate successfully on foreign markets. Implementation of measures included in the programmes for SMEs support will facilitate the access of Czech firms on foreign markets, their presence on these markets and will support their direct international marketing activities. These measures will also help Czech firms to cooperate

¹¹ Report on Development of Support for SMEs in 2004.

more closely on exporting activities and thus contribute to improve the Czech export position abroad.

To develop long lasting and fruitful partnership between entrepreneurs, public administration bodies and relevant interest groups, it is advisable to apply the principles of corporate social responsibility.

Appropriately designed legal framework has a crucial impact on constitution and functioning of the business environment. Though a certain degree of regulation is necessary and desirable, every regulation induces direct financial costs and also costs in the form of human resources and time. It is therefore necessary to create such a regulatory environment that will be friendly to entrepreneurs in all phases of their activity.

Regulatory impact assessment, which consists of a range of systematic assessment methods for assessing both negative and positive outcomes of existing or proposed regulation, is one of the key instruments for increasing the quality of regulation. The method for assessing impact of regulation on business environment in the CR was approved in April 2005. Its pilot phase, introducing impact assessment into the process of shaping regulations, will take place in 2005 and 2006. Since 2007 the obligation to carry out impact assessment for all draft acts will apply to ministries and other central state administration bodies. In future this obligation will be extended to include all secondary legislation and also non-legislative documents.

Among other things, the **evaluation of administrative burden** on both the regulated entity and on public administration is subject to regulatory impact assessment. At present the entrepreneurs, in order to meet requirements imposed on them by state administration, must allocate their resources to activities of administrative nature instead of investing them into development of their enterprise, production or other productive activities. This has a negative impact on economic growth and prosperity of the society. It is therefore necessary to decrease the administrative burden on entrepreneurs as much as possible, while respecting the public interest. Analysis of administrative burden on entrepreneurs, based on a methodology of the Dutch Standard Cost Model, will be elaborated before the end of 2005. On the basis of this analysis a proposal for changes in respective legislative acts, aimed at decreasing the administrative burden, will be elaborated. Consequently, a proposal of legislative changes that will decrease the administrative burden by at least 20% will be submitted before the end of 2006.

To safeguard a prosperous development of business environment the legislation regulating start up of entrepreneurial activities is also crucial. Starting up of a business should not be demanding in terms time or money. The existing legislation in this area creates barriers to start-ups and its simplification is therefore desirable. Since July 2005 an amendment to the Commercial Code is in force, which facilitates and speeds up incorporation in the Commercial Register by using approved forms. Apart from this the amendment introduces a deadline of 5 (in some cases 10) days for the incorporation. The process of further **simplification of business environment for entrepreneurs** will focus primarily at creating a system of central registration offices for entrepreneurs. These offices would provide all or at least most services related to starting a business and changes in a running business. The procedure will be carried out in three phases. The outcome of the first phase is that the Trade Licensing Offices provide all necessary forms and services related to notification of a trade. At present, the second phase is in process, which focuses on transfer of obligations from the entrepreneur to central registration offices. This can be solved either by concentrating representatives of all institutions involved in one place or by providing electronic interconnection between these institutions. This phase is to be terminated in 2006. In the final phase, building on the experience already gained, a complete system of central registration offices will be established. Its main outcome will be simplification of administrative procedures related to starting and running a business. This whole process is to a certain degree connected with the EU Directive on Services in the Internal Market.

A part of this third phase will also be **simplification of business start up in case of activities with no further requirements on qualification**. Attention must be paid to the problem of “double registration” of newly established legal persons, i.e. registration in both Trade and Commercial Register. The obligation of double registration is an unjustified administrative burden notably in case of activities with no further requirements on qualification (unqualified trades). A new legal framework for entrepreneurship will be created within three years. This new legislation will be built on a rule that all information provided to the administration will be shared, i.e. entrepreneurs will not be repeatedly asked to give the same information to different institutions. Simplified forms will also be available for electronic submission.

According to World Bank data, the average length of bankruptcy proceedings in 2005 was 9.2 years and only 17.9% of total claims were recovered to the creditors. Compared to OECD average (1.5 years and 73.5%) the situation in the CR is dismal and creditors' risk is high¹². The Czech Republic needs new market-friendly insolvency legislation. Decisions of a commercial nature, notably the decision on how the proceedings will be solved, have to be put in the hands of creditors, i.e. those claiming the property of the insolvent debtor. Equality of creditors must be warranted. At present, a complete **re-codification of insolvency legislation** is under way, whose effect is expected from 2007. The re-codification will introduce precise definitions of crucial institutes and deadlines for individual transactions that are part of the proceedings. Overall, the rules will be set in such a way to motivate all parties of the proceedings to keep the enterprise operating and not to sell it part by part. The option of reorganisation will be an alternative to bankruptcy proceedings. Both the participation of creditors on the proceedings and their protection will be strengthened and the requirements on bankruptcy administrator will be stricter. To ensure access to information about bankruptcy proceedings, Insolvency Register will be introduced.

For development of entrepreneurial non-financial sector, **effective functioning of financial market**, which provides entrepreneurs with financial resources and thus stimulates development of the economy, is a precondition. Compared to other “new” Member States from Central and Eastern Europe, the Czech financial sector has the greatest volume of assets. In comparison with developed European countries the deepness of financial intermediation is however lower. There are also differences in its structure – the banking sector remains the fundamental element of the financial system, though its share gradually diminishes in favour of other financial institutions¹³. At the same time as diversification of financial sector is advancing, consolidated financial units that provide different types of financial services emerge. The continuing implementation of EC directives, either based on Financial Services Action Plan or with the aim to harmonise the Czech legislation, promotes faster integration of Czech financial markets into EU markets, strengthens the competition, encourages effective allocation of capital and decreases the price of funds. This creates potential for higher effectiveness of financial sector, at the same time it may however cause difficulties. For that reason the role of supervision on a consolidated basis, in a form of cooperation of financial market regulators, is very important. The process of integration requires a change in regulation and supervision over the financial market. The cross-border cooperation of the institutions involved must be strengthened in order to ensure a fast reaction when a problem occurs. On national level the state supervision over the financial market will be integrated into one institution, which will be incorporated into Czech National Bank. This solution is to a large degree determined by the structure of Czech financial market. A complete integration of financial market supervision is expected in April 2006. After that, approximately two years of evaluation and detailed revision of legislation regulating the supervision over the individual segments of financial market will follow. The positive outcomes of integration (not only merger of the

¹² See Doing Business in 2005 – Czech Republic, <http://www.doingbusiness.org/>.

¹³ The financial market in the Czech Republic is a bank based system. The role of securities brokers, collective investment funds or pension funds, i.e. standard mechanisms for allocation of funds, is only moderately gaining on importance.

supervision but also unification of the different procedures of granting permissions, improvement in the position of consumer etc.) are expected in 2008. Since the duplicities in supervision will be removed and the number institutions to which the financial market participants have to report information regularly will decrease, positive impact on the business environment in the Czech Republic is expected.

Another measure aimed at improving the business environment in the Czech Republic is **creation of modern tax administration with high effectiveness and productivity**, which would support voluntary payment of taxes, e.g. by providing taxpayers with high-quality services. The main features of a modernised tax administration will be creation of a new organisational structure and effective management of resources (notably human resources), emphasis on unified approach and unified procedures of the tax administration, increase in the capacity and performance of tax controls. To improve the quality of services for taxpayers, e-communication between the tax administration and taxpayers will be introduced and so-called "client approach" will be applied thoroughly. Automatic processing of routine operations and standard filings will increase effectiveness. The aim is to create such an administration, which will put a minimum burden on the taxpayer and will increase the comfort of meeting tax obligations. A discussion concerning introduction of general advance binding rulings was initiated. The present concept of modernisation of the tax administration should result in a new Act on Tax Administration that will come into force at the beginning of 2007. At that time a new institution will also be set up – a Czech Tax Administration.

Business environment – priorities

- **Carry out a transparent procedure of new legislation impact assessment**
- **Decrease the administrative burden on businesses by at least 20%**
- **Simplify administration related to setting up and running a business**
- **Facilitate business start up notably in case of activities with no further requirements on qualification**
- **Strengthen the position of creditors in bankruptcy proceedings**
- **Ensure effective functioning of financial market**
- **Modernise and increase effectiveness of the tax administration**

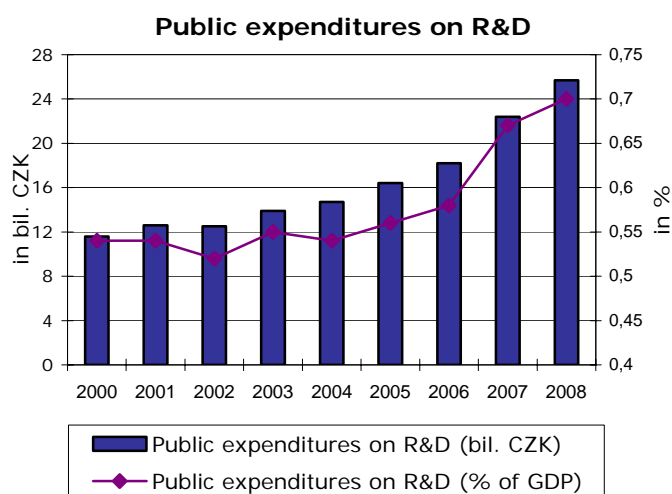
Research, development and innovations

Technical and technological development is an important factor that impacts on the economic development of regions and its long term sustainability, notably under the conditions of strengthening globalisation. Promotion of research and development together with innovation policy is therefore one of the priority areas for the Czech Republic. At present it is important to profit on and further develop the existing scientific and technical potential and notably to reach a high level of innovation capacity. Apart from this, further promotion of the basic research is also important.

Research and Development

In the area of research and development the Czech Republic lags behind developed countries in the amount of funds invested (public and private) and also in the number and quality of R&D institutions and their employees. The two serious problems are a low utilisation of R&D outcomes in innovation activities and insufficient support of industrial research. As concerns the participation of the CR in the 6th Framework Programme for R&D (2002 – 2006), it must be noted, that the percentage successfulness of the CR, i.e. the proportion of participants on "successful" projects (those that passed the evaluation and were entitled to apply for EU grant) on all participants whose projects entered the evaluation procedure reached 15.1% and that the CR ranks 19. among the 25 EU countries. One of the reasons why the Czech SMEs are not so interested in this programme are high costs of project preparation. As part of the prepared 7th Framework

Programme (2007 – 2013) the CR will focus on better utilisation of the networks of excellence and on integrated projects whose aim will be to promote stronger interconnection between national, regional and European activities.



The share of R&D expenditures on GDP in the CR is at present around 1.3%, of which approximately one half comes from private sources and the other half from public funds (the EU average is around 2%). The low amount of funds currently spent on R&D may result in stagnating competitiveness of the Czech economy and low credit of our country in the field of international cooperation on R&D. To increase R&D effectiveness in the coming years, a **gradual year-on-year increase in public expenditures** is necessary, with the aim to raise the R&D

expenditures to 1% of GDP before 2010. According to the adopted Draft State Budget for 2006 and medium term budgetary frameworks for 2007 and 2008 the R&D expenditures will increase from 16.4 bil. CZK in 2005 to 25.7 bil. CZK in 2008.

Apart from gradual increase of public R&D expenditures and better effectiveness of their use, the CR also carries out measures to stimulate the **increase of private expenditures on research and development programmes, notably by using indirect support**. In January 2005 the tax legislation was amended with the aim to support private R&D investment. The amendment introduces tax deduction from the corporate income tax base, which can be applied in case of precisely defined R&D projects. To promote the multiple-resource financing of R&D, amendments concerning inheritance tax, gift tax and real estate transfer tax were also adopted. These amendments allow exempting any property that was acquired at no cost, and is to be used for financing of R&D, from inheritance and gift tax. These tax credits will be put into effect for the first time in the 2005 taxable period, i.e. in the year 2006.

In line with the increase of public R&D expenditures also a **change in its structure** is necessary. In the future a substantive proportion of the expenditure increase should be directed at special-purpose financing at the expense of institutional financing. In 2005 the institutional support represents 57% of total public R&D expenditures. This proportion should drop to 53% in 2006 and to 44% in 2008. The aim of this proposal¹⁴ is to approach the situation in developed countries where institutional support represents only 40% of total public R&D expenditures. To promote the positive impact of R&D on innovations, R&D expenditures will be preferentially directed into industrial R&D and other innovative areas. Since 2007 research programmes will be launched, on which both a research institution or university and the future undertaker will participate and which will be financed partly from public and partly from private resources. The support will be targeted notably at industrial research whose outcomes can contribute to introduction of new products, technologies and services. Transformation of the existing research institutions from state organisations funded by contributions from the state budget into public research institutions, which will come into effect in January 2007, will also contribute to effective use and change in structure of R&D expenditures. After transformation the public research institutions will acquire full legal personality, including the right to own property and to dispose of it. These institutions should focus mainly on

¹⁴ For more details see: National Innovation Policy of the CR 2005 – 2010; Long-term Research Strategy.

non-commercial research and according to the provisions their position should not be advantageous compared to other entities engaged in R&D.

An important factor limiting the transfer of R&D outcomes into practice is insufficient use of instruments securing the rights to intellectual property. As a result, the patent activity of Czech entities is low. The reason can be either a lack of quality R&D outcomes suitable for patenting or technical and financial demands of the patenting procedure. To **promote the use of instruments securing the rights to intellectual property** by R&D institutions and enterprises, a programme will be implemented since 2007, aimed at protecting the outcomes of own research by means of patent application. A support will be provided to chosen candidates from academic background or from SMEs, which will help them to secure protection of their unprotected R&D outcomes. Utilisation of these R&D outcomes in the consequent process of innovation will be a precondition for granting the aforementioned support.

Innovations

Compared to other EU countries, in the area of innovations the Czech Republic ranks below average. The CR lacks notably in the intensity of enterprises' innovation activity, transfer of technologies, business spending on R&D and innovation, patent activity, cooperation between research and enterprise sector and use of venture capital. Since innovations are one of the prerequisites for business sector competitiveness, it can be assumed that promotion of innovations will impact positively on economic growth and employment. At the same time an increase in the number of jobs requiring high-quality workforce can be expected. High skilled labour force will help to shift the Czech economy towards knowledge society. Innovation depends mostly on the activities of private sector and its cooperation with research institutions. Apart from sufficient "inflow" of R&D outcomes suitable for innovations, the development of innovative activity also depends on the innovation infrastructure, sufficient and available funds for innovative firms and, not least, innovative human resources.

Among other things, the innovation infrastructure, which creates favourable conditions for enterprises' innovation activities, consists of scientific and technological parks, entrepreneurs' incubators and centres for transfer of technologies. The existing infrastructure in the Czech Republic is not developed sufficiently. One of the reasons of this unsatisfactory situation is a lack of quality entrepreneurs' incubators, which would provide not only free capacities to lease but also complex services for entrepreneurs. Another negative feature is a lack of transparent and simple legislation, which would motivate research and education institutions to create spin-off firms financed from public budgets. Another weakness is the lack of workers with sufficient qualification to transfer technologies. As to April 2005 there were 23 scientific and technological parks accredited in the Czech Republic, another 3 entities without accreditation and 4 parks were under preparation. To ensure further **development of innovation infrastructure** it is therefore necessary to focus on creating structures, bonds and mechanisms to improve the innovative environment. One of the key instruments of regional innovation policy is creation of clusters¹⁵, which contribute to innovative activities on the given territory. In the CR the problem of clusters and their promotion is only at the outset. The recently proposed concept¹⁶ aims at identification of key business clusters and sectors in each region of the CR, which have the potential to generate new jobs and improve enterprises' performance and thus contribute to development of the region. In this connection, the existence of programme KLAstry, a part of OPIE 2004 – 2006, is very positive. The lack of regional strategic development plans and regional industrial and innovation policies, to which the clusters or other projects promoting innovations in regions could be connected, is a serious weakness. To use the clusters effectively, a system of monitoring and

¹⁵ Clusters are networks of interconnected firms, institutions producing knowledge, supportive institutions (e.g. centres for transfer of technologies scientific and technological parks, etc.) and customers. These are all part of production chain that produces added value.

¹⁶ National Cluster Strategy 2005 – 2008.

assessing their outcomes is required. In the period 2005 – 2008 the programme KLASTRY will be adjusted in order to increase its accessibility for applicants. The main differences will consist of a change in the amount of state support, more independency concerning the membership of universities and optimal number of cooperating entities. Concurrently, the preparation and training of experts and managers in the area of innovative entrepreneurship will take place. The proposed measures will be financed from OPIE 2004 – 2006 and from a new operation programme, which will be prepared for the period 2007 – 2013. In the period 2005 – 2008 the amount of financing will reach 416 mil. CZK (of which 104 will be provided by state budget and 312 mil. CZK will be drawn from Structural Funds).

The **access of firms, notably innovative firms, to financial resources** in the CR does not correspond to their needs and their innovation potential. This applies notably to SMEs and starting entrepreneurs whose main problem is lack of disposable funds to provide pre-start activities and to start a business and get it off the ground. Entrepreneurs also cope with insufficient access to advisory services and education and training programmes. Currently, in the framework of OPIE, there are two programmes – PROSPERITA and INOVACE. Their aim is to promote infrastructure for industrial research, development and innovations, to endorse connections between R&D and industry, to improve environment for technologically oriented firms, to support implementation of programmes aimed at increase of technical and utility value of products and services by means of grant schemes etc. These programmes however do not cover implementation of research and development projects by start up firms. The entry of private investors into start up firms by means of venture capital is not very common in the CR. The main reasons are obstacles in legislation, underdeveloped infrastructure of venture capital providers and non-existence of state support. To improve availability of funds to new and innovative firms, a programme KAPITAL will be launched. Apart from private investors funds also the state funds will be involved in this programme, in order to reduce the private investors' risk. State involvement is expected to increase willingness for such investments into new innovative firms. The present amount of funds available for this programme does not cover all its needs, it is however sufficient for launching a pilot phase. In the period 2007 – 2013 this programme will continue and it will probably be co-financed from Structural funds. The preparatory works on the programme KAPITAL started by the end of 2004. Its launch is expected in the third quarter of 2006. One of the ways to increase the availability of funds to innovative firms are so-called Business Angels Networks¹⁷. The Business Angels Networks in the CR are limited. At the moment there is no mechanism, which would improve allocation of resources into innovative projects by intermediating exchange of information between providers of funds and innovative firms. To remove this weakness, a detailed analysis of existing legislative and non-legislative barriers to Business Angels Networks functioning will be elaborated during next year.

Research, development and innovations – priorities

- **Increase year-on-year public expenditures on research and development**
- **Change the structure of public R&D expenditures**
- **Promote private R&D expenditures by means of indirect support**
- **Intensify the use of instruments securing the rights of scientific and research institutions and enterprises to intellectual property**
- **Develop innovation infrastructure**
- **Increase the availability of funds to innovative firms**

¹⁷ The so-called business angels are persons disposing of a capital and willing to invest it into newly created innovative firms with high growth potential.

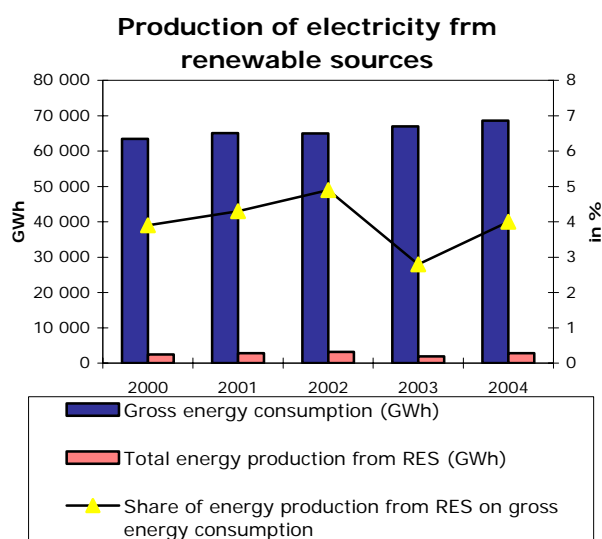
Sustainable Utilisation of Resources

Decrease in energetic and material intensity of the Czech economy through effective use of resources is necessary not only to increase the competitiveness but also to reduce the negative impact on environment. It depends notably on introduction of new production technologies with minimum requirements on energy and material resources and on achieving high effectiveness in the whole process of energy production and consumption.

The yearly consumption of natural resources in the Czech Republic exceeds the resource capacity of its territory. Material intensity of the CR (1.28 t on 1000 USD GDP) is higher than that of other neighbouring new EU Member States (1.19 t in case of Poland, 1.14 t in Slovakia and 0.85 t in Hungary) and it is more than double compared to some "old" EU countries (e.g. 0.45 t in case of the Netherlands or 0.51 t in the UK). Total energy intensity (the consumption of primary energy sources related to a unit of GDP) in the CR still exceeds that of developed EU countries and its decrease is slow. The average year-on-year decrease in the energy intensity in the period 2000 – 2004 was only 0.40%.

Even now the exhaustion of fossil fuel resources causes a continual pressure on energy prices and thus restricts competitiveness. The best solution from both economic and environmental point of view seems to be improvement in energy effectiveness, energy savings in all areas of energy utilisation, use of renewable energy sources (RES), more intense use of secondary energy sources and optimum use of nuclear energy as an alternative source with no greenhouse gas emissions and with distant depletion horizon.

Maximum energetic and material effectiveness and rational use of resources can be reached by promoting development of renewable and secondary resources industry. A strategic target of the CR is to decrease gradually the raw material and energy intensity of industrial production. Consecutive measures¹⁸ will be taken to reduce the material intensity of industrial production, e.g. development of production with low raw material



intensity and high value added, regulation of the demand for non-renewable mineral resources, introduction of low waste processing technologies, introduction and certification of environmental management systems, higher use of secondary raw materials, considerate use of domestic mineral resources and decrease in the imports of mineral resources. The legislative promotion of more intense use of renewable sources and secondary raw materials including adjustment of the tax system and definition of the life cycle of products, raw materials and resources, will have to be resolved. In future, introduction of new productions and products with high

utility value and high use of domestic renewable resources and launching of non-waste technologies will be promoted with the aim to improve the environment for living and working. To reduce the *energetic* intensity of industrial production, the increase in energy efficiency will be accelerated, the use of renewable and secondary sources of energy¹⁹ will be promoted and the use of nuclear energy in line with the State Energy Policy will be supported. Specific measures will be implemented through the State Programme for the Support of Energy Savings and the Use of Renewable Energy Sources and through the programmes for SMEs support. In the period 2007 – 2013 the measures to improve

¹⁸ Raw Materials Policy in the Area of Mineral Resources.

¹⁹ National Programme for Economical Use of Energy and Usage of Renewable and Secondary Energy Sources for 2006-2009.

energetic efficiency and to promote the use of renewable energy sources could be financed from European Regional Development Fund. These measures will focus on the increase in efficiency of the energy utilisation in industrial processes, the use of secondary energy sources in industry, energetic utilisation of municipal waste and heat generation from biomass. The funds from two national programmes for industrial R&D – IMPULS and TANDEM – which, among others, aim at promotion of nuclear energetics, will also be used in power engineering. In August 2005 a new legislature introduced minimum prices for electricity generated by renewable sources, premiums (green bonuses) to the price of electricity generated by renewable sources and guarantees for the return of investment into renewable sources of energy within 15 years on average. The aim is to reach the national indicative target, i.e. 8% share of electricity from renewable sources on gross domestic electricity consumption in 2010.

Promotion of environmental technologies will allow for reduction in damages to environment, improve the quality of life and boost the economic growth (by more effective use of energies and raw materials, lower production of emissions and decrease in waste production). Environmental technologies therefore satisfy the so-called principle of decoupling – they isolate the economic growth from its negative effects on environment. At the same time the developing market with environmental technologies boosts employment in eco-industry. In order to reduce the material and energy intensity of GDP production measures contained in the Environmental Technologies Action Plan will be backed up. These are, among other things, to include environmental technologies among R&D priorities, to promote environmental technologies by National Innovation Policy and also to intensify the use of environmental contracting in the CR by the State Programme for Support of Energy Savings and Use of Renewable Energy Sources. National programme aimed at support of environmental technologies will be elaborated before the end of 2005. As part of the preparatory works on this programme, measures are tentatively proposed for the period until 2007. Assessment will follow every two years. Since in the proposed EU Financial Perspective 2007 – 2013 in the section Competitiveness for Growth and Employment as part of the Programme for Innovations and Competitiveness the promotion environmental technologies is mentioned, we expect co-financing from EU funds.

Implementation of the Framework of Programmes on Sustainable Consumption and Production in the CR, which is an opportunity for the business sector²⁰, will also contribute to reduction in the energy and material intensity of the Czech economy.

Fiscally neutral environmental tax reform is another instrument that can be used to improve the quality of environment in the Czech Republic. The environmental tax reform will on the one hand lead to an increase of excises on fuels and electrical energy and on the other hand will allow for reduction of other taxes. The increase of excises on fuels and electrical energy will motivate to such a behaviour that limits the damages on environment. With regard to the transitional period negotiated by the CR, new excises on fuels and electrical energy will be introduced probably in January 2008. The proposed concept of environmental tax reform will be elaborated before the end of 2005.

Sustainable utilisation of resources – priorities

- **Maximise energetic and material effectiveness and rational use of resources**
- **Promote environmental technologies**
- **Implement a fiscally-neutral environmental tax reform**

²⁰ For more detail see Framework of Programmes on Sustainable Consumption and Production in the Czech Republic.

Modernisation and Development of Transport and ICT Networks

Developed infrastructure, notably transport and information and communication technologies (ICT) networks, is a basic presumption of long-term competitiveness of the Czech economy and a precondition for economic growth. The transport infrastructure has to be developed with a view to balanced use of existing networks' capacity and its expansion in all transport modes. A decline in competitiveness has to be prevented notably in those segments of the transport market that have comparative advantages on which the whole society can profit (e.g. less negative impact on environment, lower specific energy consumption). Insufficient quality and capacity of transport network negatively influences the inflow of investments into regions, causes traffic unevenness and congestions and brings financial losses. Apart from development of road and motorway infrastructure, more intense use of railway and waterway infrastructure is crucial.

Transport Infrastructure

In the Czech Republic, none of the **backbone networks of motorways, high-speed roads or modernised railway corridors** has been completed. Part of the existing network of roads and motorways is unsuitable as concerns technical and safety parameters, quality of roads and the state of structures. Only 45% of the 1st class roads have optimum parameters, tenths of towns and municipalities lying on the main roads still lack bypasses or optimal through highways. In the coming years the network of motorways and high-speed roads will expand from the current 882 km to 2130 km. Of the total 6200 km of 1st class roads approximately 3300 km will be modernised. 90 km of motorways will be in operation before the end of 2006. As concerns technical parameters, apart from some exceptions the railway infrastructure lags further and further behind the road network. Since the level of technological safety of railway transport is very low, the requirements on personnel ensuring safety of transport are very high. This however pushes the cost of railway transport up. As concerns the railway infrastructure, a modernisation of branch II of the national transit railway corridor Prerov – Ceska Trebova is under way. Its completion is expected in 2007. Modernisation of the Prague railway node continues; the New Connection (Nove spojeni) is to be finished in 2010. Modernisation of the Brno railway node is under preparation. Modernisation of the IV. railway corridor (Prague-Ceske Budejovice-Linz) has already been launched and modernisation of the III. railway corridor (Prague-Pilsen-Nuremberg) will start during this year – both these projects are priorities of European significance. Modernisation of the line Brno – Prerov and modernisation of other selected railway nodes (Breclav, Kolin, Olomouc, Ostrava, Prerov) are under preparations and will be part of the TEN-T network. Gradual modernisation of railways will be carried out in accordance with international agreements. Important lines, notably parts of TEN-T network, will also be modernised. An important task is to improve those cross-border infrastructure links that suffer from insufficient quality and capacity.

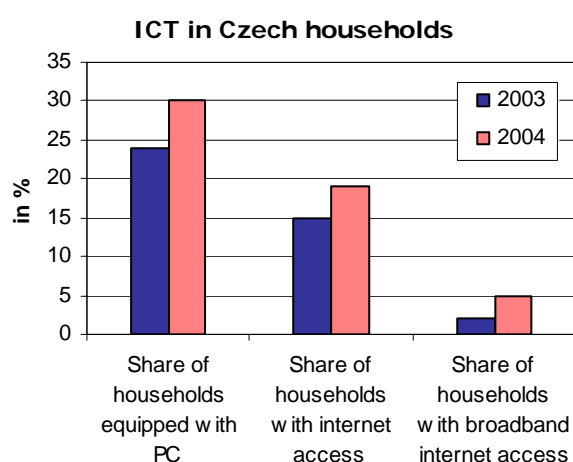
The purpose of transport infrastructure is not only to allow for smooth transport interconnection between European industrial, business and residential centres but also to provide transport users with appropriate services. The attention is focused on transport networks of European significance, so-called Trans-European Transport Networks TEN-T, which include not only transport infrastructure as such but also the systems for management, control, localisation and navigation. The main gain from **introduction of intelligent systems and services**, which either warn against dangerous situations or prevent their occurrence, is increased safety of the traffic. Though modernisation of the Czech transport infrastructure has not been finalised and some of its segments are yet to be completed, telematic applications are introduced gradually (e.g. master exchanges in big cities, applications for monitoring the intensity of traffic, weather, telematic applications to increase safety of tunnels etc.) Remote control of railway traffic on the main lines and introduction of ERTMS/ETCS are priorities for the approximately 2400 km long segment of

the Czech railway network, which is part of the trans-European railway network. As concerns the road transport, it is necessary to build up traffic management, control and information systems, notably within the motorway network. It is also important to provide language-independent information for drivers on the Czech roads and motorways. Attention will also be paid to introduction of all-European system of automatic emergency calls from vehicles (eCall). Further development of personal navigation system for blind and visually impaired users of public transport will be promoted. At present, tenths of transportation companies are using this system.

General Transport Infrastructure Development Plan of the CR will be elaborated before the end of 2005, including a timetable for a period until 2013. The timetable will consist of specific measures following from documents focused on transport infrastructure development²¹ that were already approved. A model of financing the transport infrastructure will also be included. Since up to now part of the funds were drawn from the fluctuating resources of the National Property Fund, in future it will be necessary to find a substitution for these funds. A proper solution would be to increase the co-financing from EU funds²², PPP systems and charging for the use of certain transport infrastructure. The aim is to ensure sufficient funds of at least 2.5% of GDP for maintenance, modernisation and development of transport infrastructure.

Increasing share of railway transport and development of combined transport are of great importance for the Czech transport policy. One of the effective measures is to promote establishment of intermodal terminals, open to all operators. The aim is to improve conditions for the use of railway transport but also to improve the logistics of SMEs in industry, trade and services. In the period 2006 – 2010 the Czech Republic will be implementing the Programme for Combined Transport Support, which includes both investment and non-investment (operational) support, notably for launching new lines of combined transport or possibly new technologies. As concerns combined transport, the Czech Republic participates on several international projects (INTERFACE, MARCO-POLO), whose aim is to improve the quality of international freight railway transport and also to provide the data from railway operators to other participants of the transport procedure, i.e. to combined transport operators and to customers. The purpose of all aforementioned projects is to promote energetically effective transport systems friendly to environment.

Information and communication technologies



Information and communication technologies are a means to promote productivity growth, employment and overall erudition. They also help to solve social problems, e.g. unemployment, inclusion of disadvantaged groups of citizens or uneven development of human potential. The costs of providing Czech households with ICTs and the costs of running such technologies in most cases exceed the financial potential of average household. The use of broadband internet access in the CR is below the average of developed countries. Effective use of ICT could also allow for substantial cut in the amount of money spent from public budgets.

²¹ Transport Policy of the CR 2005 – 2013.

²² The main financial sources are Cohesion Fund and European Regional Development Fund, supplementary sources are the financial instruments of TEN-T.

The existence of **consistent and countrywide broadband network interconnected with foreign networks** is a precondition for providing accessible electronic services and for further development of information society. To speed up development of broadband networks and to stimulate households and SMEs to profit on the use of new electronic services, the CR has set up a target to make the broadband internet available to 50% of population in 2010 at latest. In the period 2006 – 2010 the revenues from privatisation of the Cesky Telecom, a.s. will cover the funds necessary to develop broadband internet access, in the amount of 1% of the selling price. Among others, creation of a countrywide infrastructure for broadband access to electronic communication will facilitate implementation of projects for business, scientific and technological or university parks, projects for service infrastructure development (including service infrastructure in touristic regions), supranational participation on projects (including those connected to EU structures), and technical infrastructure for revitalisation of regions. In the process of creating concepts, projecting and constructing transport lines, power distribution system, etc., it is useful to prepare conditions that will facilitate possible future laying of electronic communications wiring, e.g. optical cables, as far as to the customer. Cooperation of relevant state, regional and local administration will ensure this as part of the construction proceedings. In the long-term, such integration of activities in construction may result in lower costs and the opportunity of renting the infrastructure for construction of broadband electronic communication network (investment return). The EU Structural Funds are an important instrument for promoting broadband access. Funds for projects concerning ICT can be drawn from European Regional Development Fund. In the period 2004 – 2006 the demand for financing development of ICT from EU Structural Funds (Measure 2.2 of the Joint Regional Operational Programme) significantly exceeds the supply. Compared to present situation, the amount of financing from Structural Funds available in the period 2007 – 2013 will rise. It can therefore be expected that the funds for ICT will also increase.

In order to promote **widespread use of ICT** in public services, SMEs and households, to diffuse rich and varied digital content and for development of applications, active development of information society services (e.g. e-Government, e-Procurement, e-Health, e-Learning) is crucial. Among other things, these services have a potential to motivate to widespread use of ICT in many sectors of the economy and to increase the demand for what they are offering. As concerns on-line services in public administration (*e-Government*), the obligation of citizens to submit (repeatedly) documents in paper form will be gradually eliminated. A reliable and safe interconnection between basic information systems of public administration is necessary. With this purpose a legislative regulation will be prepared before the end of 2005, which will deal with the exchange of data between public administration bodies and with basic public administration registers (the legislation concerning basic public administration registers is expected to come into force in the 1st half of 2007). Consequently, the authorised extracts from public administration registers become accessible from public administration contact offices and from the offices of the Czech Post. Reliable and safe interconnection between public administration bodies will be provided for (Public Administration Intranet) and on-line services will be made available to citizens and businesses via Public Administration Portal. A study will be carried out before the end of 2005, on the basis of which a decision will be adopted on abstract citizen identifier²³, on the conditions and range of its use in public administration and on rules for its gradual introduction. As concerns *e-Procurement*, the process of public procurement contracting will be fully electronic before 2006 (this target however depends on the progress of introduction of ICT in the public administration). A fully electronic process of public procurement contracting will reduce the costs and administrative burden on participants and at the same time it will increase

²³ Specification, which for the purpose of unambiguous identification should replace person's birth number. It should not however reveal more information at the first sight, e.g. age or sex, it would not change depending on the changes in reality, e.g. a change of sex, and its validity would not be limited by its structure.

the transparency of public procurement. As part of *e-Health* and in line with the EU timetable, the existing paper health insurance cards will be replaced by chip cards compatible with EU standards. Before the end of 2005 the CR will elaborate a methodology, including a timetable with measures to be taken on national level. Also before the end of 2005 a system providing public healthcare information will be introduced and before the end of 2006 an information network will be created that will interconnect the Czech healthcare provision centres with their EU partners and will allow for sharing public healthcare information and coordination of activities in situations endangering health or life. All measures have to be implemented with regard to the risks of information leak or misuse.

A continual strengthening of competition on the electronic communication market and **effective convergence of communication networks and services**, including digital radio and television broadcasting, are vital for a dynamic advancement of ICT. Promotion of new communication technologies is however impossible without continuing liberalisation and strengthening of competition on the electronic communication market accompanied by decrease in prices for consumers. Effective use of existing infrastructure will contribute to this process. The aim is to switch gradually from the regime of ex ante regulation of electronic communication market to a more liberal regime of ex post intervention based on competition legislation.

As concerns **information security**²⁴, the aim of the CR is to increase the confidence of citizens and entities from commercial and non-commercial sector in the information society, improve overall control and knowledge about information security, strengthen international cooperation in this field, collect and recommend best practice concerning information safety control. With a view to a dynamic development of ICT sector it is necessary to promote the use of open standards and specifications. Open approach facilitates the interoperability of specific ICT solutions (the ability to communicate) and thus improves the availability and use of information. As concerns the public sector services, the CR will implement the European Interoperability Framework (www.europa.eu.int/idabc) and support the international efforts to reach the semantic and organisational interoperability of these services. As concerns the security and control of informatics, the CR will strive for more detailed rules on management and operation of public administration information systems, including their interconnection. Before the end of 2005 legislation will be prepared, which will set the rules for sharing data between public authorities, while respecting the protection of personal information.

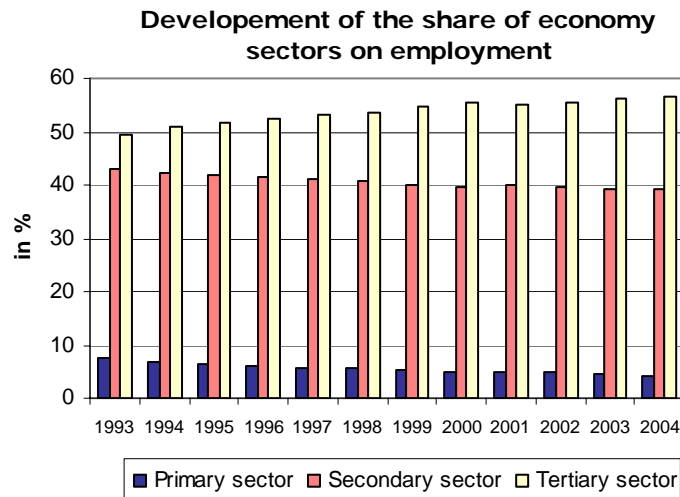
Modernisation and development of transport and ICT networks – priorities

- **Modernise and develop transport networks**
- **Introduce intelligent systems for transport and traffic control**
- **Increase the share of railway transport on the transport market and develop combined transport**
- **Create consistent countrywide broadband ICT infrastructure**
- **Promote effective development and use of ICT**
- **Ensure convergence of networks and services on electronic communications market**
- **Ensure security of networks and information and interoperability of ICT services**

²⁴ National Information Security Strategy.

EMPLOYMENT

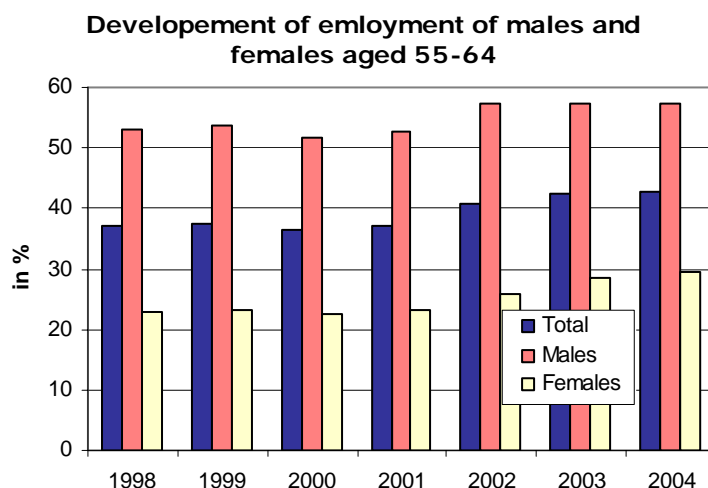
Since 1990 the Czech labour market has undergone significant changes. The number of inhabitants decreased, the number of persons in productive age increased and the economic activity of people in post-productive age declined. The market was strongly



influenced by the outcomes of economy restructuring, which resulted in a drop in the number of jobs and in a change in the structure of required qualifications. These are the main reasons for increase in unemployment since the second half of 90. With some exceptions (e.g. 2002), the employment rate (15 – 64 years) is steadily declining; in 2004 it reached 64.2% (72.3% for males, 56.0% for females). Compared to 1990, significant changes occurred in the structure of employment in the different sectors of national

economy. Continuing structural changes in the secondary sector, resulting in further decline in the number of jobs, will push up employment in the tertiary sector. The share of foreign labour force on domestic labour market also increases. In 2004 the share of active foreigners reached 3.3% of total Czech labour force.

Measures proposed by National Reform Programme will contribute to meeting the following national indicative employment targets for 2008: total employment rate 66,4 %, female employment rate 57,6 % and employment rate of older workers (55 – 64 years) 47,5 %.



According to Eurostat data, unemployment rate in the Czech Republic in 2004 reached 8.3%, compared to the EU-25 average of 9%. Significant difference in requirements on qualification, skills and performance is typical for newly created jobs. This is one of the key factors behind the increase in unemployment over the last years. Unemployment concentrates notably in regions with high share of restructured sectors (steel industry, mining, heavy industry, etc.). At the same time, these regions lack qualified labour force. The

employment policy therefore concentrates on change and increase in qualification and improving skills of labour force (both unemployed and employed). Low regional and professional mobility of employees, non-transparent system of social benefits combined with low frequency of re-assessing the social situation of beneficiaries, high tax burden on labour, notably on the low-income groups, necessity of pension system reform and non-existence of a complex lifelong learning system, those are some of the weaknesses of the Czech labour market.

Labour Market Flexibility

Flexible labour market is a precondition for dynamic economic growth. Without necessary changes on its labour market, the Czech Republic risks long-lasting difficulties accompanied by unemployment and high social costs. The Czech Republic will therefore increase the share of investment in human capital, promote commuting and regional mobility and change the existing legislation to increase the flexibility of employment relationships.

The present organisation of labour in enterprises, notably the spread and effective use of working time, satisfies neither the needs of employers nor those of employees. On the one hand, the working time is not used effectively, and on the other hand, the amount of overtime work is increasing. The employers do not react adequately to fluctuations in production process (seasonality, temporary decline of sales etc.), which causes ineffectiveness in the economy of enterprises. Temporary interruption of working career motivated by a need to change qualification is not very common. The Labour Code has created legislative background for using certain modern forms of employment, e.g. part-time jobs, flexible working time, home working. However, compared to most other EU countries, the use of these forms of employment by employers and employees is insufficient. As concerns employees, the main reason are the relatively low wages compared to the costs of living. A new Labour Code is currently under preparation, which should further **extend the principle of freedom of contract in employment relationships**. It should allow for more deviations from the general provisions in the Labour Code by means of contract or internal regulation of the employer, while respecting EC directives and other international standards of employment protection. Its adoption should allow employers and employees to adapt flexibly the organisation and working time to their needs and thus to resist the pressure of competitors. One of the measures in the prepared legislation will be introduction of working time accounts. These will significantly increase the effectiveness notably in the production enterprises and at the same time they will increase the attractiveness of the CR for foreign investors.

High statutory non-wage labour costs are one of the factors that hamper increase in employers' competitiveness and discourage them from employing educated and qualified labour force. As part of the prepared health insurance reform, **ceilings on social security contributions** will be introduced. The prepared legislation sets the maximum assessment basis for social security (and health insurance) contributions during a calendar year. For 2007 it has been set to a sixty fold of average wage (i.e. fivefold monthly), for 2008 to forty-eight fold of average wage (i.e. quadruple monthly) and from 2009 on to thirty-six fold of average wage (i.e. triple monthly).

Compared to other EU countries, labour income taxation of low wage groups is above average. This has implications on peoples' willingness to work. Reduction of personal income tax is considered to be an instrument to **stimulate the low income groups to find and maintain a job**. As of January 2006 the two lowest marginal tax rates will be reduced from 15 to 12% and from 20 to 19% respectively, the first tax brackets will be valorised and standard tax allowances will be replaced by tax credits. The aim is to increase disposable working income, notably for low-income groups, and to strengthen the vertical tax equity. The relation between minimum wage, i.e. the income attainable for low-qualified persons, and social benefits to which these persons are entitled is another factor discouraging from participation on the labour market. The proposed changes concerning subsistence minimum and assistance in material need, which are to come into force as of 2006, will be a solution; they will increase people's motivation to work by means of change in the social benefits system. Their purpose is to protect people sufficiently and fairly from material need but at the same time to motivate them to active search and acceptance of low-paid jobs. Those who prove the willingness to increase their income by working will be advantaged. The newly introduced subsistence minimum will be based on one component. The sums necessary for nutrition and other basic personal needs will be newly graded according to the ranking of household members and in case of minors also according to their age. Simultaneously a new

concept of reduced subsistence minimum will be introduced, which represents the costs of minimum living standard allowing survival. The aim of this proposed act on assistance in material need is to curb the long-term dependence on social benefits, to provide advisory services to people and thus to prevent them from social exclusion. New legislation will give preferential treatment to those beneficiaries who are actively trying to solve their situation.

Apart from professional mobility, also the **low geographical mobility of employees** is a serious structural weakness of the labour market. The mismatch between labour supply and demand differs among regions. People do not commute sufficiently and are not willing to move. In the CR approximately one third of active citizens commutes. The cost of transportation to job represents on average 10% of the family budget, while the share in case of low-income families is higher. The cost of transportation can thus become a serious barrier to their mobility. The motivation of employees to commute will be promoted by means of tax credit for employers, who provide transport for their employees. Another measure to increase mobility on the labour market will be liberalisation of housing rents. At the moment, the housing rent in approximately 750 000 apartments, i.e. almost one fifth of permanently inhabited apartments, is regulated. Around 300 000 apartments have private owners and the rest is owned by municipalities. The aim of the prepared legislation is to remove this market deformation as soon as possible and to deregulate fully the housing rents. During a six-year transition period a regulation in the form of unilateral increase in housing rents will apply in cases when no other agreement can be reached between lessor and tenant. In this transition period a so-called target value of housing rent, representing 5% of the apartment price, will be defined. Based on the target value, a growth rate of the housing rent will be specified annually, to represent the maximum possible increase of the house rent by the lessor. By the end of the transition period both of the presently different housing rates (i.e. market rate and regulated rate) should converge enough to allow for full deregulation. The average increase in regulated housing rent in the first year of deregulation is expected to be 9.3%.

Modernisation of employment policy is one of the priorities indicated by European Commission in its Specific Recommendations for Employment Policy of the Czech Republic in 2004. The CR reflected these recommendations in the National Action Plan for Employment 2004 – 2006. In future the CR will focus mainly on strengthening the employment policy priorities and employment services, on securing sufficient human and financial resources and on change in the organisation structure of employment services. The CR will develop cooperation with other labour market entities on national and regional level and public-private partnerships in the area of employment. Implementation of employment policy will provide one third of the job seekers (i.e. the most active and strongly motivated) with all relevant information administered by labour offices (job vacancies, opportunities of vocational training, counselling on choosing a career, promoting of employment, etc.) by means of internet, call-centres, information boxes and other technical devices. Owing to this, the number of job seekers attending labour offices will drop and the limited number of labour offices personnel may pay more attention to the rest of job seekers. In implementing the active labour market policy, the labour offices will focus on increase in employability of job seekers by providing counselling, information services and retraining, using the programmes and projects financed from ESF. As another active labour policy instrument, so-called Job Centres Plus will be launched, which will focus on job seekers having specific difficulties with finding a job. Their introduction will be co-financed from ESF. Labour offices will provide state administration activities, i.e. payment of unemployment benefits, state social support benefits etc. Moreover, regional labour offices will be set up, which will take on some responsibilities from Ministry of Labour and Social Affairs and some responsibilities from district labour offices. This solution allows for single state employment policy on the whole territory, guarantees implementation of the European Employment Strategy at national level and allows for a

strong and clearly defined partner for regional governors and regional authorities in implementing regional and employment policy.

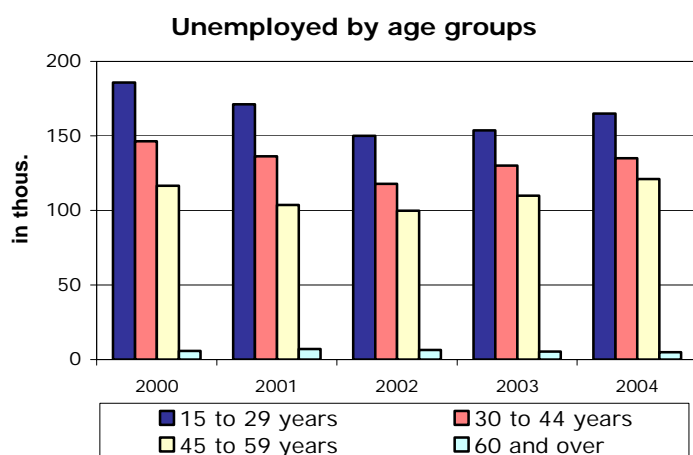
Labour market flexibility – priorities

- Extend contractual freedom in employment relationships
- Reduce statutory non-wage labour costs
- Improve the stimulation effect of direct taxes and benefits with the aim to cut down unemployment and increase the motivation of low-income groups to work
- Increase geographical mobility
- Modernise employment policy

Inclusion on labour market

Despite economic growth, continuous increase in productivity and improvement in living conditions of most Czech citizens, long-term unemployment related with social exclusion of certain groups remains a serious problem. For these people, finding a job is a way to get included into the society. In the field of social protection, the main role of employment policy is to facilitate employment by ensuring access to quality jobs for all men and women able to work, to combat discrimination on the labour market and to prevent exclusion from employment²⁵. Wide and flexible choice of social services plays an important role for combating social exclusion. Legislation regulating social services that is being prepared introduces new rules on social services with the aim to improve their accessibility and to ensure sufficient supply of all kinds of services to match the demand. Projects to support these activities will be co-financed from European Social Fund.

By the end of June 2005, there were 28 623 unemployed young people and school-leavers registered at labour offices. They represent 5.8% of total unemployment. The main causes of **youth unemployment** are insufficient practical knowledge, experience and working habits, low qualification, insufficient language skills and reluctance of school-leavers to accept certain jobs. Labour offices will therefore continue in implementing the programme “First Chance”, through which they offer to all job seekers under 25 years and to university graduates elaboration of individual action plans. In 2005 around 22 000

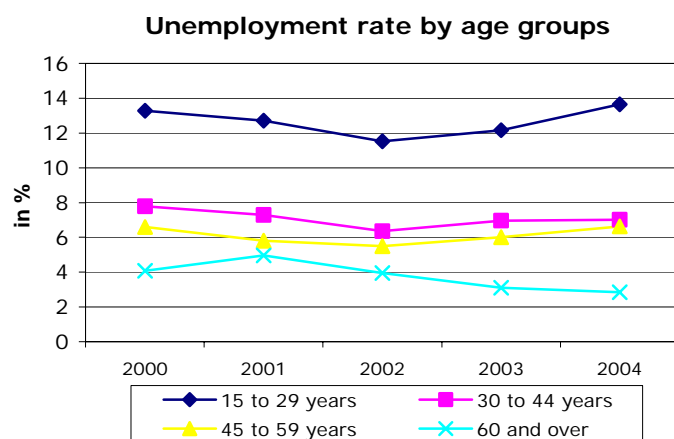


people will participate on this programme, in 2006 it will be around 25 000 people. School-leavers and young people under 25 will be involved in the community initiative EQUAL, which ensures equal access to labour market by removing the existing barriers, and in projects that are part of the Leonardo da Vinci Programme, which facilitates exchange of experiences and promotes widening and deepening of language skills. Information and counselling centres will provide consultancy for choosing

a career. They will disseminate information about development on the respective labour market and on expected need of qualified workforce to students, to their parents and also to public. At the same time they will offer education programmes of all high schools and universities, descriptions of specific professions in both written and audiovisual form, specific computer programmes that will help to find out whether client's ambitions are in

²⁵ For more information see National Action Plan on Social Inclusion 2004 – 2006.

accordance with his or her abilities, and thus contribute to optimum choice of education. Among other things, labour offices will provide retraining activities with the aim to reduce the mismatch between qualification structure of job seekers and demand on the labour market. As concerns young people, courses of practical retraining, non-specific retraining, supplementary and extension retraining and specific retraining are targeted at them.



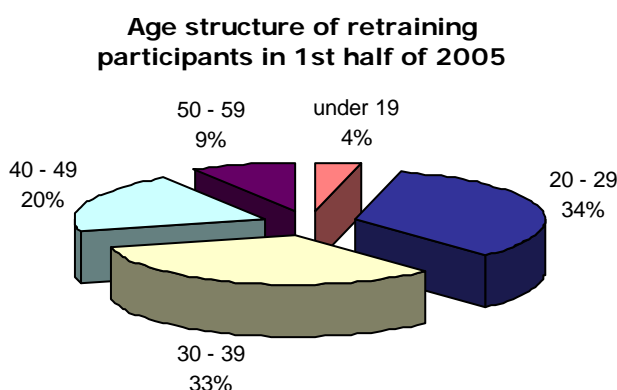
Female economic activity in the CR is high. Czech women however have to face persistent handicap and higher unemployment on the labour market. The earnings of women reach on average only 74% of men's earnings, while the greatest gap is between earnings of men and women with university education. Apart from inequalities in wages, women have to face other forms of discrimination, e.g. prejudices concerning age, motherhood and family obligations. In case of female graduates,

maternity leave is expected, which implies difficult reintegration into the profession. In case of women with school age children, family obligations are assumed. Modern forms of work organisation introduced in firms and organisations abroad, e.g. home working, on-line work, teleworking, part-time jobs etc., however are not very widely used in the CR. Statutory rights (e.g. the right to earn unlimited extra amounts while receiving the parental allowance) are difficult to apply in practice since it is complicated to ensure adequate childcare. In order to facilitate the **reconciliation between professional and family roles**, an analysis will be elaborated before the end of 2006. Its aim will be to identify possible changes in legislation regulating parental leave to allow for discontinuous drawing of the parental leave until the child reaches school age. Also stricter and more effective control of whether the ban on discrimination on the basis of motherhood/parenthood is respected will be carried out. A proposal will be worked out of how to motivate employers to provide short-term childcare facilities for children of pre-school age at the workplace or to arrange these facilities operated by another entities at affordable prices. A study will be carried out, to map the territorial and financial accessibility of pre-school childcare facilities in all regions and their limitations, notably the fees, capacity and opening hours. Another proposal will be made to motivate employers to help their employees caring for pre-school children to maintain their qualification (by providing programmes to improve the abilities necessary to assert oneself on the labour market), to allow for home working, flexible working time and part-time jobs. All these projects will be co-financed from European Social Fund.

Despite increase in the **employment rate of older workers**, also their share on unemployed increases. Job seekers older than 50 years currently represent 22% of all job seekers and their share is rising. To curb the rising unemployment of people over 50 years, the National Programme of Preparation for Ageing for 2003 - 2007 was launched. Its aim is to promote active ageing, notably by creation of such working conditions that will help to maintain the job, e.g. by providing further education, by respecting the rules for health and safety at work, by innovative and flexible forms of work organisation and by suitable instruments that will motivate employers to employ older workers. One of the measures proposed by the National Plan is to launch a Programme for Ageing Workers. This programme will include legislative changes and promotional campaign to persuade general public and employers about positive outcomes of giving jobs to older workers. Implementation of measures proposed by the National Plan will be assessed before the end of 2005 and again in 2007. Measures aimed at older workers are also included in the National Action Plan for Employment 2004 - 2006, which assumes extending of the

existing counselling activities and drawing up of individual action plans followed by possible retraining. These retraining programmes will focus mainly on extending of knowledge and skills in own profession in order to maintain the job, long-term specialised courses for adaptability at work and courses of specific retraining for acquiring working skills suitable for a specific profession. The promotion and development of social services for older people, which allows for their “active ageing” while remaining in their natural environment (family, community), is crucial. The solutions that should support full or at least partial activity of older workers will be part of the upcoming pension reform. In future, drawing partial pension benefits simultaneously with part-time job earnings will be permitted to make work more attractive for partial pension beneficiaries. One of the plans is to allow for gradual retiring with the option to draw partial pension benefits simultaneously with job earnings. Unlike the present state, the time worked after reaching retirement age would be reflected in the amount of pension benefits even though the beneficiary has already been drawing partial pension benefits.

The main instrument to **increase professional mobility is retraining**, which solves the mismatch between qualification structure of job seekers and demand on labour market. The labour offices adapt their supply of retraining on the basis their own labour market monitoring and employers’ requirements. They also provide retraining for specific professions or retraining aimed to increase job seekers’ employability and professional



mobility on the labour market. Labour offices also offer retraining to promote employability by so-called supplementary retraining, which supplements and extends the education already achieved, and employees retraining notably in case of change in production processes, introduction of new technologies and new work organisation. The latter is however available only for the most important employers in region who are undergoing the process of restructuring. The new Employment

Act allowed for extension of the existing retraining activities also to job seekers and for purchase of counselling services. In future, both the role and effectiveness of retraining and counselling will increase. It will also be supported by ESF programmes, most of which concentrate on such activities. In the coming years, the demand for retraining is expected to double and the demand for counselling even to triple, which is considered to be a reaction to social and economic needs. Other employment policy instruments will be reduced and re-oriented on specific groups, i.e. long-term unemployed or those threatened by long-term unemployment. Together with programmes focused on activation and motivation of workers by individual approach, measures will also be taken to remove the existing barriers to equal entry on the labour market and thus to integrate people with different handicaps, i.e. people with disabilities, mothers with children, persons after maternity or parental leave, people with low or no qualification, older people and people with different socio-cultural background. The share of expenditures on these activities currently reaches about 20% of total expenditures on active labour market policy. Before 2008 this share is expected to increase to 30 – 40%.

With regard to the expected lack of active citizens in the Czech Republic, active **foreigners’ participation on the labour market**, in the form of employment relationship, will be important. The share of active foreigners on the Czech labour market is increasing; by the end of 2004 they represented 3.3% of the Czech labour force. At present, foreigners have to face significant administrative barriers. Despite positive changes introduced by the new Act on Employment, loss of a job results in a loss of the work permit, since the work permit is always issued for a specific job position. Without valid work permit also the residence permit loses validity and the foreigner is therefore

obligated to leave the Czech territory. The result is a strong dependency of foreigners on their employers. The situation is even more complicated since it is impossible to differentiate work permits according to the length of stay and employment of each particular foreigner in the CR. Insufficient information about the supply of foreign specialists and domestic employers' demand is also a problem. Partial solution is an information portal launched as part of the pilot project Active Selection of Qualified Foreign Workforce. At present it is however available only for certain non-EU countries. In future, with regard to the situation on labour market, the CR will simplify the system of granting work permits. According to regular analyses carried out by labour market offices, professions and branches will be specified for a given time period within which no work permits will be demanded. Amendments to the Employment Act and Act on the Residence of foreign Nationals will allow for simplification in the system of granting work and residence permits. These measures should among other things help the migrants with expected long term and subsequently permanent residence in the CR to gradual, smooth and effective economic and social integration into the Czech society. Before 2008 a countrywide public information system will be completed, which will incorporate the information on the supply of foreign specialists and on the demand of employers on the Czech labour market. The scope of the pilot project Active Selection of Qualified Foreign Workforce is gradually extending. Initially it covered Bulgaria, Croatia, Kazakhstan, Belarus and Moldova and, with some exceptions, all graduates from Czech universities regardless their country of origin. In July 2005 Canada and Serbia and Montenegro were included. Newly also foreign graduates from Czech secondary schools and universities may apply, who finished their studies after 2000 and after 1995 respectively. Since 2006 Ukraine will also be included. The aim of this project is to test the criteria for selection, administrative and other procedures and technical potential. Finally the project will cover all non-EU countries and will determine the Czech active immigration policy. The project was set for five years (2003 – 2008).

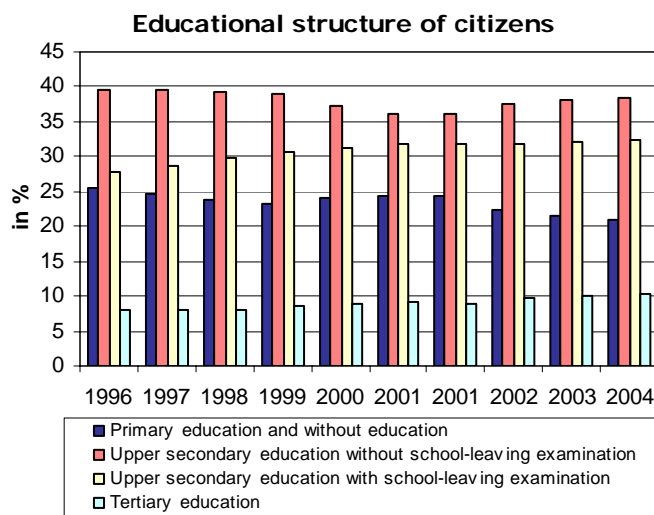
Inclusion on labour market – priorities

- **Decrease unemployment of young people (under 25)**
- **Promote equal opportunities for women and men on the labour market**
- **Increase older workers' participation on labour market**
- **Promote professional mobility via effective retraining system**
- **Facilitate foreigners' access to the labour market**

Education

To ensure long-term competitiveness of the Czech Republic, it is necessary to develop qualified, adaptable and mobile labour force. Assertion on the labour market depends notably on education, qualification and willingness to learn continuously and to retrain. Increase of the educational attainment by means of modern, quality and flexible system of education and training is therefore a precondition of economic growth. In knowledge economy the main requirements on labour force are language skills, ability to work with information and ability to work with ICT on a relevant user level. As a result of population ageing and related prolongation of active life, the programmes of further education will have to adjust to the needs of middle-aged and older people in such a way to facilitate the reconciliation of working, study and personal life.

According to the evaluation of educational policy in EU countries, the Czech Republic ranks among the best three EU countries in two of the five reference indicators. Those are the early withdrawals from educational system (the current rate in the CR is 6.1%, which is below the 10% EU target for 2010) and successful completion of higher secondary education (in 2004 the CR reached 90.0%, while the EU target value for 2010 is 85%). The CR however lacks significantly in two other areas – development of tertiary education and key competences and the concept of lifelong learning. As concerns



participation on lifelong learning, the CR reaches relatively low values (6.3% in 2004, while the EU target for 2010 is at least 12.5% of active population participating on formal or informal education). The reason is twofold – on the one hand the high rate of completion of secondary education (upper secondary general, technical and vocational schools) and on the other hand insufficient attention paid to the system of lifelong learning in the past.

In the information society individuals have to update their knowledge, competences and skills

permanently. The importance of lifelong learning is that it helps to increase the overall level of education and qualification during whole life in accordance with the changing demand on the labour market. As part of the systematic promotion of lifelong learning impact should be therefore put on the systems of primary and continuing education and their interconnection.

In the area of primary education, the **reform of the content of education provided by schools** (so-called curricular reform)²⁶ was already launched. It concerns education provided by schools and other education institutions. Its implementation will allow for modernisation of education in the CR by focusing on increase in quality, effectiveness and innovativeness of educational system at all its levels and by motivating pupils to positive attitude towards education and lifelong learning. In the coming period the educational system will focus on acquiring key competences and practically oriented skills, as a way to accomplish the targets of employment policy. National Education Programme will be elaborated and adopted before the end of 2006. The formation and introduction of framework educational programmes will continue. On the one hand, these programmes follow contemporary approach to the aims of education and define the necessary content of education. On the other hand they leave sufficient room for schools and teachers to decide about specific forms of education and thus to react flexibly to labour market requirements and to students' needs. Before the end of 2008 a reform of the school-leaving examination in all upper secondary vocational schools will be carried out. The reform of school-leaving examination in upper secondary general and technical schools will continue, so that the new examination could be introduced in the school year 2007/2008.

Compared to other countries, the educational structure of Czech adult population is characteristic by a high share of people with upper secondary education (over 90% of adults between 25 – 64 years). On the other hand, the **share of people with tertiary education is low**. Within the last 15 years the number of students admitted to universities more that doubled²⁷. The share of tertiary education graduates however remains low compared to some EU countries. One of the reasons is a relatively high proportion of early withdrawals. Another reason was insufficient supply of shorter and more practically oriented forms of tertiary education. This is however going to change due to restructuring of study programmes. In future the CR will focus not only on quantitative expansion of tertiary education (the supply of this type of education seems to be close to optimum), but much more on further diversification and facilitating the

²⁶ Long-term Education Development Plan of the CR (2005), National Education Development Programme of the CR.

²⁷ Institute for Information in Education: Yearbooks 1989/90-2002/03.

penetrability between different types of tertiary education. More attention will also be paid to practical assertion of graduates and to improvement in the quality of study programmes²⁸.

Promoting the **cooperation between employers, educational institutions and professional institutions** is crucial. It will be realised by allowing employers to take part on preparing new educational and study programmes, participation of experts on education, by providing practical experience, and by promoting mobility of students and teachers via practical traineeships in enterprises. The interconnection of activities between universities, other educational institutions and professional institutions on the one hand and regions, potential employers and users of R&D outcomes on the other hand, could help to bring more funds into educational system. In future, the representatives of employers will participate on the school-leaving examinations of students and they will also be invited to discuss the framework education programmes on a countrywide level. As part of upper secondary technical education compulsory four-week traineeships for students in enterprises will be introduced. In the period 2005 – 2008 a system project PILOT S will be implemented. This project will focus on creation and certification of pilot education programmes on selected upper secondary technical schools and selected upper secondary vocational schools. It will be co-financed from ESF. Closer cooperation between employers, representatives of employees, educational institutions, professional organisations and institutions of state and public administration, notably on regional level, should help to reduce the disparities between educational institutions' outcomes and employers' demand. These reforms will be accompanied by an integrated system of counselling at schools, notably career counselling, which is crucial for further assertion of school graduates on the labour market. In the period 2005 – 2008 a system project VIP Kariera will be implemented with this purpose. The project will be co-financed from ESF.

The ability to react flexibly to the changing requirements of labour market depends on the system of lifelong learning, which should be open to all citizens. In accordance with the systematic approach to lifelong learning, **interconnection between the systems of primary and continuing education** is crucial. To achieve the interconnection, National system of qualifications will be finalised by means of a system project financed from ESF in the period 2005 – 2007. This system will be a basis for recognition of qualifications in the labour market and will therefore boost employment. Before the end of 2007 a system of recognition and verification of the outcomes of continuing education will be set up. The certificates that will be an outcome of standardised, formalised and transparent procedure will be transferable into practice. As part of the concept of lifelong learning, continuing education on primary, secondary, post-secondary schools and universities will be promoted. The aim is to use the existing infrastructure and capacities and also to promote continuing education pedagogical staff. These activities are part of the already adopted national and grant projects financed from ESF.

Lifelong learning is closely related to **promotion of transmigration between the different stages of tertiary education**, which will allow for access to education regardless of student's age and the desired level of education. Students will be therefore allowed to continue in their studies at any stage (in the sense of lifelong learning) at either domestic or foreign institution providing tertiary education. Both the vertical (i.e. to start a different study programme after obtaining a bachelor degree or its equivalent) and horizontal penetrability between educational programmes will be promoted. The opportunity to switch from higher stages of education to lower ones (e.g. from university to post-secondary technical school) may limit the number of unsuccessful students, who leave the educational system after spending certain effort but without increasing their qualification and thus improve economic effectiveness of the system. To implement the concept of lifelong learning, creation of national framework of qualifications for tertiary

²⁸ According to the Long-term University Development Plan, by the end of 2005 around a half of university students should terminate their studies after obtaining a bachelor degree.

education, which would be compatible with the European framework of qualifications, is necessary. Development of combined and distance forms of studies, creation and introduction of learning supports (multimedia teaching aids), e-learning, interactive teaching programmes and other background necessary for these forms of studies, provision of joint educational laboratories and introduction of project and problem oriented study, will be promoted by means of development programmes, or possibly the projects of Higher Education Development Fund.

Education and training of employees imposes non-negligible costs on employers. Furthermore, many enterprises do not develop human resources effectively. Therefore **reconciliation of education targets with enterprises' targets** is needed. In 2006 enterprises will have the opportunity to introduce and obtain a standard "Investors in people" (IIP) on the Czech territory. Currently the pilot phase of this project is nearly finished. Its aim was to lay the foundations for IIP infrastructure in the CR and also to test the standard on a sample of enterprises. The programme for promoting introduction of standards in SMEs will also be prepared. Furthermore it is necessary to give preferential treatment to firms providing education as part of employees benefit system. Support will be granted to those enterprises, which offer general (i.e. language or ICT) and specific training.

In future the demands on **information knowledge** will grow. The technologies and services of so-called e-learning and educational software in general are considered to be an effective way of improving the access to information literacy. Their use will therefore be promoted in school system, libraries and public administration but also for education of public. An important instrument to develop information skills of wide public, of all professions and qualifications, including those who have never before worked with computer, is the existing National Computer Literacy Programme. Its purpose is to offer to wide public an opportunity to learn the basics of work with computer and with internet and to overcome the fear of new technologies. Before the end of 2006 all educational institutions (including libraries) will be connected to the internet²⁹. Before the end of 2006 at least half of citizens will master the basic computer literacy and selected public administration employees will be obligated to acquire certificate of computer literacy.

To ensure high quality and flexibility of educational system, the growth rate of public investment in education has to be maintained. In 2004 the public expenditure on education reached approximately 4.29% of GDP³⁰, which is substantially less than in most developed countries. Other forms of financing, i.e. from Structural Funds or public private partnerships, have to be developed. In many cases the European Social Fund (e.g. projects KVALIFIKACE – aimed at creating National system of qualifications; VIP KARIERA – career counselling; or a grant scheme Modernisation of School Educational Programmes) can be used for financing the implementation of specific reform measures.

Education – priorities

- **Implement curricular reform**
- **Improve the access to post-secondary technical and tertiary education**
- **Promote cooperation between employers, employees and educational and professional institutions**
- **Improve the interconnection between the systems of primary and continuing education**
- **Promote transmigration between specific stages of tertiary education**
- **Promote continuing education in firms**
- **Increase information literacy**

²⁹ State Information Policy in Education.

³⁰ Source: Ministry of Finance and Czech Statistical Office, 2005.