2001 Country Reports on Economic Policy and Trade Practices
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CZECH REPUBLIC

Key Economic Indicators
(Millions of U.S. dollars unless otherwise indicated)

	1999	2000	2001 1/
Income, Production and Employment:			
Nominal GDP (US$ billion) 2/	53.06	50.7	54.8
Real GDP Growth (pct)	-0.2	2.9	3.3
GDP by Sector (pct): 2/			
Agriculture	3.7	3.8	3.9
Manufacturing	26.3	27.8	29.0
Services	56.8	56.1	56.5
Government 3/	32.5	33.1	33.5
Per Capita GDP (US$) 2/	5,405	5,004	5.329
Labor Force (000s)	5,170	5,203	5,213
Unemployment (pct)	9.4	8.8	8.5
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	8.1	7.7	10.0
Consumer Price Inflation	2.1	3.9	6.0
Exchange Rate (CKR/US$)			
Official	34.60	38.59	38.90
Balance of Payments and Trade: 4/			
Total Exports FOB (USD bill)	26.8	29.0	21.6
Exports to United States	0.6	0.8	0.7
Total imports CIF (USD bill)	28.9	32.5	23.9
Imports from United States	1.2	1.4	0.9
Trade Balance (USD bill)	-2.06	-3.5	-2.3
Balance with United States	-0.53	-0.61	-0.28
Current Account Deficit/GDP (pct)	-1.5	-4.8	-5.0
External Public Debt 5/	24.3	22.0	23.0
Fiscal Deficit (Central)/GDP (pct)	1.6	1.8	9.4
Debt Service Payments/GDP (pct)	5.6	8.9	6.8
Gold and Foreign Exchange Reserves	12.8	13.1	14.0
Aid from United States 6/	6.5	6.0	8.9
Aid from All Other Sources	N/A	N/A	N/A

1/ Unless stated otherwise, 2001 figures are based on the latest data of the Czech Statistical Office (CSO) from September 2001, of the Ministry of Finance and/or unofficial estimates from the Czech National Bank.

2/ GDP at factor cost, percentage changes calculated in local currency.

3/ Central government spending as percent of GDP.

4/ January through August 2001 data. Czech imports do not include re-exports of U.S. goods through other countries.

5/ In absolute numbers, the figure for external debt does not change, the growth reflects shifts in DEM vs. US$ exchange rates.

6/ Military aid only, U.S. AID assistance was phased out by September 30, 1997.

1. General Policy Framework

The Czech Republic is a small, open economy with a free and competitive market. It is currently recovering from unfinished structural reforms problems mainly in the fields of bank privatization, industrial restructuring, legal reform, and financial markets transparency. Unfinished structural reforms lay at the heart of the Czech Republic's severe recession in 1998-1999, which led to an economic contraction of 2.3 percent in 1998. Economic recovery has been strong in 2000 and 2001, growing at 3.9 percent in the first half of 2001. However, a growing fiscal deficit and the effects of the worldwide slowdown may threaten continued expansion.

Until 1998, the Government of the Czech Republic pursued balanced budgets, incurring only small actual deficits. Budget deficits have traditionally been financed through the issuance of government bonds purchased by private investors, predominantly commercial banks. Economic recession, tax shortfalls, and the Social Democratic government's pledge to support a wide range of social welfare and investment programs led to a 1999 budget deficit of 1.6 percent of GDP. The deficit planned for the 2000 budget (1.8 percent of GDP) grew to 2.4 percent, and the deficit planned for the 2001 budget (2.4 percent of GDP) is currently 9.5 percent of GDP and may continue to grow. The 2002 budget, under discussion in late 2001, will also be in deficit.

In 1998, the Czech government approved a package of incentives to attract investments. The incentives are offered to foreign and domestic firms that invest $10 million or more in manufacturing through a newly registered company. The package includes tax breaks of up to 10 years offered in two five-year periods; duty-free imports of high-tech equipment and a 90-day deferral of Value-Added Tax payments (VAT); potential for creation of special customs zones; job creation benefits; training grants; opportunities to obtain low-cost land; and the possibility of additional incentives for secondary investments and production expansion. The incentives package was further enhanced by the new Act on Investment Incentives, effective as of May 1, 2000, which codifies, simplifies and extends the original national incentives scheme. The investment threshold was lowered to $5 million in regions with the unemployment rate at least 25 percent higher than the national average and investors in these regions can receive up to 200 thousand crowns (US$ 5,000) for each newly created job plus 35 percent of the requalification costs, among other improvements.

The incentives resulted in a strong inflow of foreign direct investment ($4.9 billion in 1999, $4.6 billion in 2000, $2.3 billion to June 30, 2001), and the trend is expected to continue. Portfolio investments in 2001 were $3.7 billion to June 30, 2001.

The Czech National Bank (CNB) is responsible by law for monetary policy. The primary instrument used by the bank to influence monetary policy is the two-week repo rate. Following sharp and growing current account imbalances in the spring of 1997, the central bank implemented a series of measures including a floating exchange rate, relatively high interest rates, and high compulsory bank reserves designed to dampen inflation and reduce external imbalances. Monetary policy during most of 1998 remained restrictive. In 1999, with the current account well on the way to recovery and the exchange rate of the crown relatively strong, the central bank, ahead of its inflation target for a second year in row, cut interest rates several times. Influenced by the government's expansive fiscal policy, increasing consumer demand and the possibility of new demands for wages increase in the fall, the CNB slightly increased interest rates in 2001. The CNB is likely to meet its net inflation target of two to four percent at the end of 2001.

2. Exchange Rate Policy

The Czech crown is fully convertible for most business transactions. The Foreign Exchange Act provides a legislative framework for full current account convertibility, including all trade transactions and most investment transactions, subject to government action on implementing regulations. As of 2000, all capital account restrictions were removed except for the purchase of real estate in the Czech Republic by foreigners. Foreign company branches will be able to acquire real estate as of 2002, in accordance with the Czech Republic's commitments in the Organization for Economic Cooperation and Development (OECD).

The Czech crown, floating freely since the spring of 1997, has remained relatively steady, withstanding Russia's 1998 financial turmoil. The crown appreciated in value due to significant interest rate differentials between the Czech Republic and its major trading partners. It has remained strong even after the central bank reduced interest rates significantly in 1998 and 1999, as currency traders bet on EU convergence. The CNB's recent move against inflation, weakening foreign currencies, and expected inflows from privatization have pushed the crown to record highs in late 2001.

3. Structural Policies

The government sees full membership in the European Union (EU) as one of its highest foreign policy priorities. Relations between the Czech Republic and the EU are currently governed by an EU association agreement signed in 1991. Detailed accession negotiations began in November 1998. Even though the Czech government is striving for full EU membership by end 2003, most observers do not anticipate that will be achieved prior to 2004 or 2005. As part of the EU accession process, many of the Czech Republic's regulatory policies and practices are being harmonized with EU norms. Through membership in OECD, the Czech Republic agreed to meet, with relatively few exceptions, OECD standards for equal treatment of foreign and domestic investors and restrictions on special investment incentives. The United States has succeeded in using the OECD membership process to encourage the Czech Republic to make several improvements in the business climate for U.S. firms.

Czech tax codes are generally in line with European Union tax policies. According to OECD methodology, in 2000 tax collections amounted to 39.5 percent of GDP. In 2000, the government reduced taxes on corporate profits from 35 percent to 31 percent. The tax rate for the highest personal income tax bracket was lowered to 32 percent. Employer and employee social insurance contributions are respectively 35 and 12.5 percent. The government permits tax write-offs of bad debts, although with less generous treatment of pre-1995 debts. Firms are allowed to write off the first year's share of a bad debt without filing suit against the debtor, though subsequent write-offs must document unsuccessful efforts to collect past due amounts. U.S. firms have complained that Czech tax legislation effectively penalizes use of holding company structures by leveling both corporate tax and dividends withholding tax on profit flows between group companies, thus creating double taxation on such profits. Czech law does not permit intra-group use of losses (i.e., offsetting losses in one group entity against profits in another), and imposes corporate tax on dividends received from foreign holding without allowing use of a foreign tax credit for the underlying tax suffered in the subsidiary's home jurisdiction.

The need for an improved bankruptcy code remains an important structural impediment. Most observers believe the slow and uneven courts and weakness of creditors' legal rights has hampered the current bankruptcy law from acting as an effective vehicle for corporate restructuring. Members of Parliament and others have called for a bankruptcy law with provisions similar to the U. S. Chapter Eleven or "London Rules" for out-of-court settlements to encourage resuscitation of troubled firms. Several amendments, the latest in force as of May 1, 2000, have sought to address these concerns. Presently, there is a three to four-year backlog in the bankruptcy courts and only a small secondary market for the liquidation of seized assets. A complete overhaul of the bankruptcy code is under consideration for late 2001.

4. Debt Management Policies

The Czech Republic maintains a moderate foreign debt and has received investment grade ratings from the major international credit agencies. In 2000, gross foreign debt measured $22 billion and is not expected to change much in 2001. As of June 30, 2001, gross foreign debt measured $21 billion, the bulk being the debt of companies ($11.8 billion) and commercial banks ($8.3 billion). Debt service as a percentage of GDP and debt service to exports stand at 7.1 percent and 8.5 percent, respectively. The Czech Republic repaid its entire debt with the International Monetary Fund (IMF) ahead of schedule. Under the Paris Club, the Czech Republic, as member of OECD, rescheduled its official credits to Russia. The government was considering its first issuance of Eurobonds in 2001.

5. Significant Barriers to U.S. Exports

The Czech Republic is committed to a free market and maintains an open economy with few barriers to trade and investment. It is a member of the World Trade Organization (WTO) and of the WTO's Information Technology Agreement. The Czech Republic is not a signatory to the General Agreement on Tariffs and Trade (GATT) civil aircraft code.

The Czech Republic's EU association agreement established preferential tariffs for non-agricultural, EU-origin products to the Czech markets, while maintaining higher most-favored-nation rates for U.S. and other non-EU products. As of 2001, EU industrial products enjoy duty-free status. A number of U.S. companies from different industry sectors have complained that tariff preferences given the EU under the agreement have diminished their business prospects and ability to compete against EU-origin products.

Trade in agricultural/food products is generally free of major trade barriers, although technical barriers continue to hamper imports of certain products. In anticipation of EU membership, the Czech Republic is rewriting much of agricultural/food products standards and trade legislation. During this transition phase, it is not always clear which rules apply, a situation which has led to some delays in approval. The harmonization of standards with the EU should ease the paperwork burden for those exporters already exporting to the EU. However, the alignment of the Czech food legislation with the EU also means that certain products currently prohibited in the EU will also be prohibited in the Czech Republic. U.S. exporters of beef, poultry, pork and horsemeat are not able to ship to the Czech Republic due to concerns about special risk materials shared by the EU. In November 2000, reacting to the EU BSE outbreak, the Czech State Veterinary Administration prohibited specific risks' materials usage in pet food, and the Animal and Plant Health Inspection Service (APHIS) cannot guarantee that U.S. pet food producers meet this requirement. Another problem with the pet food certificate is the bacterial testing requirement, which is stricter in the Czech Republic than in the EU. APHIS is currently in the process of negotiating possible changes to the Czech veterinary requirements

A final bill in line with EU directives to regulate Genetically Modified Organisms (GMOs) entered into force January 1, 2001, including decrees regulating new GMO varieties for field testing that the Czech Republic continues to approve.

In July 2000, the Czech Republic signed the Protocol on Conformity Assessment and Acceptance of Industrial Products (PECA) with the EU, which as of January 1, 2001, enables imports of EU industrial products without any additional testing. The Czech Republic has refused to extend the benefit of this agreement to products produced in the United States that meet EU certification requirements.

American business people often cite a convoluted, bureaucratic system (both at national and local levels), which can act as an impediment to market access. Often considerable time is required to finalize a deal, or enforce the terms of a contract. On occasion, European companies have sought to use the Czech Republic's interest in EU membership to gain advantage in commercial competition.

The government is required by law to hold tenders for major procurement. A procurement law introduced in 1994 proved unsatisfactory. Several revisions aimed at making the law simpler and more transparent failed. Recognizing that no amendment will help, the Czech Republic is currently working on a brand new procurement law to enter force in 2002. The Czech Republic is not a signatory of the WTO Government Procurement Agreement.

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

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

U.S. investors interested in starting joint ventures with or acquiring Czech firms have experienced problems with unclear ownership and lack of information on company finances. Investors have complained about the difficulty of protecting their rights through legal means such as enforceable secured interests. In particular, investors have been frustrated by the lack of effective recourse to the court system. The slow pace of court procedures is often compounded by judges' limited understanding of complex commercial cases. The Czech Republic imposes a Czech language requirement for trade licenses for most forms of business. This requirement can be fulfilled by a Czech partner, but this can be burdensome and involves additional risks.

The opaque nature of the stock market puts U.S. investors and financial services providers at a competitive disadvantage. While stock market reforms were enacted in 1996 to help protect small shareholders and increase transparency of transactions, enforcement has been uneven. A Czech Securities Commission opened in 1998 with a mission of improving the regulatory framework of the capital market, increasing capital market transparency, and restoring investor confidence. To the date, the Commission issued 5,405 authorized rulings, and in the re-licensing process, which is complete, revoked 240 licenses. It has, however, been hampered by budgetary constraints and a lack of rule-making authority. A new law on the Securities Commission is being prepared to improve its status.

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

6. Export Subsidies Policy

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

7. Protection of U.S. Intellectual Property

The Czech Republic is a member of the Berne and Universal Copyright Conventions and the Paris Convention on Industrial Property. Czech laws for the protection of intellectual property rights (IPR) are generally good, but enforcement has lagged. Existing legislation guarantees protection of all forms of property rights, including patents, copyrights, trademarks, and semiconductor chip layout design. The Czechs continue to harmonize with the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement. An amendment providing 70 years of copyright protection for literary works, up from the present 50 years entered into force on December 1, 2000. The Czech Republic passed most of its TRIPs-related legislation in 2000 and the last commitment, the broadcasting law, entered into force in July 2001.

As a result of enforcement weaknesses and delays in indictments and prosecutions, the U.S. government placed the Czech Republic on its Special 301 Watch List during the 1999 cycle. The Embassy continues to work with U.S. industry and Czech government officials to improve enforcement of IPR norms. Two recent legislative amendments expanded the tools for enforcement of IPR. One entered force on December 1, 1999, and boosts the powers of the customs service to seize counterfeit goods. The other, in effect as of September 1, 2000, allows the Czech Commercial Inspection (CCI) to act directly in IPR cases. Formerly, the CCI could only act in conjunction with the police. As a result of these changes, the United States government removed the Czech Republic from the Special 301 Watch List in 2001.

8. Worker Rights

a. The Right of Association: Czech law provides workers with the right to form and join unions of their own choice without prior authorization, and the government respects this right in practice. Most workers are members of unions affiliated with the Czech-Moravian Chamber of Trade Unions (CMKOS), a democratically oriented, republic-wide umbrella organization for member unions. The unions are not affiliated with political parties and exercise their independence. Workers have the right to strike, except for those whose role in public order or public safety is deemed crucial. By law, strikes may take place only after mediation efforts fail. Unions are free to form or join federations and confederations and to affiliate with and participate in international bodies. Union membership, compulsory under the Communist regime, has declined since 1990.

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

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

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

e. Acceptable Conditions of Work: The government sets minimum wage standards. The minimum wage is 5,000 Czech crowns per month (approximately $132), although the monthly average is 14,018 Czech crowns (approximately $369) per month. Average net wages are 2.7 times as high as official sustenance costs. The minimum wage provides a sparse standard of living for an individual worker or family, although allowances are available to families with children. The law mandates a standard workweek of 40 hours. It also requires paid rest of at least 30 minutes during the standard 8-hour workday, as well as annual leave from four weeks up to eight weeks depending on the profession. Overtime ordered by the employer may not exceed 150 hours per year or 8 hours per week as a standard practice. Industrial accident rates are not unusually high. Workers have the right to refuse work endangering their life or health without risk of loss of employment.

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

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category	Amount	
Petroleum		86
Total Manufacturing		151
Food & Kindred Products	49	
Chemicals & Allied Products	42	
Primary & Fabricated Metals	7	
Industrial Machinery and Equipment	15	
Electric & Electronic Equipment	-88	
Transportation Equipment	136	
Other Manufacturing	-10	
Wholesale Trade		119

Banking	(D)
Finance/Insurance/Real Estate	(D)
Services	42
Other Industries	35
TOTAL ALL INDUSTRIES	802

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