

# **REGULAR REPORT**

**FROM THE COMMISSION**

**ON**

**CZECH REPUBLIC'S**

**PROGRESS TOWARDS ACCESSION**

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## **A. Introduction**

### **a) Preface**

In Agenda 2000 the Commission said it would report regularly to the European Council on progress made by each of the candidate countries of Central and Eastern Europe in preparations for membership and that it would submit its first report at the end of 1998. The European Council in Luxembourg decided that

“From the end of 1998, the Commission will make regular reports to the Council, together with any necessary recommendations for opening bilateral intergovernmental conferences, reviewing the progress of each Central and East European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the Union *acquis*. Prior to those reports, implementation of the accession partnerships and progress in adopting the *acquis* will be examined with each applicant State in the Europe Agreement bodies. The Commission's reports will serve as a basis for taking, in the Council context, the necessary decisions on the conduct of the accession negotiations or their extension to other applicants. In that context, the Commission will continue to follow the method adopted by Agenda 2000 in evaluating applicant States' ability to meet the economic criteria and fulfil the obligations deriving from accession.

A dynamic approach should be maintained in assessing the progress made by applicant States in the regular reports which the Commission will submit to the Council.”

The European Council in Cardiff supported those conclusions, stating that “The Union’s priority is to maintain the enlargement process for the countries covered in the Luxembourg European Council conclusions, within which they can actively pursue their candidatures and make progress towards taking on the obligations of membership, including the Copenhagen criteria. Each of these candidate countries will be judged on the basis of the same criteria and will proceed in its candidature at its own rate, depending on its degree of preparedness. Much will depend on the efforts made by the candidate countries themselves to meet the criteria. All will benefit from strengthened relations with the EU including through political dialogue and tailored strategies to help them prepared for accession.”

In accordance with the guidance provided by these Council Conclusions, the progress report on the Czech Republic follows the same structure as the Opinion. It

- describes the relations between the Czech Republic and the Union, particularly in the framework of the Europe Agreement;
- analyses the situation in respect of the political conditions set by the European Council (democracy, rule of law, human rights, protection of minorities)
- assesses the Czech Republic’s situation and prospects in respect of the economic conditions mentioned by the European Council (functioning market economy, capacity to cope with competitive pressures and market forces within the Union)

- addresses the question of the Czech Republic's capacity to adopt the obligations of membership, that is, the *acquis* of the Union as expressed in the Treaty, the secondary legislation and the policies of the Union

It also covers judicial and administrative capacity as requested by the Madrid European Council which underlined the necessity for the candidate countries to adapt their administrative structures so as to guarantee the harmonious implementation of Community policies after membership.

This approach ensures equal treatment for all the candidate countries. The report takes into consideration progress since the Opinion. It looks at whether intended reforms referred to in the Opinion have been carried out and examines new initiatives, including those directly related to addressing Accession Partnership priorities. There port contains a separate section which examines the extent to which the Czech Republic has addressed the short term priorities set out in the Accession Partnerships.

While the assessment of progress in meeting the political and *acquis* criteria focuses on that which has been accomplished since the Opinion, the economic assessment is based on a longer term evaluation of the Czech Republic's economic performance. The assessment of progress made in adopting the *acquis* has been made on the basis of adopted legislation rather than legislation which is in various stages of either preparation or Parliamentary approval. Only in this manner was it possible to objectively measure and compare concrete progress in preparation for accession.

The report draws on numerous sources of information. The candidate countries were invited to provide information on progress made in preparations for membership since the publication of the Opinion. Their presentations at the meetings held under the auspices of the Europe Agreement, their National Programmes for the Adoption of the *Acquis* and the information provided in the context of the analytical examination of the *acquis* provided were additional sources of information. Council deliberations on the Opinion and the reports and resolutions of the European Parliament on the Commission Opinions<sup>1</sup> and in particular the report on the application of the Czech Republic for accession to the EU prepared by Mr. Carnero Gonzalez were taken into account in the preparation of the reports. The Commission also used assessments made by the Member States, particularly with respect to the political criteria for membership and the work of various international organisations, and in particular the contributions of the Council of Europe, the OSCE and the IFIs as well as that of non-governmental organisations in preparation of the regular reports.

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<sup>1</sup> European Parliament Doc. 224.339 'Report on the Communication from the Commission Agenda 2000' (Rapporteurs: A. Oostlander and E. Baron Crespo; Co-rapporteurs: M. Aelvoet, J. Donner, O. Von Habsburg, E. Caccavale, F. Kristoffersen, M. Hoff, C. Carnero Gonzales, P. Bernard-Raymond, R. Speciale, J. Wiersma, J.W. Bertens)

## **b) Relations between the European Union and the Czech Republic**

### *The enhanced Pre-Accession Strategy*

On 30 March 1998 the accession process was formally launched by a meeting of the Ministers for Foreign Affairs of the fifteen EU Member States, the ten Central and East European applicant states and Cyprus. In advance of this meeting country specific Accession Partnerships were adopted to support the applicant countries in their preparations for membership. These documents set out the priorities for further work and the supporting financial assistance available from the EU. In March the Czech Republic presented a first version of its National Programme for the Adoption of the *Acquis* (NPAA) which describes in more detail the actions needed to reach the objectives set out in the Accession Partnership. Following the opening of the Intergovernmental Conference, the Czech Republic presented the main elements of its integration strategy at the opening session of the EU-Czech Republic accession negotiations in Brussels on 31 March. An analytical examination of the *acquis* ("screening") started on 3 April. Pre-accession aid will be increased substantially. Alongside the Phare programme, it will, as from the year 2000, comprise aid for agriculture and a structural instrument which will give priority to measures similar to those of the Cohesion Fund in environment and transport. The Phare programme will concentrate on institution building and investment in other areas.

### *Recent developments in bilateral relations*

The implementation of the Europe Agreement by the Czech Republic has been uneven although the difficulties encountered have been solved through the functioning of the various joint institutions.

The Association Council met in October 1997. Two Association Committee meetings were held in July 1997 and July 1998. The July 1998 meeting was the first to discuss the implementation of the Accession Partnership priorities. The system of subcommittees continues to function as a forum for technical discussions.

Since the issuing of the Opinion the Joint Parliamentary Committee comprising representatives of the Czech and European Parliament met twice, in October 1997 and March 1998.

Trade between the EU and the Czech Republic has continued to increase. Between 1996 and 1997 EU exports to the Czech Republic increased from ECU 14 to 15,8 billion and EU imports from ECU 9,8 to 11,7 billion. In the first five months of 1998, EU exports grew by 6,8 % compared with the same period in 1997 and EU imports by 30 %. Trade with the Union accounts for 61 % of Czech foreign trade.

Under the Europe Agreement an adaptation protocol, covering in particular agricultural and processed agricultural products, has been signed to take into account the results of the Uruguay Round and the accession of Austria, Finland and Sweden to the EU.

A number of trade issues have been resolved through the consultation mechanisms provided for in the Europe Agreement (e.g. the Import Deposit Scheme, the import quota for

Community apples and the import restrictions for Community potatoes). One unresolved issue is the amendment to the Czech Law on Lotteries and Similar Games, which the Czech authorities have undertaken to amend rapidly.

In the area of industrial standards and conformity assessment, negotiations have started on the conclusion of a Protocol on European Conformity Assessment (PECA), designed to speed up the process of aligning Czech horizontal and technical legislation in this area to the *acquis*. However, certain products originating in the Community and complying fully with Community standards have to undergo additional procedures before they are admitted into the Czech market.

Positive developments were the signing in July 1998 of a Veterinary and Phytosanitary Protocol to the Europe Agreement. Mention should also be made of the adoption by the EU-Czech Association Council in June 1998 of Implementing Rules for state aids as foreseen in the Europe Agreement.

The 1998 national Phare programme consists of a national allocation (27 MECU), based on the Accession Partnership priorities, to support in particular regional policy, Justice and Home Affairs and agriculture as well as the participation in Community programmes and Tempus. An additional 19 Mecu have been allocated for the cross-border co-operation programme.

The Czech Republic also participates in and benefits from Phare funded multi-country and horizontal programmes such as customs, environment, small and medium sized enterprises, statistics, public administration reform and TAIEX.

## **B. Criteria for membership**

### **1. Political Criteria**

#### *Introduction*

In its 1997 Opinion on the Czech Republic's application for EU membership, the Commission concluded that:

'The Czech Republic presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities.'

The Accession Partnership with the Czech Republic mentions as medium-term priorities "further work on the integration of the Roma; strengthening of laws which guarantee press freedom; further attention to ensuring equal access to public services."

#### *Recent Developments.*

Since July 1997, there have been two changes of government in the Czech Republic. In November 1997, the government resigned and was replaced by a caretaker government, until

elections in June 1998. The results of the June elections led to the nomination of a minority government on 22 July.

The change in Government has not resulted in any major shift in the country's policy towards the European Union.

## **1.1. Democracy and the Rule of Law**

### *The Parliament*

The Parliament continues to operate effectively. Its powers are respected and the opposition plays a full part in its activities. The June 1998 elections brought five parties into the Lower House. The ultra-right nationalist Republicans were not re-elected. The OSCE concluded that the elections were held in accordance with OSCE obligations; at the same time it recommended limited changes to the Czech election law. One third of Senate seats will be subject to re-election in November 1998 at the same time as the local elections.

### *The Executive*

The central institutions of the State continue to operate well.

In December 1997, Parliament passed a Constitutional Act providing for the creation of 14 regions (Higher Self-Governing Units) from 1 January, 2000, as required by the constitution. The Czech Republic has signed but not ratified the European Charter for Local Self-Government.

There has been virtually no progress in public administration reform since July 1997. The only concrete measure taken was the passing on 23 March 1998 of Government Resolution No. 202/98 which laid down an indicative timetable for the reform of the civil service. There has been slippage in regard to its deadlines. The civil service law which was intended to come into force in January 2000 has still not been drafted. Its absence continues to be a major obstacle to the necessary improvement in the functioning of the public administration. Salaries continue to be low, which makes recruitment of qualified staff difficult. The government however has made public administration reform a priority and has taken some first steps such as clarifying responsibilities and increasing salaries.

There are no plans to extend the 'lustration' law, which excludes members of the former security service and active members of the Communist regime from public service, beyond 2000, the final date of its applicability.

### *The Judiciary*

Overall the functioning of the judiciary has not improved over the past year. There are no signs that adequate measures have been taken to address the challenges identified in the Opinion. The serious backlog in unresolved cases remains. The main causes are: the large number of vacancies for judges (390 out of a total of 2726), a general lack of basic equipment

in the courts, insufficient internal communication, both within the Ministry of Justice and between the Ministry and the Courts, the lack of specialisation of judges (who have to deal with different types of cases at the same time as well as having to perform many administrative tasks).

Training of judges in Czech law is the responsibility of the Institute for the Further Training of Judges, which has not been restructured since 1989. The training which it provides does not appear to be sufficiently in line with the needs of a modern judiciary. Earlier this year training of judges in EC law started in earnest thanks to foreign funding.

The lack of sufficiently qualified state prosecutors, with better-qualified graduates tending to seek employment outside the judiciary for reasons of remuneration, is also reason for concern. The establishment of a Supreme Administrative Court is required by Article 91 of the Constitution, but this has not yet been done. Recently the Constitutional Court and the Supreme Court agreed that the Constitutional Court would have final jurisdiction in court decisions considered to be in breach of the Constitution or the Charter of Fundamental Rights and Freedoms.

### *Anti-corruption measures*

In recent years the Czech government has recognised that corruption is a serious problem in the country and that efforts have to be undertaken to address the problem. In October 1997 it adopted a Resolution, which assigns priority tasks to different ministries, in the area of the fight against corruption. Earlier this year the Government approved an amendment to the penal law increasing the penal sanctions for bribery. The Ministry of Finance has a unit responsible for anti-money laundering and anti-corruption policy. It has thus far not proved effective due to lack of qualified staff. In September 1998 the Government established a Ministerial Committee for the Protection of Economic Interests, chaired by the Prime Minister.

Insufficient manpower, equipment, financing and low pay for state employees continue to be serious obstacles to an effective approach. Additional sustained efforts over a considerable period of time will therefore be necessary.

## **1.2. Human rights and the Protection of Minorities.**

Prior to publication of the Opinion the Czech Republic had already acceded to most of the major international human rights instruments. In December 1997 it ratified the Framework Convention for the Protection of National Minorities. The European Charter of Local Self-Government and the European Social Charter have not yet been ratified.

In September 1998 the Government decided to appoint a Human Rights official in the office of the Deputy Prime Minister for Legislative Affairs, with responsibility for the Council on National Minorities, the Interministerial Roma Commission and NGO matters.

### *Civil and Political Rights.*

There are no major problems regarding the respect of civil and political rights. Freedom of expression was improved by a September, 1997 decision the section of the Criminal Code prescribing sentences of up to 2 years' imprisonment for defamation of the Republic and its President.

In June 1998, the Senate rejected a proposed "Act on the Access of Citizens to Information" on the grounds that the obligation which it placed on civil-servants to provide unrestricted information to all citizens would be impracticable.

The application of Czech law on citizenship continues to be problematic. The amendment which gave the Ministry of the Interior the discretion to waive the clean criminal record requirement (previously a condition for obtaining citizenship) has not had much effect. Bureaucratic obstacles, administrative fees and the lack of a concerted approach by the relevant Ministries have delayed a successful resolution to the problem, leaving a large number of persons without citizenship (Roma, children in foster homes, persons in penal institutions). Amending the law to include a further 'opting period' for those people who missed the previous deadline, as suggested by UNHCR, would contribute to settling the issue.

The new government's Programme foresees an amendment to the citizenship law so that all former Czechoslovak citizens residing in the Czech Republic at the time of the dissolution of the Czechoslovak federation and who are still living there now may acquire Czech citizenship. This would seem to offer an effective solution.

The non-governmental sector in the Czech Republic is not as developed as in a number of neighbouring candidate countries, and foreign assistance remains the main source of financing for most NGOs. This seems to be for more historic/cultural reasons than due to the legal framework. On 3 September 1997 Parliament passed an act on Foundations and Foundation Funds. As a result Czech NGOs now enjoy full exemption from VAT.

### *Economic, Social and Cultural Rights.*

Basic economic, social and cultural rights continue to be respected.

### *Minority Rights and the Protection of Minorities.*

While the situation of other minorities continued to be satisfactory, the situation of the Roma has not really improved since July 1997, despite increased attention to the problem from the previous government.

In October 1997, the government adopted a report analysing the situation of the Roma and an 'Action Plan' based on the report's recommendations. The report explained the high levels of unemployment (70 % to 90 %) and lack of education among the Roma. An Inter-ministerial Commission on the Affairs of the Roma Community was established in October 1997. It is responsible for co-ordinating government policy regarding the Roma Community. In June

1998, this Commission submitted to the Government a *Progress Report on the Situation of the Roma Community in the Czech Republic and the government measures for its integration*. It shows that many of the envisaged measures have not been fully implemented, while others have been postponed. Positive measures implemented are the hiring by the Ministry of Interior of three Roma to monitor racially motivated crimes and employment of Roma in the police. In March 1998 the government adopted measures against the advocating, dissemination and spreading of extremist ideologies and against the activities of extremist groups.

Cases of racially motivated attacks and discrimination mentioned in the June 1997 Opinion have continued, some of which attracted widespread media coverage. The overall image of the Roma in the media is rather negative and only minimal attention is paid to racially motivated attacks. Some local officials have added to the problem by suggesting that 'problem citizens' be moved out of city centres or by proposing to subsidise those Roma who sign over their flat to the city upon their departure. Earlier this year there was a high-profile departure of Roma to Canada and the United Kingdom where they requested political asylum. There have also been some incidents of municipalities proposing to separate Roma from other residents.

This shows the continued need for the authorities to take effective measures, to ensure the protection and support of the Roma. The new government's Programme is encouraging in this respect. It is important that future policy also addresses the situation at local and district level.

### **1.3. General Evaluation**

Developments in the Czech Republic confirm the conclusion of the Opinion that the Czech Republic fulfils the Copenhagen political criteria. Nonetheless the Czech Republic needs to devote continuing attention to the reform of the judiciary, to fighting corruption more effectively and to improving the situation of the Roma.

## **2. Economic criteria**

### **2.1. Introduction**

In its 1997 Opinion on the Czech Republic's application for EU membership, the Commission concluded:

“The Czech Republic can be regarded as a functioning market economy”; it “should be able to cope with competitive pressure and market forces in the Union in the medium term”.

In examining the economic developments in the Czech Republic since the Opinion, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993 which stated that membership of the Union requires :

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

In the analysis below the commission has followed the methodology applied in the Opinion.

### **2.2. Economic developments since the Commission published its Opinion**

The macroeconomic situation in the Czech Republic has been difficult over the last year: real GDP has been falling; unemployment has risen sharply; and real incomes have started to contract. The downturn has proved deeper and lengthier than expected, and macroeconomic prospects continue to look bleak. However, there have been some positive trends: export performance has been strong, and combined with lower domestic demand, this has resulted in a considerable narrowing of the country's previously troublesome external deficits. Inflation has also returned to a downward trend. The current economic problems have highlighted the need to press ahead with structural reforms – over the last year there has been good progress on the implementation of the two packages of economic reforms announced in April and May 1997. Before the elections of June 1998, economic decision making had been complicated by political difficulties – these have not completely disappeared completely with the appointment of a new minority government.

#### *Macroeconomic developments*

In 1997, a sharp slowdown in growth emerged in the Czech Republic; real GDP growth for the full year declined to only 1%, down from 3.9% in 1996. The slowdown first emerged in investment expenditure, but deepened later on in the year, as cuts in state expenditure hit public consumption, and as private consumption started to decline. In fact net exports were the only component of demand which grew significantly in 1997. The slowdown in economic activity has deepened further in the first half of 1998, when real GDP contracted by 1.7% year-on-year due to a collapse of domestic demand. Even an extremely good performance on the export side could not prevent a slide into recession in the second quarter of 1998.

The unemployment rate has risen sharply. This is mostly due to the slowdown in economic activity, but also reflects some acceleration in enterprise restructuring. At the end of August

1998, the unemployment rate was 6.4%, up from the 4% registered at the end of June 1997. Increasing unemployment and a decline in nominal and real wage growth, leading to a deterioration of consumer confidence, are behind the current contraction of household consumption, which had been growing strongly until recently.

On the more positive side, the previously high trade deficit narrowed considerably in 1998, as slowing economic growth constrained imports, and as recovery in the EU spurred exports. Exports have remained buoyant despite a strengthening of the currency in 1998. In the first seven months of 1998, exports grew by 29% in local currency terms over a year earlier, and imports by 15%. The improved export performance led to a recovery of industrial output in the last months of 1997 and the first half of 1998.

The narrowing of the trade balance has also led to a considerable improvement in the current account from ECU 1.7 billion in the first half of 1997 to ECU 400 million in the first half of 1998. The decline in the trade and current account deficits is partly cyclical, and the current account deficit is likely to widen somewhat once growth resumes. A sustained improvement in the current account deficit would require that wage pressures are kept firmly under control, and that enterprise restructuring be accelerated to spur productivity growth.

One further improvement has been the recent slowing of inflation. After peaking at 13.4% in February 1998, twelve-month inflation has followed a downward path; it had declined to 9.4% by August 1998. To some extent this decline represents base year effects (there was a step increase in the consumer price index in June 1997 after the steep depreciation of the currency following the May 1997 currency crisis), but it is also due the strict anti-inflationary policy of the central bank. At the end of 1997, there was an important shift in the framework for monetary policy employed by the Czech National Bank. The Bank moved away from a policy of targeting money supply, to setting explicit inflation targets. Moreover, the Bank decided to target "net" price inflation, rather than consumer price inflation, because of the lack of predictability of the pace and impact of price deregulation. The net inflation measure excludes the direct impact of administrative price changes on consumer prices. Targets were set for 1998, and for the year 2000, of 6.0%±0.5% and 4.5%±1% respectively. Twelve-month net inflation was 4.9% in August 1998.

Czech Republic: Main economic trends		1994	1995	1996	1997	1998 latest	
Real GDP growth rate	per cent	2.7	6.4	3.9	1.0	-1.7	Jan-Jun
Inflation rate							
annual average	per cent	10.0	9.1	8.8	8.4	11.7	Jan-Sep
December-on-December	per cent	10.1	7.8	8.6	10.0	8.8	Sep-on-Sep
Unemployment rate, end-year							
ILO definition	per cent	3.8	4.1	3.5	4.7	5.9	Mar
registered	per cent	3.2	3.0	3.5	5.2	6.8	Sep
General government budget balance	per cent of GDP	-1.3	-1.3	-1.8	-2.2		
Current account balance	per cent of GDP	-1.9	-2.7	-7.6	-6.1	-1.9	Jan-Jun
	billion ECU	-0.6	-1.0	-3.4	-2.9	-0.4	Jan-Jun
Foreign debt							
debt/export ratio <sup>1</sup>	per cent	51	58	69	71	65	Mar
gross foreign debt	billion ECU	9.0	12.7	16.4	18.8	18.6	Mar
Foreign direct investment inflow							
net inflow according to EBRD	per cent of GDP	1.8	5.0	2.5	2.5		
balance of payments data	million ECU	732	1959	1126	1147	512	Jan-Jun

Source: Commission services, national sources, EBRD  
<sup>1</sup> Gross hard currency debt as a percentage of exports of goods and services

Although there is no longer any explicit exchange rate policy or target, the Czech crown has been in a managed float against the DM since mid-1997. This policy is aimed at avoiding excessive volatility of the currency. Nonetheless, since May 1997, the value of the currency has fluctuated considerably: after having been weak for most of 1997, the currency strengthened in the first half of 1998, mostly due to tight monetary policy, but also due to improved investor confidence as the current account deficit narrowed. However, monetary policy has been eased, as inflation data have become more and more encouraging.

In 1997, developments on the capital account had mostly been characterised by an outflow of short-term capital, due to both the currency turbulence of May and political instability at various points of the year. In 1998, improved investor confidence as a result of the improvement in the current account situation, along with an interest rate differential, has led to a return of short-term capital. Inflows of foreign direct investment, at ECU 1.1 billion, remained at about the same level as in 1996 in dollar terms.

In recent years, the primary focus of fiscal policy has been a balanced state budget. However, in 1997 the full year state budget ran a deficit, despite two packages of emergency expenditure cuts announced in April and May of last year. The election of a new government is likely to lead to a change of emphasis in fiscal policy; the new government's first budget proposal plans for a deficit. It has recently emerged that significant contingent liabilities for the state budget have been accumulated through off-budget funds and institutions, raising concerns about the future sustainability of the public finances.

### *Structural reforms*

Over the last year, the main impetus for economic reform in the Czech Republic has been the two packages of economic measures announced in April and May 1997. The reforms proposed included: completion of privatisation of the remaining state-owned banks and enterprises; measures to make the capital market more transparent; measures to clarify the relationship between the financial and enterprise sectors and to improve corporate governance; improvement of the conditions for business activity; and stronger action against economic and financial crime.

The privatisation of the remaining banks is the biggest and most controversial of the announced reforms. Nevertheless, its completion is key to improving the health of the banking sector as well as to clarifying the links between the financial sector and the enterprise sector; a sale to a strategic investor should lead to a cleaning up of the loan portfolio, and a less passive attitude towards bad debtors. Some progress has been made with banking privatisation and most of it by the previous caretaker government. The sale of the first of the remaining four large state controlled banks, IPB, was completed in March 1998. Expressions of interest were called for the second, CSOB, by the end of June 1998, from which a shortlist of investors was to be drawn up. Advertisements calling for expressions of interest in the two remaining banks could be issued shortly by the new government. The new government intends to complete banking privatisation by 2000.

The intimate links between the banking and the enterprise sector were addressed by two sets of proposed amendments to the Banking Act. The amendments prohibit banks from holding controlling stakes in non-financial firms, and set limits on their exposure to these enterprises. Banks are also required to separate their commercial and investment banking arms to prevent

banks' equity positions from dictating lending policy. In the past, conflicts of interest between banks' roles as both lender and proprietor have encouraged the practice of soft lending, and have prevented banks from taking an assertive attitude towards debtors. Other changes to the Banking Act aim to strengthen the arm of the Czech National Bank as a supervisory power. Amendments have also been made to the Investment Funds Act. These are designed to improve the management of these funds, force the elimination of the weaker funds, and to reduce the perception of fraudulent behaviour on the part of investment managers. These amendments are hoped to encourage more active corporate governance by the financial sector.

In order to address concerns about the bad loan problem in the banking sector, the Czech National Bank has introduced more stringent loan classification and provisioning rules. The Czech National Bank is also pressing banks to be more assertive towards debtors, and to write-off more bad loans. Classified loans formed a very high 29% of the loan portfolio by the end of the first half of 1998.

A Securities Commission was established in 1998. Although it is still dependent on the State budget for financing, and does not have full regulatory authority (regulations must be passed through the Ministry of Finance to the government), it does have important enforcement powers, and has shown the willingness to use them in its first few months of operation.

Changes have also been made to bankruptcy laws in order to speed up bankruptcy procedures. In addition, the definition of insolvency has been widened and made more precise. In the past, the delays involved in the bankruptcy procedure, have dissuaded creditors from pursuing bad debtors. This has allowed the continued existence of some loss-making enterprises and an accumulation of bad debt by the banking sector.

Preparation for the privatisation of non-financial enterprises also continued under the caretaker government. Specific schedules for the privatisation of fifty or so strategic enterprises have been approved. In particular, consultants had been selected to handle the sales of the 16 gas and electricity distributors. However, it is not yet clear which of these privatisations will be pursued by the new government.

<b>Czech Republic: Main indicators of economic structure in 1997</b>		
Population	<i>million</i>	10.3
GDP per head	<i>PPS-ECU</i>	12000
as % of EU-15 average	<i>per cent</i>	63
Share of agriculture in:		
gross value added	<i>per cent</i>	5.0
employment	<i>per cent</i>	5.8
Investment-to-GDP ratio	<i>per cent</i>	31
Gross foreign debt/GDP	<i>per cent</i>	41
Exports of goods & services/GDP	<i>per cent</i>	58
Stock of foreign direct investment <sup>1</sup>	<i>billion ECU</i>	6.8
	<i>ECU per head</i>	657
<i>Source: Commission services, national sources, EBRD</i>		
<sup>1</sup> <i>FDI stock converted at end-1997 exchange rate of 1 ECU=\$1.10421</i>		

On 29 April, the Czech government approved a package of incentives for both foreign and domestic entities investing a minimum of ECU 22 million through a newly registered company. The package includes a five-year direct tax holiday, duty free technology imports, the possibility for the creation of duty free zones, and subsidies for training.

The appointment of a minority government after the elections held in late June 1998, is unlikely to lead to a major change in the direction of economic policy, although it could mean a slowing in the pace of some reform measures. One key development under the new government has been the appointment of a Deputy Prime Minister in charge of overall economic policy in order to improve economic policy co-ordination and consistency. One of the first tasks of the Deputy Prime Minister will be to draw up a medium-term economic strategy.

## **2.3 Assessment in terms of the Copenhagen criteria**

### *The existence of a functioning market economy*

The existence of a functioning market economy requires that prices, as well as trade are liberalised and that an enforceable legal system, including property rights, is in place. The performance of a market economy is enhanced by macroeconomic stability and consensus about economic policy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

The framework for a market economy is largely in place in the Czech Republic. Market forces freely determine the prices of a vast majority of goods. Price liberalisation has progressed rapidly in the last year. The trade and foreign exchange regimes have been broadly liberalised.

Private ownership is the dominant form of ownership. However, the state still retains significant stakes in a number of companies – this includes the energy distribution companies, mines, steel-mills and some of the large banks. So far, the new government has only made an explicit commitment to the completion of the privatisation of banks, which had been accelerated significantly by the previous interim government.

The land market has been liberalised, but significant amounts of agricultural land remain in state hands. There are still some obstacles to the development of a functioning market for land, for instance those related to agricultural co-operatives. The operation of the land register also needs to be improved.

The main institutions of a market economy have been established. However, despite recent amendments to the bankruptcy laws, there are still some deficiencies. The law does not allow the option of “work-out” bankruptcies. Moreover, bankruptcy proceedings are hampered by the lack of administrative capacity in the court system. Whilst recent changes are designed to increase the number of bankruptcy filings and speed up proceedings, they may merely lead to a bigger backlog in the courts.

The macroeconomic difficulties which emerged over the last year, illustrate that macroeconomic policies must be underpinned by structural reforms. The recent discovery of significant contingent liabilities for the state budget, which had been accumulated by off-

budget funds and institutions, calls into question the future sustainability of public finances. More attention should be paid to increasing the transparency of the public finances with a view to preventing a similar build-up of public debt in the future.

The failure of fiscal policy to address the problem of the widening current account deficit in a timely fashion illustrates some reluctance on the part of the fiscal authorities to take unpopular decisions. The central bank, on the other hand, has demonstrated that it is able and willing to take unpopular decisions if the need arises. In fact, the recent tough stance of the central bank has inspired calls for a reduction in central bank independence. Any such move would, of course, be considered to be a significant backwards step. Nonetheless, there is considerable scope for improvement in the co-ordination of monetary and fiscal policy within the current institutional set-up.

Even though there may be disagreements about the pace of reform, there seems to be a consensus about the general direction of economic policy. The recent progress with the drafting of a medium-term economic strategy should help to improve the co-ordination and consistency of economic policy.

One of the key weaknesses of the Czech economy continues to be the financial sector. A strong and efficient financial sector capable of efficiently channelling private sector savings into productive investment is key to the development of a strong market economy. At present, the Czech banking sector remains burdened by an important bad loans problem, with some banks more badly affected than others. Moreover, in the past, tax rules have discouraged high levels of provisioning.

The build up of a large number of classified loans in the Czech Republic has been due in part to the passive attitude that banks have adopted towards bad debtors. This should change somewhat with the privatisation of some of the larger state banks, the improvements in bankruptcy legislation, and the increased separation between the commercial and investment arms of banks. Nonetheless, the links between the banking and enterprise sectors remain strong, and continue to prevent a clean up of banks' portfolios, and a further acceleration of enterprise restructuring.

In the past the light regulatory framework and the wide variety of trading channels and practices led to the perception of non-transparent deals and price manipulation in the Czech capital market. The regulatory framework has been strengthened, and the establishment of the Securities Commission represents a considerable improvement. However, the capital market is still illiquid, does not encourage strong corporate governance, and is a negligible source of finance for commercial and industrial enterprises. The continued presence of divergent prices for the same stock due to the fragmented organisation of the securities market remains an important problem. The new Securities Commission needs to be made fully independent with regard to both revenue raising and regulatory power.

Although the Czech Republic can be considered to be a functioning market economy, there is still considerable scope for improvement. The recent worsening of the macroeconomic situation has highlighted the need for accelerated structural reform. This should include the completion of the privatisation programme, especially that of banks; further measures to improve corporate governance; a cleaning up of the banks' loan portfolios; and increases in the efficiency of the capital markets. There should be increased transparency in the public

accounts in order to prevent a further accumulation of liabilities by public institutions. It is also important that the authorities adopt policies to restore growth in the country and ensure sustainability of the external accounts over the medium-term. The current work on a medium-term economic strategy will be key in the elaboration of the necessary policy steps.

### *The Capacity to Cope with Competitive Pressure and Market Forces within the Union*

The Czech Republic ability to fulfil this criterion depends on the existence of a market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union prior to accession. Evidence of this is provided by both the volume and the range of products traded with EU's Member States .

The Czech Republic can be considered to be a functioning market economy, however further progress in structural reform is needed to improve its prospects for coping with competitive pressure in the Union in the medium-term. Macroeconomic policy has been conducted with a sufficient degree of predictability to allow proper decision making by economic agents.

Nevertheless, the current downturn in macroeconomic activity highlights the fact that to date, enterprise restructuring has not progressed as quickly and as effectively as might have been expected. Evidence of this includes the low number of completed bankruptcies, the relatively low rate of unemployment enjoyed by the country and the poor profitability of the enterprise sector.

The main obstacle to a more rapid increase in the competitiveness of the enterprise sector has been the relationship between the financial sector and the enterprise sector which has not fostered financial discipline. Moreover, the financial sector itself, especially the banking sector is still in need of further restructuring. Some of the largest banks, especially the state-owned banks are still burdened by a high proportion of bad loans, which are themselves a significant contingent liability for the state budget in the coming years. Privatisation of these banks is key to cleaning up their portfolios, and increasing their efficiency.

The acceleration of enterprise restructuring will be the challenge for the Czech Republic in the coming years, both for the restoration of strong economic growth and for the creation of a dynamic and competitive export sector. The recently announced reforms designed to improve corporate governance, and to clarify the role of the financial sector, are steps in the right direction.

The Czech Republic has enjoyed high overall levels of investment; fixed investment as a share of GDP has been around 30%. The country also has a skilled and educated workforce and relatively well developed infrastructure. However, these favourable factors do not seem to have led to consistently higher productivity growth as might have been expected, and this raises some questions about the suitability of investments undertaken by both private and public sector managers.

Although FDI inflows have been relatively strong, inflows of FDI have declined somewhat in the period under consideration. This is in part due to a decrease of investor confidence in the Czech Republic. To encourage investors back to the country, the authorities have announced a comprehensive package of incentives for investment. However, the restoration of macroeconomic stability and the continued implementation of structural reforms will be more important in restoring investor confidence.

One important indicator illustrating the competitiveness of Czech industry is the degree of trade integration already achieved with the EU. Trade integration is relatively high, with the EU accounting for around 60% of exports and 62% of imports in 1997. The Czech Republic's main exports and imports tend to be manufactured goods and machinery and transport equipment; these categories have increased in importance as a share of total exports to the EU. However, it is not currently exporting and importing similar range of products, which will be a clear indicator of competitiveness on the EU market. This reveals that much can still be done to improve the quality and competitiveness of exports. The modernisation of industry and the introduction of new technologies through the more widespread involvement of foreign investors, together with continued restructuring of enterprises, should lay the foundations for a more dynamic and competitive industrial sector.

Overall, recent developments have shown that progress in the area of structural reform has been insufficient. The current programme of reform measures designed to improve corporate governance and reduce the links between the financial and the enterprise sector, once fully implemented, will go a long way towards strengthening financial discipline and deepening enterprise restructuring. This will result in more efficient enterprise and banking sectors and will clear the way for sustained increases in productivity and greater competitiveness. The country can continue to be regarded as able to cope with competitive pressures and market forces within the Union in the medium term, provided that it vigorously implements its programme of reforms.

## **2.4. General Evaluation**

The Czech Republic can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that it improves corporate governance and accelerates enterprise restructuring.

Since the Opinion, there has been some progress on structural reform measures, including proposals for capital market reforms that will further encourage enterprise restructuring and improve the competitiveness of the Czech economy. The setting up of a Securities Commission is an important development, but should now be completed by making the body fully independent both with regard to regulatory power and finance.

Priority should now be given to further reform in the financial sector with a view to improving the framework for corporate governance and accelerating enterprise restructuring. The privatisation of the banking sector should be completed and changes to the banking acts should be implemented expeditiously. Banks should be encouraged to clean up their portfolios

and increase provisions. The authorities, in conjunction with the Securities Commission, should consider further measures to make capital markets more transparent and effective.

### **3. Ability to Assume the Obligations of Membership**

This section aims to up-date the Commission's Opinion of 1997 as concerns the Czech Republic's ability to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union puts into effect its objectives.

In the 1997 Commission's Opinion on the Czech Republic's application for EU-membership, the Commission concluded that

“If the Czech Republic continues its efforts on transposition of the *acquis* relating to the Single Market and intensifies work on its implementation, the Czech Republic should become capable in the medium term of applying it fully. The import deposit scheme will need to be resolved within the terms of the Europe Agreement. Particular effort, including investment, will be needed to meet the *acquis* in sectors such as agriculture, environment and energy”.

The presentation which follows uses the same structure as the 1997 Opinion, but the general descriptions of each sector have been omitted. Instead, the report focuses on progress made since July 1997. Under each heading legislative decisions and progress in implementing and enforcing the legislation are reported.

#### **3.1. Internal Market Without Frontiers**

As explained in the Opinion, the Union's internal market is defined in Article 7a of the Treaty as an area without internal frontiers in which the free movements of goods, persons, services and capital is ensured. This internal market, central to the integration process, is based on an open-market economy in which competition and economic and social cohesion must play a full part.

Effective implementation and enforcement of these four freedoms requires not only compliance with such important principles as, for example, non-discrimination or mutual recognition of national legislations but also the effective application of common rules, such as those designed for safety, environmental or consumer protection, and effective means of redress. The same principles apply to certain common rules, for example in the areas of public procurement, intellectual property and data protection, which are important in shaping the general framework within which the economies operate.

##### *General Framework*

No concrete progress was made in the area of public procurement, copyright law, industrial property rights or data protection.

There has been little progress since mid-1997 in the field of company law, apart from alignment with the 12<sup>th</sup> Directive.

Amendments to the 1991 accounting act, which already represents an important step in alignment with the Fourth Directive, will become effective on 1 January 1999. Amendments to the Act on Auditors implementing the Eighth Directive became effective on 1 January 1998. Certain transitional problems relating to the implementation in practice of the new rules are evident, including a shortage of qualified auditors.

### *The Four Freedoms*

#### **Free Movement of Goods**

In September 1997 the law on technical requirements for products and conformity assessment entered into force. This framework law aims at implementing the Community's New Approach and formed the legal basis for the subsequent entry into force of implementing decrees in the mechanical, electrical, medical, toys, gas appliance, simple pressure vessels and construction products sectors. Certain gaps with the *acquis* remain, including the definition of standards, of the person responsible for putting a 'safe product' on the market, market surveillance and CE marking. The law achieves the necessary separation between the functions of legislation (Czech Office for Standardisation, Metrology and Testing), standardisation (Czech Standardisation Institute) and certification (previously in the hands of the Czech Office for Standardisation, Metrology and Testing, currently performed by independent third bodies). The law on liability for damage caused by defective products entered into force on 1 June 1998. It is not fully in line with Community law.

The adoption of EN harmonised standards as Czech standards has almost been completed. The Czech Standardisation Institute is a full member of CEN, Cenelec and ETSI.

In 1997, progress was made in the implementation of the New approach Directives, where mechanical, electrical, medical, toys, gas appliances, simple pressure vessels and construction products Directives were partially transposed.

No progress has been made in the sectors relating to the EC Directives on legal metrology, pre-packaging and gas cylinders.

The Act on Foodstuffs was adopted in 1997. It was complemented by a number of executive decrees, and mainly concerned, specific foodstuffs and horizontal requirements such as labelling, foodstuffs intended for special nutrition and food control. The Act on Pharmaceuticals was adopted in 1997 and will be implemented by a number of executive decrees concerning registration, labelling, classification and good distribution practices.

In 1998 a government decree was adopted on cosmetic products. Further alignment of technical legislation was achieved by the adoption in the same year of new law on chemical substances and chemical preparations (covering also detergents and good laboratory practises), on fertilisers and on narcotic drugs, psychotropic substances and precursors.

#### **Free Movement of Capital**

The Opinion concluded that the Czech Republic had already achieved a very substantial degree of capital movement liberalisation. The government continued in this direction with the approval in May 1998 of changes to the Foreign Exchange Act, which should enter into force in 1999. These will have liberalising effects in the area of financial credits and guarantees, issuing of foreign securities on the Czech market, operations in money market instruments and derivatives and purchase abroad of currency by residents.

On 1 September 1998 an amendment to the Czech Lottery Law entered into force which prevents Czech companies with foreign capital interest from receiving licenses to operate lotteries “and similar games” (the latter comprising a number of marketing activities such as consumer competitions or prize games). The amendment is a breach of the provisions on the movement of capital in the Europe Agreement and the new government has submitted an amendment to Parliament in October.

### **Free Movement of Services**

The same gaps in Czech banking legislation that were identified in the 1997 Opinion remain (banking accounts, consolidated supervision, capital adequacy).

Existing legislation was modified by two amendments. The first amendment, which entered into force in February 1998, prohibits banks from holding controlling stakes in companies other than banks, financial institutions and companies providing banking support services. It also requires banks to separate their commercial and investment banking divisions. The second amendment, which entered into force on 1 September 1998, tightens the terms for granting a banking license, broadens obligations on public information, provides the same treatment of domestic and foreign investors in acquiring shares in banks and improves the deposit insurance system. These amendments constitute a step forward in aligning Czech legislation with the Second Banking Directive.

One of the four remaining state-owned banks was privatised in March 1998. Preparations for the privatisation of the three other banks are continuing. The new government is committed to completing the process by 2000.

Although the Czech Republic has already a relatively developed payments system, further improvements are still needed to implement the real-time gross settlement system.

The continuing existence of anonymous savings accounts, in contradiction with the provisions of the EC money-laundering directive, remains a concern. Moreover implementation is hampered by lack of qualified staff.

The Czech Republic has recently started approximating its legislation to the *acquis* in the field of securities markets and investment services. On 1 April 1998 the Securities Commission Act entered into force, establishing a Securities Commission charged with the supervision of the capital markets. Its independence and regulatory powers need to be strengthened. In May 1998 the Stock Exchange adopted a “System for the Support of the Markets with Shares and Bonds” (SPAD) with the aim of improving transparency and liquidity. Parliament approved an amendment to the Act on Investment Funds and Companies, which entered into force in June 1998. This obliges Investment Funds to reduce their holdings in companies and to take measures for the protection of minority shareholders.

Despite these improvements, Czech capital markets do not provide sufficient capital for companies. This is due in part to the non-existence of initial public offerings, the illiquid secondary market and weaknesses in the judiciary.

No progress can be reported on alignment in the insurance sector. The former State Monopoly continues to have a high but gradually decreasing market share of 60%.

The supervisory authority in the Ministry of Finance remains weak.

### **Free Movement of Persons**

No further developments can be reported in this area.

### *Competition*

There have been no new developments in anti-trust legislation, which is already largely in line with the *acquis*. Gaps which remain in the current legislation concern restrictive agreements, definition and notification of mergers and market dominance.

No real progress has been made in establishing a proper legal framework for state aid control. The current budgetary rules stipulate that subsidies may be provided to legal persons and natural persons operating a business, without further qualification on the requirement that these subsidies should be compatible with the Europe Agreement. The annual report on State aid granted in 1996 was submitted to the Commission in July 1998. The report broadly follows the methodology and the presentation of the Commission's survey on State aid in the Union. The official body responsible for the monitoring of state aids is the State Aids Monitoring Authority, which is a unit in the Ministry of Finance.

In June 1998 the Association Council adopted the Implementing Rules for State Aids foreseen in Article 64 of the Europe Agreement. These facilitate consultation and exchange of information between the Commission and the State Aid Monitoring Authority.

### **Conclusion**

The Czech Republic's record in meeting the short-term priorities of the Accession Partnership is insufficient. Progress has been made in the fields of standardisation and certification, industrial property rights and accounting.

Some progress was achieved in the securities sector, to a lesser extent also in the banking sector.

No progress was recorded in the areas of public procurement, copyright, data protection, insurance, anti-trust and state-aids.

## **3.2. Innovation**

## *Information Society*

In July 1998 the Czech Government adopted guidelines for a national policy on the information society which is inspired by EU policy in this area.

The Czech Republic participates in the joint High-Level Committee on the Information Society and actively supports the development of the information society.

## *Education, Training and Youth*

A new Act on Higher Education was adopted in 1998. It addresses problems highlighted in the Opinion concerning the Czech higher education system, such as the non-existence of private universities, the underdeveloped non-university sector (schools providing only bachelor studies), improvement of university management and financing.

Since 1 October 1997 the country has been fully participating in the Socrates, Leonardo da Vinci and Youth for Europe III educational programmes

## *Research and Technological Development*

In December 1997, the Czech Republic asked for full association with the Fifth Framework Programme. Three rounds of exploratory talks aiming at preparing the negotiations have already taken place.

Research is mentioned as a priority in the National Programme for the Adoption of the *Acquis*.

On 10 June 1998 the Government approved a policy document intended to lay the basis for a national Research and Technological Development policy, which will facilitate Czech participation in the above programme.

## *Telecommunications*

Little progress has been achieved in aligning Czech legislation to the *acquis* in the telecommunications field. In October 1997, in line with the requirements of the Interconnection Directive, the operating licenses of SPT Telecom was amended so as to impose obligations concerning the interconnection of networks. In November 1997, the authorities issued a set of general licenses and published a "unified rule" concerning the public telephone network's numbering plan and another concerning the National Frequency Table. The Czech Republic needs to continue its efforts in this area, in particular concerning the establishment of a separate and independent regulator.

No progress activity can be reported concerning postal services.

## *Audio-visual*

The Opinion concluded that Czech legislation was not compatible with the Community TV without frontiers directive. No progress has been made in this area.

### **Conclusion**

While attention has been paid to developing policies and programmes in the information society, education and training and research and technological development areas, no progress has been made in either the telecommunications or audio-visual fields. In the latter, the Czech Republic has requested a transitional arrangement until 2005 for pay and cable television. .

### **3.3. Economic and Fiscal Affairs**

#### *Economic and Monetary Union*

The Czech Republic has made little additional progress in preparing itself for participation in the Economic and Monetary Union.

At the end of 1997, the Czech National Bank changed the framework for monetary policy by moving to direct inflation targeting, and set targets for net inflation (consumer price inflation excluding the direct impact of administrative price changes). The exchange rate regime remains a managed float.

Significant problems still remain in the financial sector, especially in the banking sector, which suffers from an acute problem of bad loans. In order to create a sound and competitive banking sector, the remaining state-owned banks need to be privatised.

No changes have been made to the central bank legislation - this needs to be made compatible with EC rules.

#### *Taxation*

The Czech Republic has not given priority to alignment of its VAT legislation with the *acquis*. The same can be said for legislation on excise duties where significant discrepancies continue between the Czech excise system and Community requirements. There are no indications that efforts have been made to improve the functioning of the administration in these sectors.

#### *Statistics*

Alignment with the *acquis* is progressing well. Special attention needs to be paid to the upgrading of the quality and coverage of the business register, improvement of government finance statistics, improvement of structural business statistics and agricultural statistics. The consequences for regional statistics of the establishment of 14 regions in 2000 need to be taken into account.

The administrative structures to implement and enforce the statistical *acquis* are largely in place, but the coordinating role of the Statistical Office should be strengthened.

### **3.4. Sectoral Policies**

#### *Industry*

Privatisation in the industrial sector is already quite advanced. In 1997 the share of the private sector in GDP rose to 78%. However, some 50 strategic enterprises, including utilities, continue to be owned by the National Property Fund.

A number of measures taken by the government since July 1997, and described elsewhere in this report, aim at speeding up the restructuring process and at improving the competitiveness of Czech industry. The most important are : the amendment of the Bankruptcy law of January 1998, the start of the privatisation of the four largest banks and the government's commitment to complete this by the year 2000, the separation of the investment and commercial activities of banks, the limits on banks' participation in non-financial enterprises and the establishment of a Securities Commission; the obligation for investment funds to reduce their ownership in companies.

These measures are important because until now the role of the partially state owned banks in the Czech economy and the complex ownership structure of industry have negatively affected industrial restructuring. No real efforts have been made to restructure the steel or other heavy industries.

#### **Conclusion**

Efforts are needed to progress on the privatisation of strategic enterprises and to continue the process of enterprise restructuring, particularly in steel and other heavy industries.

#### *Agriculture*

##### **Agricultural situation**

In 1997 the share of agriculture was around 3% of GDP and the share in employment around 4%. Between 1996 and 1997 agriculture production decreased from Ecu 2.25 billion to Ecu 2.11 billion which equals 70% of the pre-transition level. Crop production decreased from Ecu 1.01 billion to Ecu 0.98 billion and livestock production from CZK 44.5 to 40.8 billion. Estimates for 1998 point to a further decrease in agricultural production.

##### **Agricultural policy**

The Opinion identified a number of areas in the agricultural sector requiring particular attention, such as the strengthening of administrative structures to ensure the necessary capacity to implement and enforce policy instruments of the Common Agriculture Policy; solving the difficulties which have arisen in the application of the trade provisions of the

Europe Agreement; alignment with the veterinary and phytosanitary *acquis*; and the further restructuring of the agri-food sector to improve its competitive capacity.

Czech phyto-sanitary and veterinary legislation are in general close to the EU's. New legislation on potato sprout suppressants represents a small but important step forward in phytosanitary alignment.. Further steps need to be undertaken in order to develop the necessary administrative capacity to apply the *acquis*.

Areas where progress in harmonisation of Czech legislation with the *acquis* was achieved are nutrition labelling, foodstuff hygiene, quick frozen foodstuffs and foodstuffs for particular nutritional uses. In the field of animal welfare a relatively high-level of compatibility was reached in the area of breeding and use of laboratory animals.

No progress can be reported on efforts to increase the competitiveness of the agri-food sector.

In the context of its preparations for the participation in the Structural Funds the Ministry has identified a number of areas with poor natural conditions and low socio-economic potential, which are intended to benefit from future assistance.

No progress was achieved in the improvement of the functioning of the administrative structures, of the Ministry of Agriculture, to ensure the preparation for and implementation and enforcement of the policy instruments of the CAP.

## **Conclusion**

Little progress was made in the short term priority on reinforcement of institutional and administrative capacity in agriculture and further efforts are needed here. Efforts to align Czech legislation with the *acquis* need to be stepped up, in particular in the phytosanitary and veterinary fields.

## *Fisheries*

No developments can be reported in this area.

## *Energy*

Czech alignment with the energy *acquis* is continuing. Energy prices have been further increased. In January 1998 an Energy Regulatory Administration was established. It should be transformed into an independent regulator in a future internal energy market. The government is expected to present shortly a new restructuring plan for the solid fuels sector. Currently CZK 3 billion per annum are spent on mainly the social aspects of restructuring in the solid fuel sector.

In the nuclear sector, the Atomic Law went into force in July 1997 and secondary legislation needs to be adopted. At the end of 1997 an Agency for Radio-active Waste Management was set up. A Nuclear Account, funded by a percentage of the electricity price, was established to

finance the cost of disposal of spent fuel and decommissioning. The dry storage facility set up at the Dukovany nuclear power plant, is expected to be full by 2005.

## **Conclusion**

Further efforts should be undertaken to prepare for the internal energy market, including the adjustment of monopolies, access to networks and energy pricing; emergency preparedness including the building up of mandatory oil stocks; state interventions in the solid fuels and uranium sectors and the development of energy efficiency and fuel quality standards.

Adequate attention should be paid to the respect of nuclear safety standards in order to bring all the nuclear power plants to the required safety level. In this respect it is important that the delays and cost overruns at the Temelin nuclear power plant do not affect the upgrading programme foreseen for Dukovany. Long term solutions for nuclear waste have to be developed.

## *Transport*

In June 1998 the government adopted a resolution which includes an action programme for a new national transport policy. This document stipulates the conditions, goals and instruments related to the transport sector, including the infrastructure, social and environmental aspects.

An amendment to the road transport act of 1994 came into effect in April 1998. It introduces inter alia the concept of 'financial fitness' for hauliers operating in international road transport. This provision will only come into effect in January 2000. Further work appears to be necessary as regards inspection of vehicles. No progress can be reported for civil aviation. Concerning the restructuring of the state-owned railways the government, on 22 April 1998, approved a resolution outlining the measures which should accompany the restructuring programme which it had approved in 1997. Alignment with the railway *acquis* remains also necessary.

As regards transport infrastructure, the Czech Republic is particularly interested in improving its links with neighbouring countries through the completion of road and railway projects in Corridors IV and VI. The construction of the motorway D5 (Prague-German border) was completed in November 1997. Reconstruction of the railway corridors I and II is advancing. The country is participating actively in the Transport Infrastructure Needs Assessment (TINA) exercise.

### **Conclusion**

Alignment efforts need to be stepped up in the area of road transport (market access, safety and taxation) and civil aviation. It is important that sufficient financing remains available for investment in transport infrastructure. The railway system needs to be restructured.

## *Small & Medium Enterprises*

Apart from the Czech Republic's participation, from 1998 on, in the Community's third SME Programme for the period 1997-2000 no further measures have been taken since July 1997 to align Czech SME policy to that of the Union.

### **3.5. Economic & Social Cohesion**

#### *Employment and Social Affairs*

By the end of May 1998, unemployment had risen to 5.4% compared with 4% in June 1997. This trend appears to be continuing. In response, a framework for action in 1998-2000 has been drawn up by the authorities along the lines of the EU employment guidelines; and the authorities are making concrete preparations for a joint employment review with the Commission, as envisaged in the Accession Partnership.

No legislation has been adopted in the reference period to transpose EU provisions in the fields of labour law, equal opportunities, health and safety or tobacco products. As regards equal opportunities for women and men, in the first half of 1998 the Ministry of Labour &

Social Affairs was given formal responsibility for cross-government co-ordination of equal opportunities issues. As regards health and safety at the workplace, as well as labour law, the authorities have drawn up a plan on how to proceed in transposing legislation and have provided a realistic timetable for this covering the period 1998-2003, except for the Insolvency Directive. On this question further work is required.

The Czech Republic has applied to participate in the four available Community Public Health Programmes and the Fourth Community Action Programme on Equal Opportunities from 1999.

### **Conclusion**

No specific legislative progress has been made in this area

### *Regional Policy and Cohesion*

The Opinion concluded that the Czech Republic needed to achieve greater progress on the establishment of a legal, administrative and budgetary framework for regional policy. Since then good progress has been achieved.

In November 1997 a separate Ministry for Regional Development was established. The Ministry is also responsible for the preparation for EU structural policy and inter-ministerial co-ordination. On 8 April 1998 the Government adopted a resolution outlining principles for regional policy in the Czech Republic and calling for the establishment of a regional development strategy and related legislation by mid 1999. In December 1997 the Czech Parliament approved the establishment of 14 regions.

Current financial instruments for regional policy are limited. Financial procedures, monitoring and control procedures are weak.

### **Conclusion**

The Czech Republic has made progress in its preparation to participate in EU structural policy, particularly in the institutional field. Efforts in this area should continue and should be speeded up in the legislative field.

## **3.6. Quality of Life and Environment**

### *Environment*

Since 1997 Parliament adopted the following major pieces of legislation : an act on the import and export of endangered species, two framework acts on waste management and nuclear issues, the act on the right to environmental information and an act on chemical substances and preparations. In addition, existing acts have been amended and a number of decrees and regulations have been issued in the water and waste sectors, not all of them linked to requirements resulting directly from the *acquis*.

For full compliance in the waste sector, a number of specific waste directives, such as on waste oils, batteries and packaging waste still have to be transposed. The same is true for the nuclear sector, where further implementing legislation on information to the public, emergency preparedness and the shipment of radioactive waste is required.

Future legislation is urgently needed in the water sector and for industrial pollution. Although work on directive-specific implementation programmes has started, it will be crucial to bridge the gap between policy intentions and actual implementation. This is particularly true for the financing aspects of compliance with the *acquis* since the current fine system will not be sufficient to provide the necessary means.

## **Conclusion**

Limited progress has been made in meeting the environment short term priorities of the Accession Partnership. Considerable efforts remain necessary to align Czech environmental legislation with the *acquis*, particularly with respect to industrial pollution and the water sector. Substantial efforts will be needed to achieve effective compliance with the *acquis*, which will require considerable investment, in cooperation with the international financial institutions and administrative efforts.

### *Consumer Protection*

Czech legislative alignment with the consumer protection *acquis* is progressing rather slowly. Legislation on general Product Safety provides very limited alignment and is there no legislation on Dangerous Imitations. The new act on Liability for Damage caused by Defective Products is not in line with Community legislation. Legislation on Misleading Advertising and on Price Indications need further alignment.

The Ministry of Industry and Trade, which has the overall responsibility for consumer affairs, has recently established a Department of Domestic Trade and Consumer Policy, which includes a unit for Consumer Policy.

The Czech Republic needs to make substantial efforts in this field, including the improvement of structures.

### **3.7. Justice and Home Affairs**

In its Opinion in July 1997 the Commission noted that drafts of most of the outstanding legislation were being prepared. The areas concerned were border controls, measures to combat organised crime and the provision of adequate human and other resources for the police and judiciary.

#### *Immigration /border control*

The Czech Republic has not yet adopted either a new law on aliens or any concrete measures which would bring management of borders into line with EU rules.

However, an interdepartmental committee has been set up under the Minister for Home Affairs to pave the way for adaptation of the *acquis*, and the ministry has drafted two "strategic" documents on measures to improve border management and control immigration.

#### *Asylum*

The first step in the reform of the procedure for examining asylum requests came into force on 1 October. Initial appraisal is now carried out by the Ministry of the Interior's Department for Refugees rather than the Border and Aliens Police. The new appeals body is still part of the Ministry of the Interior but now involves NGO representatives and lawyers. These reforms are to be enacted in the planned asylum law, which has not yet been adopted.

#### *Police*

The government laid down its strategy for tackling organised crime in a resolution adopted on 29 October last year, with a timetable running up to the year 2000. An initial review of results was put in hand on 30 June. Further work is needed on the legislative framework on money laundering, and the Financial Unit needs to be strengthened.

On 23 September the government set up a ministerial committee for the protection of economic interests; this constitutes an important step forward in the fight against corruption and economic crime.

#### *Drugs*

On 23 February the government adopted a resolution laying down its policy on drugs for the period 1998-2000. The criminal law was amended in June, making possession of illicit drugs a criminal offence and imposing administrative and criminal penalties even for personal use. Parliament has adopted a law on precursors, which will come into force on 1 January.

For the purposes of participation in the European Monitoring Centre for Drugs and Drug Addiction, more information is needed about the function and administrative position of the National Contact Point for Drug Information.

#### *Judicial cooperation*

On the civilian side the Czech Republic has secured the necessary sponsorship by a contracting party to accede to the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters. A number of other contracting parties have already agreed.

There has been no significant progress on the criminal side, and efforts to improve the efficiency of the judicial system appear inadequate, particularly as regards the training of the judiciary.

## **Conclusion**

There has been a marked slowing down in the rate of progress required to adjust to the EU *acquis*. The short-term priority of improved border control has not been achieved. The new government must now apply itself to carrying out its intentions and press ahead with reforms to meet the medium-term priorities of the Accession Partnership, specifically:

- more efficient border controls and the adoption of new laws on asylum and migration, including adjustment of visa policy, to comply with EU standards;
- stronger action against drugs, organised crime (especially money laundering and trafficking in human beings) and corruption, with adequate resources allocated to enable the police and courts to operate effectively and receive the training they need to cope with the challenges facing them.

## **3.8. External Policies**

### *Trade & International Economic Relations*

Coordination between the Czech Republic and the Commission has been enhanced over the last year with increasing contact on both bilateral and WTO matters.

The Czech Republic has continued its policy of enlarging the group of countries with which it has concluded free trade agreements and contributing to the expansion of the Central European Free Trade Association. Since last year's Opinion it has concluded free trade agreements with the following countries : Lithuania; Latvia; Israel; Estonia; Turkey. In February it has started consultations with Morocco on a free trade agreement. The possibility of concluding preferential agreements with Malta and Cyprus is under consideration.

In the area of foreign trade with third countries the Czech Republic continues its policy of aligning itself with the *acquis*.

### *Development*

Since July 1997 the Czech Republic continued with its foreign development assistance through its Humanitarian Assistance budget of Ecu 830.000 and Foreign Development Assistance budget of Ecu 9.05million. Bilateral assistance accounts for 2/3 of these amounts and multilateral assistance for 1/3.

### *Customs*

In July 1998 two implementing regulations relating to directives on relief from import duties entered into force. In mid-1998 legislation was adopted aiming at alignment in the areas of customs regimes with an economic impact (“outward processing procedure”), customs valuation of goods and suspensive arrangements (relating to customs duties and quotas applied to third countries).

As part of a modernisation strategy the customs services dealing with fraud have been strengthened. As of July 1997 a pre-accession unit has become operational. Computerisation of the Czech customs is progressing well. The Czech Republic wishes to participate in the Community’s Mattheus programme for the training of customs officials.

## **Conclusion**

Alignment to the *acquis* is progressing satisfactorily.

### *Common Foreign and Security Policy*

The Czech Republic has continued to participate actively in the multilateral political dialogue within the framework of the Common Foreign Security Policy (CFSP) since July 1997. It participates in the regular meetings of political directors, European and associate European correspondents and in CFSP working groups. It has regularly aligned its positions with those of the Union and, whenever invited, it has adhered to the Union’s statements, declarations and démarches, including in the context of the UN and OSCE.

In December 1997 the NATO Ministerial Session approved the Accession Protocol for the Czech Republic. The Czech Parliament approved Nato membership on 15 April 1998.

The Czech Republic’s relations with its neighbours remain good. One issue still to be resolved between the Czech Republic and Slovakia is the division of part of the state assets of the former Czech and Slovak Federal Republic.

Czech alignment with the CFSP *acquis* has continued to progress smoothly.

### **3.9. Financial Questions**

#### *Financial Control*

With regard to external financial control, no particular development can be reported.

Concerning internal financial control, some progress has been achieved since the Opinion, which highlighted this area as problematic. In May 1998 the Ministry of Finance created a Unit of Methodology and Financial Control to improve cooperation and coordination with the control units in other ministries.

The Administrative Cooperation agreement with the Commission (June 1998) will provide cooperation measures on public internal control and will support the pre-accession.

#### **Conclusion**

Due to the importance of the sector, and in the perspective of the management of pre-accession funds and Structural Funds in the future, it is essential that current efforts are reinforced for establishing an effective internal financial control system. The 1998 National Programme for the Adoption of the *Acquis* provides for a well-defined plan with short and medium-term objectives.

### **3.10 General Evaluation**

The Czech Republic has made only little progress in the overall approximation process since the Opinion. In regard to the internal market, good progress was made in the area of standards and certification and to a lesser extent in banking and capital market supervision. Although the Czech Republic started from a solid base, no progress has been made in other key internal market areas such as intellectual property, public procurement, data protection, audio-visual, insurance and state aid control. The slow down in the approximation and institution building process has been equally felt in the JHA field.

While the Czech Republic has addressed short term Accession Partnership priorities in the macroeconomic area, banking and financial sector, standards and certification, regional development and veterinary areas, it has not satisfactorily addressed priorities in the areas of industrial restructuring, administrative capacity, the internal market (alignment of intellectual property, anti-trust and state aid legislation) and JHA (border enforcement, judiciary).

## **4. Administrative capacity to apply the *acquis***

This chapter updates the information given in the Opinion. The European Council in Madrid in December 1995 referred to the need to create the conditions for the gradual, harmonious integration of the candidates, particularly through the adjustment of their administrative structures. Taking up this theme, Agenda 2000 underlined the importance of incorporating Community legislation into national legislation effectively, but the even greater importance of implementing it properly in the field, via the appropriate administrative and judicial

structures. This is an essential pre-condition for creating the mutual trust indispensable for future membership.

In this year's report the Commission has worked with the candidate countries to identify an illustrative list of enforcement bodies in key areas of the *acquis*. Wherever possible information is provided on whether these bodies have sufficient legal powers to implement the *acquis*, on staffing levels and on staff qualifications and on budget availability. In some cases it is already possible to give information on the quality of decisions being taken. The Commission intends to further develop this aspect in future reports.

In its Opinion the Commission concluded that further progress is still required to ensure the effective application of the *acquis*.

#### **4.1. Administrative structures**

It is regrettable that little progress has been made in public administration reform since July 1997.

The absence of a civil service law, low remuneration and the lack of civil service-wide training, combined with insufficient government attention to these issues, impede the development of a modern effective administration capable of applying the *acquis*.

A positive development was the government's adoption on 23 March 1998 of a resolution laying down an indicative time-table for the reform of the public administration. There has been slippage in regard to the proposed deadlines therein.

The new Government has made public administration reform one of its main priorities and has taken some encouraging steps responsibility for public administration has been clarified, and salaries are being increased.

There is a Government Committee for European Integration. The new government has appointed a Deputy Prime Minister as chairman. The Committee is supported by a Working Committee of senior officials and by 30 specialised working groups.

The Ministry of Foreign Affairs is responsible for the coordination of relations with the Union, including the preparation of the accession negotiations.

In July 1998, the Chamber of Deputies decided to establish a Committee for European integration and the Senate Foreign Affairs and Security Committee recently set up a Subcommittee to deal with European integration questions.

## 4.2 Administrative and judicial capacity : key areas for implementation of the *acquis*:

**The uniform application of Community law:** The judiciary still faces considerable problems, including a large number of vacancies for judges (390 out of a total of 2 726).

The preparation of judges in Community matters progresses very slowly. Training in Community law is not required to become a judge. The Institute for further Training of Judges, is currently implementing the first major Phare project for training of judges in EC law (100 judges). It is essential that such training is widened to include more judges over a sustained period.

The Ministry of Justice has a specialised department for the compatibility of EC law which has a staff of 8.

**Single market :** - In the area of standardisation and certification, the Czech Office for Standards, Metrology and Testing (COMST) is the central state administration responsible for legislation in the field of industrial goods. It performs its duties independently of the Ministry of Industry and Trade, to which it is formally subordinated. The Office has four Departments: International affairs (including an EU Section), Legal and Conformity Assessment, Metrology and Administration. The Office has a staff of more than 60 people. Its equipment is generally of good quality and the technical competence of the Office as a whole does not seem to be disputed.

In 1997 the Standardisation Institute, the independent national standardisation body set up in September 1997, replaced COMST as the Czech member of CEN and CENELEC.

About half of the testing laboratories have been privatised. Nevertheless the State keeps several strategic laboratories for security reasons, until a monitoring system for the privatised laboratories becomes fully operational.

The Czech Accreditation Institute, which accredits testing laboratories, has the status of an independent company, with only the chairman being appointed by the Ministry of Industry and Trade. The Institute is full member of EAC since June 1998.

Inspection bodies in the area of industrial goods are defined by law and fall under the responsibility of various ministries (Czech Foodstuffs Inspection, Veterinary Inspection, etc.). The Ministry of Industry supervises the Czech Trade Inspection which performs market surveillance.

The Czech Republic has achieved the necessary separation between legislative, regulatory, and market surveillance functions. Its standardisation and certification sector appears generally to be well prepared for membership, both in terms of personnel and technical equipment. This is also demonstrated by the country's full membership of CEN and CENELEC.

- The Czech Industrial Property Office is responsible for the administrative enforcement of industrial property rights and functions satisfactorily. However, border enforcement, which is the shared responsibility of police, customs, and the judiciary, must be improved.
- Public procurement is the responsibility of the Office for the Protection of Economic Competition. In 1997, the Office dealt with 324 administrative proceedings and issued 287 decisions.
- No steps have been taken to set up an independent body for the supervision of data protection.
- Banking supervision is the responsibility of the Czech National Bank. Its supervisory department has recently been reorganised to make it more effective. Its staff of 86 should be increased to 106 before the end of the year. The scope of the Banks supervisory activities needs to be broadened to cover all aspects of the *acquis*.
- The new Securities Commission (SEC) became operational in April 1998 and took over supervision of capital markets from the former Securities Office at the Finance Ministry. The SEC can impose fines, prevent the trading and movement of securities and freeze financial means. It has a staff of 120. In the first three months of its activity, the Commission made 119 decisions, performed 24 inspections and adopted 42 remedial measures. It imposed Ecu 1.02 million worth of fines. Forced administration was imposed on one investment company and three investment funds.

The setting up of the Securities Commission is an important step forward. It has made rapid progress in pursuing cases, although its independence and regulatory authority need to be strengthened.

- The supervisory body for the insurance sector is the Insurance and Pension Scheme Department of the Ministry of Finance, which has a very small staff. Supervision in this field remains very weak.

**Competition :** The Office for the protection of Economic Competition is responsible for anti-trust policy. It has a staff of around 150. In 1997, the majority of the Office's 180 administrative proceedings, dealt with concentrations. There were 37 appeals. Fines imposed during 1997 amounted to Ecu 291.527.

The State Aid Monitoring Authority is a unit of the Ministry of Finance. It has a very small staff. For the moment the monitoring authority does not have competence to assess the compatibility with the state aid rules of all aid given by all aid granting authorities. Its responsibility and staff levels need to be reinforced. The independence of the Monitoring Authority should also be ensured.

**Telecommunications :** The Czech Telecommunication Office (CTO), is the regulatory body and has a staff of 490. No steps have been taken yet to make it legally separate and to ensure effective structural separation from activities associated with ownership or control of commercial operations.

The Ministry, including the CTO has 752 staff.

**Customs and indirect taxation :** Both the tax and the customs administrations are part of the Ministry of Finance. The Directorate General for Customs has a staff of 9.300 and 8 regional offices. Computerisation is progressing well. The tax administration has a total staff of 14.200 divided over the Central and Financial Tax Directorate (180) and district and local offices. Of the total number 8.000 are tax administrators.

The performance of the customs administration has improved, although delays in processing remain a problem. Border enforcement for industrial and intellectual property rights needs to be reinforced.

**Agriculture :** The Ministry of Agriculture has a staff of 932 and 400 are employed in regional offices. The Ministry has a European integration unit. The organisation, management and training of the Ministry needs to be improved in order to be able to better prepare Czech agriculture for accession.

- The State Veterinary Inspectorate employs 1755 people, including 400 veterinary offices and 600 meat inspectors. Its structures for veterinary control and inspection are well established and generally function well, both in the country and at the border.

The facilities at border inspection posts (BIPs) and testing laboratories appear to be adequate to carry out controls and testing according to internal market requirements. The computerised network between the veterinary BIPs and the central veterinary services is well-established, but must be completed. Procedures, frequencies and results of veterinary checks at external borders are similar to those applied in EU Member States. Testing and inspection facilities however need to be upgraded.

- The State Phytosanitary Administration has a total staff of 494, of which 139 in headquarters. It has 7 regional offices, 72 district offices, 7 district laboratories and 24 border inspection posts. The poor equipment of district offices and district laboratories needs to be addressed. The communication structures between headquarters and districts need improvement.

- The Czech Agriculture and Food Inspection has a generally well qualified staff of 432 and appears to be functioning well. It has a network of 21 border inspection posts in which 65 inspectors are employed.

**Transport :** The Ministry of Transport and Communications has a staff of 752 employees, including the Telecommunication Office with 490 people. The Ministry has upgraded its European section to a Department without increasing its staff of 4. It lacks qualified staff for European affairs and harmonisation of legislation.

**Employment and Social policy :** The Ministry of Labour & Social Affairs has a staff of 542.

Enforcement of health and safety at work provisions is in large part the responsibility of the Czech Occupational Safety Office (COSO) and its 8 Labour Safety Inspectorates. COSO is

backed by an Institute of Technical Inspection, a Research Institute of Occupational Safety and an Institute of Occupational Safety Education (IOSE). COSO has a staff of 449, 268 of whom are labour inspectors. Staff training is regularly organised by IOSE. A particular concern is co-ordination between the Ministries of Labour & Social Affairs and of Health, and of their respective agencies (COSO and the hygiene services). Whilst figures for 1997 suggest that COSO is operating to reasonable effect, the hygiene services in particular are rather poorly equipped and in need of modernisation.

**Regional policy and cohesion :** The Ministry for Regional Development, set up in November 1996, employs 450 people, including 100 persons in semi-autonomous bodies of the ministry. The Government made the Ministry the co-ordinator for the preparation of the country for participation in Structural Funds. The number of staff for this coordination function is not sufficient.

The country's regional programmes will be implemented through Regional Development Agencies. However, many of them have not yet been established.

**Environment :** The Ministry of the Environment has a staff of about 460 people. There is no specific unit dealing exclusively with the EU approximation process. Enforcement is carried out by the Czech Environmental Inspectorate (CEI). The CEI has a national head office and ten regional offices employing in total a staff of 420 people, 280 of them being inspectors. Overall the technical infrastructure for implementing environmental legislation, such as data collection and environmental monitoring, is of relatively high standard in the Czech Republic.

A new agency for radioactive waste management was created in 1998.

For the time being, the approximation process is mainly dealt with at the national level. It is too early to assess the impact of the envisaged regionalisation on environmental approximation.

**Consumer protection :** In August 1998 the Ministry of Industry and Trade, which has the overall responsibility for consumer affairs, created the department of Domestic Trade and Consumer Policy, with a Consumer Policy Unit. This is a positive development, although the Unit's staff of 7 might not be sufficient.

**Justice and Home Affairs :** The Ministry of Justice is composed of three main departments (legislative; codification of law; economic matters) and has a number of independent sections, such as the one for prisons, the institute for criminology and the penal register. The ministry's staff totals 284. One of three departments is responsible for the organisation of the courts and prosecutors" and has certain administrative responsibilities for these two bodies. The setting up of a unit responsible for relations with the EU is a positive development, as is the recent establishment of good relations between the Ministry and the Union of judges and the Association of State prosecutors.

The Alien and Border Police, which falls under the responsibility of the Ministry of the Interior, has a staff of some 6300, of which 50% have been newly recruited since 1990.

Complicated communication structures result in overlapping responsibilities and loss of information.

There are 40,000 police officers. Staff-skills and the distribution of tasks between police officers and civil employees, should be improved. Many tasks, that can easily be done by civil staff, are carried out by executive police officers.

**Financial Control :** - The Supreme Audit Office (SAO) is the independent external control authority responsible for controlling the State budget and the management of State assets. It has a staff of 490, including around 200 regional auditors. The SAO is answerable only to Parliament. It is entitled to request corrective measures, but has no power to impose any sanctions, apart from disciplinary fines for non-cooperation during audit.

The SAO has a good track record and is well integrated in the European network of Audit institutions.

- The Ministry of Finance is responsible for internal controls over the State budget, taxes, fees and customs duties, financial control and foreign exchange and prices. It employs 62 people in this sector. A new specialised section was established in May 1998, with the task of improving cooperation and coordination of control sections of other governmental institutions.

### **4.3 Twinning**

In order to help candidate countries meet the challenge of strengthening their administrative capacity and adapting their administrations to implement the *acquis* the Commission and the Member States are developing a process of twinning under the Phare programme. In the EU the *acquis* is implemented in the Member States by national administrations (at central, regional and local level) and by agencies, professional bodies and the private sector. This vast body of administrative and technical expertise is now being made available to the candidate countries. Initially twinning will cover four sectors – agriculture, environment, finance and justice and home affairs but will gradually be extended to the whole of the *acquis*.

Czech Republic is participating actively in twinning.

## 4.4 General evaluation

The Czech Republic has recognised public administration reform as a priority but has not yet taken the necessary steps to translate that political commitment into concrete actions. Nonetheless since the Opinion, banking and financial services capacities has improved, institutions in the standards and certification area have continued to strengthen and veterinary structures have undergone a period of consolidation. There is an important need for training and career development in the judiciary.

## C. Conclusion

The Czech Republic continues to fulfil the Copenhagen political criteria although continued attention needs to be focused on the situation of the Roma in Czech society.

The Czech Republic can be regarded as a functioning market economy and it should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that it improves corporate governance and accelerates enterprise restructuring.

The Czech Republic should be able to take on the obligations of membership provided that the momentum in the adoption of the *acquis* and the strengthening of related administrative structures is resumed rapidly so as to make up for the slow progress in the last year, particularly in the areas of internal market, agriculture and justice and home affairs.

## D Accession Partnership/ National Programme for the Adoption of the *Acquis*: Global Assessment of Implementation

The purpose of the Accession Partnership is to set out in a single framework the priority areas for further work identified in the Commission's Opinions; the financial means available to help the candidate countries implement these priorities and the conditions which will apply to that assistance. Each candidate country was invited to adopt a National Programme for the Adoption of the *Acquis* setting out how it would deal with the Accession partnership, the timetable for implementing its priorities and outlining human and financial resources implications. Both the Accession Partnerships and the National Programme for the Adoption of the *Acquis* will be revised regularly to take account of progress made and to allow for new priorities to be set.

### 1. Accession Partnership : Assessment of short-term priorities

The Accession Partnership with the Czech Republic sets out the following short-term (1998) priorities:

- **Economic reform** : establishment of medium-term economic policy priorities and joint assessment within the framework of the Europe agreement, implementation of policies to maintain both internal and external balance; improvement of the framework for corporate

governance, in particular by accelerating the restructuring of certain industrial sectors such as steel as well as of banks, by implementing the laws regulating the financial sector (banks and investment companies), and by enforcing the supervision by the new Securities and Exchange Commission.

- **Reinforcement of institutional and administrative capacity** : improving capacity in banking supervision securities, and insurance sectors, internal financial control, environment, agriculture, reinforcement of phytosanitary and veterinary administrations particularly as regards facilities at external borders, begin to set up structures needed for regional and structural policy.
- **Internal Market** : including in the areas of intellectual property rights (legislation and enforcement), and certification and standardisation (further alignment of legislative measures and conclusion of a European Conformity Assessment Agreement), amendment of anti-trust law, further development of the legislative framework for state aid control and increased transparency through submission of additional state aid inventory.
- **Justice and Home Affairs** : development of effective border management
- **Environment** : continue transposition of framework legislation, establishment of implementation of detailed approximation programmes and implementation strategies related to individual acts. Planning and commencement of implementation of these programmes and strategies.

Progress concerning the short term priorities of the Accession Partnership can be summarised as follows:

- **Economic Reform:** The two packages of special economic measures which the government adopted in early 1997 had a positive effect on internal and external balance and on structural reform. The current account and fiscal situation improved considerably. The overall economic situation remains difficult, however, as shown by the negative growth figures at the beginning of 1998. In July the government approved a medium-term economic strategy, which should help the coordination and consistency of economic policy. Steps have been taken to set up a formal assessment of economic policy priorities with the Commission. Measures have been taken for the stricter supervision of capital markets and the privatisation of banks. The bankruptcy law was amended. Two amendments to the Banking Act bring banking legislation closer to the *acquis*. Modest progress was made in internal financial control. Not much progress has been achieved in industrial restructuring.
- **Reinforcement of Institution and Administrative Capacity:** No progress was achieved in overall **public administration** reform. The Ministry of Agriculture has not started to improve its structures. On the other hand the Phytosanitary Administration is adequately staffed and functioning well. The equipment of district offices and district laboratories and the communication links with headquarters need to be improved. The Veterinary Inspection functions well. Good progress was made in the regional policy area with the establishment of a Ministry for Regional Development and the decision to set up 14 regions. The government also approved principles for regional development and instructed the Ministry to submit a strategy and legislation by June 1999. Other

improvements are the restructuring of the supervisory department of the Czech National Bank and the establishment of a Securities Exchange Commission to supervise the capital markets.

- **Internal Market:** Progress was made on certification and standardisation with the entry into force on 1 September 1998 of the law on technical requirements for products and conformity assessment. The separation of the functions of legislation, standardisation and certification has been achieved. A number of gaps in the legislation, however remain. There was no progress in the alignment of intellectual property rights legislation. The same applies to anti-trust and state-aids legislation and the reinforcement of the state aid supervisory body.
- **Justice and Home Affairs:** No real progress can be reported. The Ministry of Interior is preparing legislative and organisational measures to reinforce border protection.
- In the **environmental sector** transposition of legislation has continued, albeit at a slow pace, but efforts need to be reinforced, in particular in the water sector and regarding industrial pollution. The development of directive specific implementation programmes, including investment, is not progressing well.

The Czech Republic has a mixed record in terms of meeting the short term Accession Partnership priorities. Efforts were made in the areas of economic reform (measures to improve external and internal balances, improvement in banking and financial sector supervision), in the standards and certification area and in reinforcing administrative capacity in the regional development and veterinary area. However important priorities such as industrial restructuring, administrative capacity (general public administration reform and strengthening agricultural institutions), the internal market (alignment of intellectual property, competition legislation and in particular state aids), JHA (border enforcement) and environment (development of implementation programmes) were not satisfactorily addressed.

## **2. National Programme for the Adoption of the *Acquis* assessment.**

The Czech government approved the first version of the “Czech National Programme for the Preparation of the Czech Republic for Membership of the European Union” (National Programme for the Adoption of the *Acquis*) on 11 March 1998. It was presented on 31 March 1998.

The National Programme is a comprehensive, document composed of 26 chapters which follow broadly, but not fully, the structure of the negotiation chapters. The document is specific with regard to the planning of legislation, but the quality and level of detail of the institution building component varies greatly between chapters and is generally inadequate. Likewise the sections implementation on timetables and on the national and Phare budgets are not adequately developed.

The quality of individual chapters varies considerably. The chapters on free movement of workers, employment, social affairs; statistics and the environment are well done. Insufficient information provided on competition policy, public procurement and state aids; justice and home affairs; agriculture; transport; energy, and to a lesser extent free movement of goods in the non-harmonised sector. The National Programme for the Adoption of the *Acquis* contains

a short chapter on public administration but it is not linked to specific policy initiatives and does not mention corruption. It lacks precision as to legislative and budgetary measures foreseen.

The National Programme for the Adoption of the *Acquis* generally covers the priorities of the Accession Partnership (AP). However short-term priorities not covered include improving administrative capacity in the agriculture sector and phytosanitary/veterinary facilities at external borders; the annual reporting system for state aids. Medium term Accession Partnership priorities not covered are : strengthening the laws which guarantee press freedom and equal access to public services; strengthening of competition authorities; data protection (administrative issues); corruption; migration policy; visa policy; environmental aspects of agriculture and biodiversity; transport: (safety rules, taxation); alignment of public health standards.

Apart from the Accession Partnership priorities, areas of the *acquis* which are not sufficiently covered include part of the environmental *acquis*; mutual recognition of professional qualifications; a number of transport directives and the establishment of a market-surveillance system. No mention is made of barriers to trade other than technical barriers. The National Programme for the Adoption of the *Acquis* is rather vague on consumer protection.

The political criteria are not adequately dealt with. The Roma issue is treated in a summary fashion.

Once the Czech authorities have revised the National Programme for the Adoption of the *Acquis* the Commission will take a position on the document which it will communicate to the Council during the second half of 1999 at the time of the re-examination of the Accession Partnership.

# **Annex**

## STATISTICAL DATA

## STATISTICAL DATA

	1993	1994	1995	1996	1997
Basic data	in 1000				
<b>Population (end of period)</b>	10334	10333	<b>10321</b>	<b>10309</b>	<b>10299</b>
<b>Total Area</b>	in 1000 hectares				
	<b>7886</b>	<b>7887</b>	<b>7887</b>	<b>7887</b>	<b>7887</b>
National Accounts	in BNB Czech Koruna				
<b>Gross Domestic Product at current prices</b>	1002.3	1148.6	1348.7	1532.6	1649.5
	in Bn ECU				
<b>Gross Domestic Product at current prices</b>	<b>29.4</b>	<b>33.5</b>	<b>38.8</b>	<b>44.5</b>	<b>45.9</b>
	in ECU per capita				
<b>Gross Domestic Product at current prices</b>	<b>2800</b>	<b>3200</b>	<b>3800</b>	<b>4300</b>	<b>4500</b>
<b>Structure of Production</b>	in % of Total Gross Value Added				
- Agriculture	:	:	<b>4.6</b>	:	:
- Industry	:	:	<b>33.6</b>	:	:
- Construction	:	:	<b>8.1</b>	:	:
- Services	:	:	<b>53.7</b>	:	:
<b>Structure of expenditure</b>	as % of Gross Domestic Product				
- Final consumption expenditure	:	:	<b>70.4</b>	<b>71.5</b>	<b>71.6</b>
- household and NPISH	:	:	<b>49.5</b>	<b>50.4</b>	<b>51.4</b>
- general government	:	:	<b>20.9</b>	<b>21.1</b>	<b>20.2</b>
- Gross fixed capital formation	:	:	<b>32.8</b>	<b>33.0</b>	<b>30.7</b>
- Exports of goods and services	:	:	<b>56.0</b>	<b>53.4</b>	<b>57.6</b>
- Imports of goods and services	:	:	<b>60.5</b>	<b>60.4</b>	<b>63.0</b>
	% change over the previous year				
<b>Gross Domestic Product</b>	0.6	2.7	6.4	3.9	1.0
	in Purchasing Power parities				
<b>Gross Domestic Product per capita</b>	:	9900	10800	11600	12000
Inflation rate	% change over the previous year				
<b>Consumer Price Index</b>	20.8	10.0	9.1	8.8	8.6
Balance of payments	in millions of ECU				
-Exports of goods	12127	13453	16420	17084	:
-Imports of goods	12529	14602	19237	21714	:
-Trade balance	-402	-1148	-2817	-4628	:
-Services, net	3167	3939	3732	4933	:
-Income, net	-100	-18	-80	-569	:
-Net current transfers	75	107	437	302	:
-of which government transfers	:	:	79	102	:
-Current account balance	437	-654	-1050	-3386	:
-Reserve assets (incl. gold)	4079	5649	11119	10443	9089



- Industry	:	:	:	32.5	31.8
- Construction	:	:	:	9.5	9.8
- Services	:	:	:	51.7	52.6
Infrastructure					
in Km per 1000 Km2					
<b>Railway network</b>	<b>120</b>	<b>119</b>	<b>120</b>	<b>120</b>	<b>120</b>
in km					
<b>Length of motorways</b>	:	:	<b>414</b>	<b>423</b>	<b>506</b>
Industry and Agriculture					
previous year = 100					
<b>Industrial production volume indices</b>	94.7	102.1	109.2	102	104.5
<b>Gross agricultural production volume indices</b>	97.7	94	105	98.6	94.9

## Methodological Notes

**Gross domestic Product per capita in PPS:** Revised data using the new PPP results from the 1996 International Comparison Project.

Imports and exports (current prices): The data is based upon the “special trade” system, according to which, external trade comprises goods crossing the customs border of the country. Trade data excludes direct re-exports, trade in services and trade with customs free zones as well as licenses, know-how and patents. Value of external trade turnover includes the market value of the goods and the additional costs (freight, insurance etc.). *Trade Classification:* Merchandise trade flows are using the commodity classification according to the Combined Nomenclature. Imports are recorded on FOB basis and are captured with the date the commodities are released into circulation in the country. Exports are recorded on FOB basis.

Eurostat has converted the National Currency to the US dollar by applying the International Monetary Fund annual average exchange rates.

**Terms of trade:** The figures are calculated from the base 1994 = 100 by deflating according to ten SITC groups with current weights of the quarter concerned.

**Imports and exports with EU-15:** Data declared by the Czech republic. Data for years 1993 and 1994 refer to trade with EU-12 only.

**Economic activity rate (ILO Methodology):** Percentage of labour force in total population aged 15+.

**Unemployment rate (by ILO methodology):** - Percentage of the unemployed in labour force  
These 2 rates are derived from LFSS (Labour Force Sample Survey) observing the following ILO definitions and recommendations:

*Labour force:* employed and unemployed persons in the sense of the ILO definitions stated below.

*The employed:* all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

*The unemployed:* all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

For practical reasons, up to the end of 1997, the quarters of the survey did not correspond to the calendar ones, but they were shifted one month ahead. Up to the end of 1995 the persons on compulsory military service are excluded from the employed. On the other hand, persons on additional child-care leave (family leave) are included. From the beginning of 1996, persons on compulsory military service are included in the employed and persons on additional child-care leave (family leave) are excluded.

In 1998, the data will be retrospectively recalculated according to the comparable ILO methodology. Data for 1994 and 1995 have been recalculated but only preliminary, i.e. they may be different after the total recalculation (methodological adjustments and the shift to the calendar quarters) has been made.

**Average employment by NACE branches (LFS):** This indicator is derived from LFSS (Labour Force Sample Survey) observing the ILO definitions and recommendations.

**Industrial production volume indices:** Industrial production covers mining and quarrying, manufacturing and electricity, gas, steam and water supply (according to the NACE Rev.1 Classification Sections C,D,E). In 1993-94 the index of total industrial production is based on exhaustive surveying in enterprises with 25 or more employees and on estimates proceeding from quarterly sample surveys for enterprises up to 24 employees and for natural persons - tradesmen not registered in the Business Register. Indices for branches, however, cover only enterprises with 25 or more employees up to the end of 1994. Since 1995, Industrial output is measured by an exhaustive survey among enterprises with 100 employees or more. The output of enterprises up to 99 employees and unincorporated natural persons is measured on the basis of a quarterly sample survey. In doing so, estimate is made to the full set.

The industrial production index (IPI) calculated from 1996 on by a new method complying with international standards covers 88,6% of industrial activity in the Czech Republic. The IPI replaces the “goods production index” in use until 1995. Before October 1997, IPI published for the Czech Republic were calculated from monthly and cumulative annual IPIs based on 1993 weights (IPI 1996/95) and 1995 weights (IPI 1997/96). In October 1997 Czech Statistical Office made a revision. The revision consisted in re-basing the indices to the 1995 average month = 100 base and the monthly basic IPI was then used to provide cumulative IPIs (which are not seasonally adjusted).

**Gross agricultural production volume indices:** Indices based on evaluation of all individual products of gross agricultural production in constant prices of 1989.