

I. GENERAL INFORMATION

Major Political and Economic Events in 1999

January 15

State budget for 1999 approved with a deficit of 31 billion CZK.

February 8

The official unemployment rate reached 8.1 per cent; recession continues.

March 12

The Czech Republic, together with Hungary and Poland, became members of NATO.

May 13

The Czech government decided in favor of completing construction of a nuclear power plant near the town of Temelín, which was started in 1980. The estimated cost of completion approaches 100 billion CZK.

May 16

The Czech national team won the Ice Hockey World Championship for the eighth time in history, just one year after winning the Gold Medal in the Nagano Winter Olympics.

May 26

The Government for the first time discussed the issue of a proposed fence between a state-owned high-rise housing estate and single family homes in Ústí nad Labem. The problem which started as a local social issue in 1994 became a nationwide political and racial issue.

May 31

The sale of ČSOB, one of the largest Czech banks, was approved, and it was sold to a Belgian bank (KBC) for 40 billion CZK.

June 22

The Czech Statistical Office announced a 4.5 per cent decrease in GDP during the first quarter of 1999 (year-on-year comparison.) Economic recession peaks.

July 20

Vice-Premier Pavel Mertlík was appointed Minister of Finance.

August 28

Václav Fischer, the founder of the country's largest travel agency, wins in a Senate by-election. As an independent candidate, he defeated all established party candidates in the first round with more than 71 per cent of the votes.

October 7

The famous Czech brewery which produces "Pilsner Urquell" was sold to South African Breweries.

October 11

Eleven insurance companies are licensed to provide mandatory no-fault car insurance, ending the former state insurance company's monopoly.

October 13

The European Commission publishes its annual report on EU member candidate countries. The report criticizes the same problems as in the previous year. In the majority of areas, the report finds that the Czech Republic has made almost no progress since the last report.

October 19

A controversial governmental plan to provide direct state aid to selected large enterprises officially started. The unofficial estimated costs of the plan were approximately 60 billion CZK.

October 20

The Parliament rejected the government's Year 2000 state budget proposal, which assumed a 39.8 billion CZK deficit (i.e., 6.7 per cent of the total budget), during the first reading.

November 8

The official unemployment rate reached 8.9 per cent and inflation was 1.4 per cent.

November 10

The "Savings & Loan" crisis reached its peak.

The government announced its intent to sell another one of the four biggest state-controlled banks (Česká spořitelna) to the Austrian Erste Bank. It was reported that an agreement should be ready to be signed by the end of January 2000.

November 12

The government proposed a second version of the Year 2000 state budget proposal that assumed a 42 billion CZK deficit.

November 17

George Bush, Mikhail Gorbachev, Helmut Kohl, François Mitterand (in memoriam), Ronald Reagan, Margaret Thatcher and Lech Wałęsa were awarded the highest decoration of the Czech Republic, the Order of the White Lion (Řád bílého lva), by President Václav Havel for their contribution to the defeat of communism.

On the tenth anniversary of the Velvet Revolution, former student leaders publish an open letter titled "Thank You, Now Step Aside" which criticized the current political representatives and demanded their resignation in order to let the younger generation play a more active role in politics.

December 31

The state budget for 2000 is still not approved by the Parliament.

An Economic Summary of 1999

The Czech economy entered 1999 with a quite pessimistic outlook as the economy was in recession, unemployment was rising and the deficits were creating a serious burden on public finance. The political situation was not overly optimistic either. Although there was an agreement reached between the ruling minority social-democratic government and the major opposition party, the resulting governmental position was weak, and the government was not able to push new crucial initiatives ahead. This inability of the government to pursue its own legislative agenda was commented upon later in the year both in the European Commission's yearly report as well as in the World Bank Country Study: both reports noted that there was no significant improvement in the harmonization of legislation compared to the previous year. The European Commission went on to cast doubt on whether the Czech Republic would be able to reach the required legal standards in time to maintain its place in the group of "fast-track" accession countries.

The most significant problems included, but were not limited to, lagging structural reforms, inadequate legal framework, capital market regulation, and weak legal enforcement through the judicial system. Further economic challenges arose from increasing pressure on the pay-as-you-go pension system, and overall systematic problems in the financial sector.

Which of these restraints can be eventually overcome during the next year? Unfortunately, there is not too much space for optimism given the weak position of the current minority government. Each of the above-mentioned issues requires a fundamental change in the current law and hence majority support for such changes from the Parliament. Recently, political negotiations have begun which might yield a broad coalition which would indeed have such a mandate; although, this is an ongoing process.

Despite the current political situation as the year draws to a close, the economic recession seems to be coming to an end. The GDP decline has ceased, yet recovery is slow. Unemployment is still rising and is expected to reach 9.5 per cent by the end of this year. This rise is caused primarily by a structural reallocation of the labor force. The trade deficit has stabilized to a level of around 2 per cent of GDP. Exchange rate trends remain puzzling, since they do not seem to respond logically to the movement of prevalent economic fundamentals. The strong restrictive policy of the central bank resulted in a 2 per cent inflation rate (including price deregulation allowed by the government). The public finance deficit continues to be a significant problem; the government has used several off-budget outlays and contingency liabilities to (at least formally) keep the state budget deficit at an acceptable level and is currently proposing a tax increase.

I.1 History

The first signs of people living in what is today the Czech Republic are as old as 1.6 – 1.7 million years and were found near Beroun in Central Bohemia. The first Slavonic people came in the 5th and 6th centuries. The first written references to the Czechs, Prague, and regions of Bohemia appeared in the 8th and 9th centuries. In about the year 870, the Czech prince Bořivoj was mentioned for the first time. He came from Prague and belonged to the house of Přemysl, which later became the royal dynasty of Bohemia. This dynasty governed the Czech kingdom until 1306. After the reign of the House of Luxembourg (1310-1436), Bohemia was the center of the so-called Holy West Roman Empire of German People and Prague became one of the cultural centers of Europe. A short period of elected kings ended in 1526, when the Czech Kingdom (Bohemia, Moravia and Silesia) became a part of Austria, later the Austro-Hungarian monarchy.

In 1918, after World War I, Czechoslovakia emerged from the ruins of the Austro-Hungarian monarchy as a modern democratic state. Czechoslovakia consisted of Bohemia and Moravia, Slovakia and Carpatho-Russia (today a part of Ukraine). In 1939, Slovakia separated from Czecho-

slovakia and the Czech part of the country was occupied by the German army and incorporated as a special autonomous state into the German Empire. In 1945, Czechoslovakia was liberated by the Soviet and American army. The Czechoslovak state was restored without Carpatho-Russia which joined the Soviet Union.

In February 1948, the Communist party gained power (in a formal constitutional way), and Czechoslovakia was under the Soviet sphere of influence until 1989. After the “Velvet Revolution” in 1989, the democratic regime was restored.

In response to the Slovak desire for greater self-determination, a federal constitution was introduced in 1968. Completely controlled by the Communist Party, the Czechoslovak Federation had not satisfied the legitimate aspirations of the Slovak people. From 1990 on, Czech and Slovak political parties negotiated the future form of the federation. After two years of unsuccessful negotiations and following the 1992 parliament elections, the division of the country began. On January 1, 1993, the Czech Republic and Slovak Republic were peacefully separated and established as independent states.

Milestones of the Czech Lands in the 20th Century

- 1918** After the collapse of the Austro-Hungarian monarchy, the first Czechoslovak Republic as a common state of Czechs and Slovaks was established.
- 1920** A democratic constitution was adopted.
- 1938** The Munich agreement, occupation of part of Czechoslovakia by Germany and Hungary; the so-called Second Republic, Czecho-Slovakia, was established with extended Slovak autonomy.
- 1939** The rest of the Czech territory was occupied by Germany, an independent Slovak State was established.
- 1945** Liberation, the Czechoslovak Republic was restored.
- 1948** Communists took over the country, marking the beginning of a 40-year totalitarian regime.
- 1968** Prague Spring, the invasion of Warsaw Pact armies, a federal constitution adopted.
- 1989** The Velvet Revolution, end of the totalitarian regime.
- 1990** The first democratic parliamentary election in 42 years.
- 1991** Last Soviet military troops left the country.
- 1992** The separation of Czechoslovakia, establishing the Czech and Slovak Republics in 1993.
- 1999** On March 12, the Czech Republic officially joined NATO.

I.2 Geography



In terms of its area (76,867 square kilometres), the Czech Republic ranks among the smaller European countries. The Czech Republic shares borders with Germany, Austria, the Slovak Republic and Poland. It has special trade relations with the Slovak Republic based on the Customs Union Treaty of 1992.

The Czech Republic is a signatory of CEFTA (Central European Free Trade Agreement, which also includes Hungary, Poland, Romania, the Slovak Republic and Slovenia), an associated member of the EU, and has been a member of the OECD since 1995. It is a founding member of the UNO, a member of the World Bank, the IMF, the WTO and the Council of Europe. The Czech Republic submitted its application for full

EU membership in 1996. The Czech Republic joined the Partnership for Peace with NATO and after the 1997 Madrid summit was invited (together with Poland and Hungary) to join NATO. It became a full member of NATO in 1999. Since the 1997 Amsterdam summit of the EU the Czech Republic has been considered one of the “first wave” countries (together with Poland, Hungary, Estonia, Slovenia and Cyprus) to negotiate entry into the European Union.

The Czech Republic has no unresolved territorial disputes with neighbouring countries. With the exception of the Principality of Liechtenstein, which has made property claims dating back to before the communist regime, the Czech Republic enjoys good diplomatic relations with all European countries.

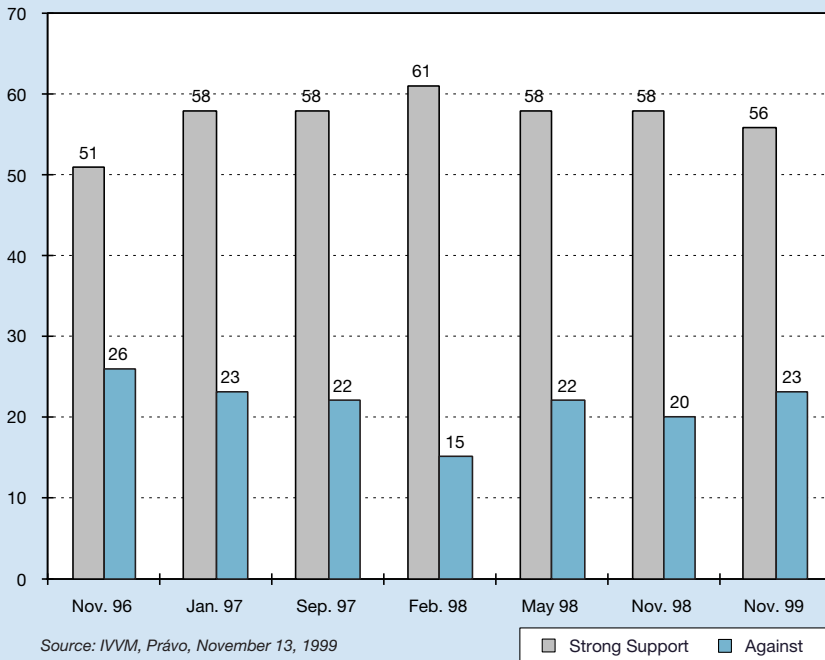
Membership in NATO

On April 15, 1998, the Lower House of Parliament of the Czech Republic ratified by an overwhelming majority (154 to 38 votes) the Czech Republic's entry into NATO. In May 1998, NATO accession was also ratified by the Upper House of Parliament and by the President. This act of ratification closed discussions on Czech membership, bringing an end to considerations of a neutral national security strategy.



Popular support for entering NATO has increased. While in 1990 only 7.4 per cent of people supported entering NATO (more than 2/3 of people preferred neutrality), the latest public opinion pools shows reversed figures: 2/3 of the population are in

Popular Support for Entering the NATO in the Czech Republic (in %)



favor of entering NATO, more than 1/2 are strong supporters. Not surprisingly, the support increases with education and declines with age.

The Czech Republic joined the Partnership for Peace with NATO in 1994 and has participated in the UNPROFOR mission in Croatia since 1992. Since 1996 it has taken part in the IFOR mission in Bosnia-Herzegovina. The most influential political parties in the Czech Republic clearly declared their unreserved support for North Atlantic Treaty Organization membership. Negotiations between the government of the Czech Republic and NATO on accession started in the fall of 1997. On November 16, 1997, the NATO accession documents were signed. The parliaments of NATO member states completed the ratification process of NATO extension in November 1998. On March 12, 1999 the Czech Republic, Poland and Hungary officially entered NATO.

There are still problems to be solved in the near future. In the past the government has paid little attention to reforming the armed forces. The low defense budget does not allow for the necessary modernization of the armed forces. The Czech Air Force in particular is in bad condition. The problem is exacerbated by young officers leaving the armed forces, which could lead to a staff shortage at some point in the future. Since 1996 the Czech government has been firmly committed to increasing defense spending by 0.1 per cent of GDP each year to achieve the level of 2 per cent of GDP in the year 2000.

Comparison of 1997 Defense Expenditures in the Czech Republic and Some Other Countries

	Bln USD	% GDP	per capita USD
Czech Republic	0.79	1.66	76.71
Hungary	0.71	1.50	69.41
Poland	4.00	2.28	103.64
Slovakia	0.47	2.18	87.64
Austria	2.05	0.83	258.19
Belgium	3.32	1.60	330.02
Netherlands	7.10	2.00	464.66
Spain	7.00	1.10	178.89

Source: ČR vstupuje do NATO. Česká atlantická komise. Praha 1998

1.3 Population

With a population of 10.331 million (1995), the Czech Republic is similar in size to Austria, Belgium or Hungary. Its ethnically homogeneous population with an overwhelming majority of Czechs (94.8 per cent), a Slovak minority (3.1 per cent) and small Polish (0.6 per cent) and German (0.5 per cent) minorities minimizes the possibility of ethnic conflicts. The Czech language is a part of the family of west Slavic languages (together with Polish and Slovak).

The working age population (15-59 years) accounts for 63.5 per cent of the total (1995). The population tends to be ageing slowly as life expectancy, which is still far behind that in West European countries, increases. The prognoses of demographic development suggest a slow decrease in the

Ethnic Minorities in the Czech Republic (in thousands)

	1991		1995	
	Census	%	Estimate	%
Slovak	315	3.1	300	2.9
Polish	59	0.6	60	0.6
German	49	0.5	48	0.5
Romany	33	0.3	300	2.9
Hungarian	20	0.2	21	0.2
Ukrainian	8	0.1	12	0.1
Russian	5	0.1	5	0.1
Total	489	4.7	746	7.2

Source: *Lidové noviny*, May 5, 1998

population from 10.333 million in 1995 to 10.289 million in 2000.

Descriptive Statistics of the Population

	1993	1994	1995	1996	1997	1998
Population (in thousands, average)						
Total	10,331	10,336	10,331	10,315	10,304	10,295
Women	5,309	5,315	5,311	5,301	5,293	5,287
Age structure of population (in %)						
0 – 14	20.00	19.50	18.80	18.30	17.90	17.70
15 – 64	67.10	67.60	68.00	68.40	68.70	69.00
65 –	12.90	13.00	13.10	13.30	13.40	13.60
Average age	36.60	36.80	37.00	37.30	37.60	37.90
Median age	35.90	36.00	36.20	36.40	36.60	36.80
Life expectancy at birth						
Men	69.28	69.53	69.96	70.37	70.50	71.13
Women	76.35	76.55	76.63	77.27	77.49	78.06
Men at age 60	75.67	75.86	75.94	76.25	76.39	76.72
Women at age 60	79.79	79.90	80.04	80.39	80.67	81.00

Sources: *Population Development in the Czech Republic*, Dept. of Demography and Geodemography, PF UK
CSO Statistical Yearbook of the Czech Republic 1999

The Wall in Ústí: Unresolved Problems of the Romany Minority

In 1999 the most frequently quoted issue of Czech internal politics was the decision of local authorities in the the North-West Bohemian city Ústí nad Labem to build a ceramic wall in Matiční street separating the “non-adjustable” Roma inhabitants from other Czech residents. Although the state government took a clear position opposing the wall, it was constructed in October 1999. After long and complicated negotiations between the state and local governments, a compromise solution was found. The state bought the houses of dissatisfied residents making it possible for them to move and the wall was removed. The wall came to symbolize the complex situation of the Romany minority in the Czech Republic.

It is difficult to establish the total number of Romanies living in the Czech Republic. In the 1991 population census, respondents were given the opportunity to declare their own nationality. Only 32,900 inhabitants of the Czech lands declared themselves Romany, perhaps out of fear of persecution. On the other hand, an unofficial survey of local governments in 1989 reported 145,738 Romanies living in the Czech lands. After the separation of Czechoslovakia, part of the Romany population migrated from the Slovak Republic to the Czech Republic to obtain Czech citizenship. Recently the Romany population in the Czech Republic has been estimated at 300,000 (which represents almost 3 per cent of the total population).

The distinctive culture and way of life of the Romanies has led them to be less assimilated in the Czech society than other ethnic groups. During the communist regime, a policy of forced assimilation was adopted providing special subsidies and facilities for this ethnic group. After 1989, liberal economic policies reduced these special support policies, coinciding with an increase in unemployment among the Romany population.

Racial hatred and discrimination against the Romanies has increased recently while social conditions have deteriorated. Since 1990 there have been 21 racially motivated murders in the Czech Republic, with prevailing Romany victims. On average, the Romany population has a lower level of education, fewer professional qualifications, and a higher incidence of criminal involvement. This, coupled with the government's and society's indifference towards improving the legal, social and economic status of the Romanies, has led to the Romany exodus. Hundreds of Romanies left the country and applied for political asylum in Canada, UK and other countries in 1997 and 1998.

Only in the last years, when awareness of the problem extended beyond national boundaries, did the Czech government start to look for a long term policy to address minority problems.

Racially Motivated Crimes in the Czech Republic

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Number of crimes	26	20	26	99	172	230	208	137	133

Sources: Police of the CR, MF Dnes, November 14, 1998; 1999 Regular Report from the Commission on CR, 13.10.1999.

I.4 Economy: Ten Years of Transformation

Until the “Velvet Revolution” Czechoslovakia was one of the most conservative socialist countries in Central Europe relative to other socialist countries. In 1989, The Czechoslovak economy was extremely centralised with less than 4 per cent of GDP produced by the private sector (some sources estimate below 1 per cent). No attempts at liberalizing the economic and political system were implemented in the 1970s and 1980s, and the rigid party nomenclature ran the country with the legacy of post-1968 “normalization.” More liberal segments of the Communist Party and the Czechoslovak political establishment had been eliminated, expelled from the country or isolated and persecuted for the last two decades of communism.

The radical political change in the last months of 1989 was supported by the

majority of the population, but was only made possible by the international changes initiated by Soviet “perestroika.” The people were asking for democracy. However, at the very beginning almost no one raised an economic program going beyond the “democratic market socialism” rhetoric.

At the end of 1980s, in the absence of any partial market reforms, the relatively competent management of the fully state controlled centrally planned economy paradoxically had left the country in a better economic starting position than those of more liberal and more market oriented socialist countries such as Hungary and Poland. Czechoslovakia had no significant external debt, low inflation, a positive trade balance, and a balanced government budget. On the other hand, the non-competitive structure of the economy was com-

Basic Macroeconomic Indicators of the Czech Republic, 1990 – 1999

Year	Real growth of GDP (GR)	Rate of inflation (IR)	Rate of unemployment (UR)	Balance of current account, % of GDP (CA)	Synthetic rate of macro-economic performance SR=GR+CA-IRUR	GDP level (1989=100)	Consumer price level (1989=100)
1990	-1.2	9.7	1.0	-1.1	-13.0	98.80	109.70
1991	-11.5	56.6	4.1	4.5	-67.7	87.44	171.79
1992	-3.3	11.1	2.6	-1.0	-18.0	84.55	190.86
1993	0.6	20.8	3.5	1.3	-22.4	85.06	230.56
1994	3.2	10.0	3.2	-2.0	-12.0	87.78	253.61
1995	6.4	9.1	2.9	-4.4	-10.0	93.40	276.69
1996	3.9	8.8	3.5	-7.0	-15.4	97.04	301.04
1997	1.0	8.5	5.2	-6.2	-18.9	98.01	326.63
1998	-2.7	10.7	7.5	-1.9	-22.8	95.37	361.58
1999	-0.8	3.6	10.8	-2.7	-17.9	94.60	374.60

Sources: Zpráva vlády o stavu České společnosti (The Government Report), *Hospodářské noviny*, 5. 3. 1999, *Countries in Transition 1998*, WIIW Handbook of Statistics, Vienna 1998.

pletely subordinated to strategic objectives of the USSR and Warsaw Pact and was oriented towards undemanding COMECON markets.

The strategy of economic transition became a priority in 1990. Price and trade liberalization, privatization and reorientation of foreign trade towards western markets, together with the creation of a corresponding social net (to keep the transformation process socially feasible) and a significant reconstruction of the institutional and legal framework to facilitate transition from a centrally planned to liberal market economy were the hot discussion topics during 1990. Surprisingly no concept of economic transition was on the table at the end of 1989; neither the dissidents in former socialist

countries nor the experts in numerous institutes of Soviet or East European Studies in the West had seriously anticipated the collapse of the communist regime and the practical implications of such an event.

The concept of radical economic reform won support (at least theoretically) in the new political establishment, and ideas of “democratic market socialism” lost their attractiveness for the majority of the Czech society. Optimistic (and not very rational) expectations prevailed and people were prepared to suffer for few years, expecting prosperity afterwards. The political pendulum moved to the “right.” In this relatively favourable social atmosphere, the economic transition began in 1991.

Real GDP Growth Rate (in %)

	Czech Republic	Slovakia	Poland	Hungary	Slovenia
1990	-1.2	-2.5	-11.6	-3.5	-4.7
1991	-11.5	-14.5	-7.0	-11.9	-8.1
1992	-3.3	-6.5	2.6	-3.1	-5.4
1993	0.6	-3.7	3.8	-0.6	1.9
1994	2.7	4.9	5.2	2.9	4.9
1995	5.9	7.4	7.0	1.5	3.5
1996	3.9	6.6	6.0	1.3	3.5
1997	0.3	6.5	6.8	4.6	4.6
1998	-2.3	4.4	4.8	5.1	4.7
1999	-0.4	2.5	5.2	5.5	4.8

Source: CNB, CESTAT, 1999 CERGE-EI estimate