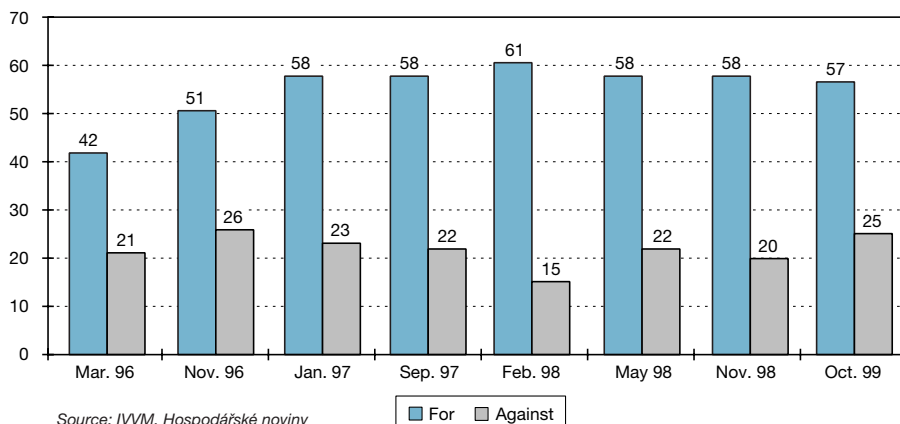


VIII. THE CZECH REPUBLIC ON ITS WAY TO THE EUROPEAN UNION

VIII.1 From Trade Co-operation and Association to Full Membership

Popular Support for Entering the EU (in %)



Rapid accession to the European Union, NATO and the West European Union has remained the primary target of Czech foreign and security policy since the first days of the Czech Republic.

The democratization and liberalization of foreign trade regimes shortly after the “Velvet Revolution” made possible rapid improvement in relations between post-communist Czechoslovakia and the European Union in the early 1990s. The liberalization of trade flows started with the Trade and Co-operation Agreement between Czechoslovakia and the European Union, signed on November 1, 1990. In a further step, the European Union temporarily incorporated

former Czechoslovakia into the General System of Preferences (in January 1991). On December 16, 1991, the Association Agreement (the so-called Europe Agreement) between Czechoslovakia and the European Union was signed. According to the Association Agreement, a free trade area among the European Union and Central and East European countries for non-agricultural products should be created by 2002.

After the division of Czechoslovakia on January 1, 1993, the Association Agreement had to be renegotiated and the new Agreement between the Czech Republic and the European Union was signed on October 4, 1993, and went into effect on February

1, 1995, after its ratification by the Parliament, the parliaments of the EU member states and the European Parliament. This agreement opened the association process whose final objective was the Czech Republic's full membership in the EU.

On January 23, 1996, the government submitted an application for EU membership to the government of Italy, which was at that time the country holding the office of the Presidency of the EU Council of Ministers. On July 26, 1996 the government presented a completed questionnaire to the EU Commission. In 1997, based on a detailed evaluation, the Commission recommended opening accession negotiations with Cyprus and the five Central and East European candidates – the Czech Republic, Estonia, Hungary, Poland and Slovenia. At the Helsinki summit in December 1999 other countries were invited to join negotiations for full EU membership: Bulgaria, Latvia, Lithuania, Malta, Romania, Slovakia, and conditionally Turkey.

In the conclusion the Commission stated that "The Czech Republic presents the char-

acteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. It 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. It should be capable, in the medium term, of applying fully the *acquis communautaire* relating to the Single Market, provided that it continues its efforts on transposition and intensifies work on its implementation. However, particular effort, including investment, will be needed to meet the *acquis* in sectors such as agriculture, environment and energy. Further administrative reform will also be indispensable if the Czech Republic is to have structures to apply and enforce the *acquis* fully."

Between 1992 and 1998 the right-center government contributed significantly to the international recognition and the economic and political transition of the Czech Republic. As one of its foreign policy priorities the new government declared it will meet the requirements for full membership in 2003.

Economic Performance, Comparison to Selected EU Members

	Czech Rep. (1998)	Austria (1997)	Greece (1997)	Portugal (1997)	EU-15 (1997)
Population (in mil.)	10.3	8.1	10.6	9.9	374.3
GDP, billions of USD (at ER)	56.4	234.0	130.0	107.0	8,981.0
GDP, real growth rate %	-2.3	2.1	3.5	3.5	2.3
GDP/capita PPP	13.2	21.8	13.3	13.8	19.8
General budget balance (% GDP)	-1.6	-2.5	-4.0	-2.5	2.4
Rate of inflation (average) %	10.7	1.1	5.2	1.8	1.6
Rate of unemployment (% , end of year)	7.5	4.3	9.0	7.1	10.8
Current account balance (% GDP)	-1.9	-1.6	-3.6	-2.5	1.1

Sources: *European Economy, Annual Economic Report for 1997 European Commission, 1997, CESTAT 1999/1*

CEEC Enlargement

Besides the Czech Republic, nine other Central and East European countries (CEECs) – Bulgaria, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia – applied for EU membership before the 1996 Inter-Governmental Conference of the EU.

Until the end of the Cold War the eastern part of Europe had no opportunity to participate in the process of European integration. The East European economic integration organization, the Council for Mutual Economic Assistance (COMECON), was established in January 1949, with the purpose of promoting and facilitating all forms

First Wave Candidates – Basic Economic Indicators

	Czech Rep.	Cyprus	Estonia	Hungary	Poland	Slovenia	EU-15
Population (million)							
1997	10.3	0.8	1.5	10.2	38.6	2.0	374.3
GDP/capita PPP (thousand USD)							
1997	11.5	13.5	4.9	7.3	6.0	11.7	19.8
1998	n.a.	n.a.	n.a.	10.6	8.4	14.9	n.a.
growth of GDP (real, %)							
1996	3.9	n.a.	4.0	1.3	6.1	2.7	n.a.
1997	1.0	2.5	6.1	4.4	6.9	3.8	2.3
1998	-2.3	4.7	5.7	4.9	6.5	4.2	n.a.
Inflation (CPI, %)							
1996	8.8	n.a.	23.1	23.6	19.9	9.9	n.a.
1997	8.5	3.6	11.2	18.3	14.9	8.4	2.2
1998	10.7	2.5	8.9	15.0	11.9	8.2	n.a.
Unemployment (%)							
1996	3.5	n.a.	n.a.	10.7	13.2	14.4	n.a.
1997	5.2	3.4	3.3	10.4	11.5	14.5	10.8
1998	7.5	3.2	3.5	10.0	10.0	15.0	n.a.
Budget deficit (% GDP)							
1996	-0.1	n.a.	n.a.	-2.0	-2.5	0.6	n.a.
1997	-1.0	-5.3	2.1	-4.4	1.3	-1.2	-2.4
1998	-2.0	-5.7	1.0	-4.2	-2.9	-2.4	n.a.

Source: CESTAT, WIIW, Eurostat

of economic cooperation between the Communist states of Central and Eastern Europe based on the principles of centrally planned economies. The founding members were the USSR, Bulgaria, Czechoslovakia, Hungary, Poland and Romania, countries that had been prevented by Stalin from taking part in the Marshall Plan and from joining the Organization for European Economic Cooperation. Membership was later extended to Albania (from 1949 to 1961) and the German Democratic Republic (in 1950), and to some non-European Communist states: Mongolia (in 1962), Cuba (in 1972) and Vietnam (in 1978). Under Article 4 of the COMECON Charter adopted in 1959, all decisions had to be unanimous, but in fact the USSR and its strategic interests overwhelmingly dominated the organization. The collapse of the Soviet empire between 1989 and 1990 completely transformed trading patterns among COMECON states and led to their new economic orientation toward the European Economic Community. In June 1991 the remaining members of COMECON decided to dissolve the organization; this was formally accomplished in September 1991.

The new East European democracies that emerged after 1989 expressed a strong political will to participate in the European integration process. The ten Central and East European countries would enlarge the total territory of the EU by 1,078 million square kilometers, the population would increase by 106 million people (about 30 per cent) and economic performance would grow by 637 billion USD (about 9 per cent by purchasing power parities). At first glance this additional economic potential does not appear very significant on an international level. However, this integration will be the most important factor in assuring the future security and stability of Europe.

Accession Negotiations and European Commission Assessment

In June 1993, the Copenhagen European Council stated that those associated countries of Central and Eastern Europe who wish to join the European Union might do so once they complied with the relevant obligations and satisfied the preconditions for membership, which were defined as:

a) Political Criterion: Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for the protection of minorities;

b) Economic Criterion: The existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the European Union;

c) Adoption of the Acquis Communautaire: The ability to take on the obligations of membership including adherence to the aims of the political, economic and monetary union.

Accession negotiations with the “first wave” candidates began on March 30, 1998. The applicant states’ overall progress towards complying with the Copenhagen criteria is to be evaluated by periodic reports by the European Commission. The first report was published in November 1998, the second in October 1999.

Both reports were rather critical about the progress of the Czech Republic. The 1999 report concludes: “The Czech Republic’s record in terms of meeting the short term Accession Partnership priorities is not satisfactory, despite efforts by the government to prepare and put forward legislation. The difference between the government’s policy intentions and implementation can be explained by the length of parliamentary procedures, the minority status of the government, and the fact that certain priority policy areas did not receive sufficient attention from previous governments. While the Czech Republic met short term Accession Partnership priorities in areas such as economic reform, standards and certification, regional development and veterinary, priorities in the areas of industrial restructuring, administrative capacity (strengthening environmental and agricultural institutions), the internal market (alignment of intellectual property and state aid legislation), justice and home affairs (border enforcement) and environment have not been adequately dealt with.”

VIII.2 Czech Republic and Convergence Criteria

Numerical benchmarks were defined in the framework of the Maastricht Treaty. These four so-called EMU convergence criteria aim to ensure monetary and fiscal stability of the joint currency area. Their assessment is not obligatory for candidate countries at this stage of the accession process, but it is interesting to evaluate the situation of the Czech Republic vis-a-vis EU member states concerning Maastricht convergence criteria.

Two of these criteria are monetary; one is linked to currency rate stability, and the last one is fiscal.

1. The **inflation convergence** criterion, defined as an inflation rate which should not exceed the average inflation rate of the three best performing countries by more than 1.5 per cent.

2. The **interest rate convergence** criterion, meaning that the average long term nominal interest rate should not be more than 2 per cent above the average interest rate of the three countries with the lowest interest rates.

3. The **ERM** criterion which postulates that the currencies of future EMU members should follow the rules of ERM without currency devaluation or revaluation for at least two years.

4. The **excessive debt** criterion, composed of a budget deficit component, which declares that a country's budget deficit should not exceed 3 per cent of its GDP, and of a stock debt component, which declares that the government debt should not exceed 60 per cent of that country's GDP.

Additionally, an "operational" element was also set concerning the legal and institutional features of the national central bank,

namely its independence from government interference. Concerning the exchange rate stability criterion, the Czech Republic is not a member of ERM, but it has a relatively stable currency. The CNB, the national central bank, has an independent legal status. In 1998 only the inflation convergence criterion was higher than the reference value but a steep decrease in inflation in 1999 holds promises of meeting this criterion as well. The policy of decreasing nominal exchange rates was extended in 1999.

Performance of the Czech Republic and EU Member States in Relation to Convergence Criteria (1998)

	Inflation %	Deficit % of GDP	Debt % of GDP	Interest rate
Reference value	2.7	-3.0	60.0	7.8
Czech Rep.	10.7	-1.6	40.0	6.0
Czech Rep. (1999)*	2.1	-1.6	41.0	5.5
Austria	1.1	-2.5	66.1	5.6
Belgium	1.4	-2.1	122.2	5.7
Denmark	1.9	0.7	65.1	6.2
Finland	1.3	-0.9	55.8	5.9
France	1.2	-3.0	58.0	5.5
Germany	1.4	-2.7	61.3	5.6
Greece	5.2	-4.0	108.7	9.8
Ireland	1.2	0.9	66.3	6.2
Italy	1.8	-2.7	121.6	6.7
Luxembourg	1.4	1.7	6.7	5.6
Netherlands	1.8	-1.4	72.1	5.5
Portugal	1.8	-2.5	62.0	6.2
Spain	1.8	-2.6	68.8	6.3
Sweden	1.9	-0.8	76.6	6.5
United Kingdom	1.8	-1.9	53.4	7.0
EU	1.6	-2.4	72.1	6.1

* CERGE-EI forecast

Sources: EURO 1999, European Commission Report, March 25, 1998; Countries in Transition 1999, WIIV

VIII.3 The European Union as a Major Trading Partner of the Czech Republic

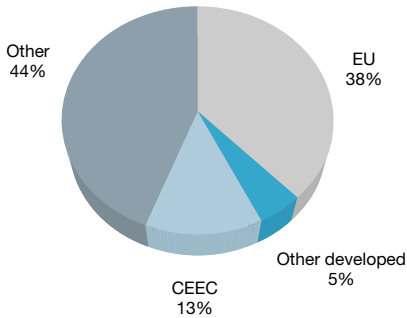
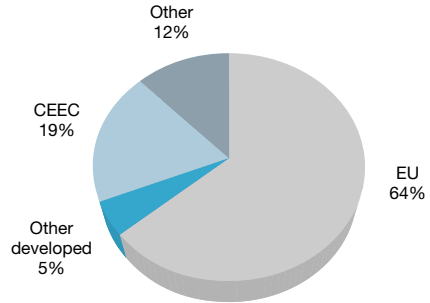
With the breakdown of the East European trading system and the collapse of COMECON, Czech industry lost its traditional links with markets in Eastern Europe. Until then the Soviet Union had played the most important role: imports comprised mainly energy and raw materials and exports mainly final products including military equipment. The economy had been protected from the world market and was poorly equipped for international competition. However, under these new circumstances the industrial sector managed to turn very quickly towards Western Europe. The comprehensive reforms after 1989 led to the

elimination of import quotas and export licensing requirements for most commodities (the major exceptions being agricultural products and military equipment). Export support and import subsidies were abolished. The implementation of the Europe Agreement opened EU markets to Czech goods (with the exception of agricultural products). A highly undervalued currency in a fixed exchange rate regime helped exports expand during the first half of the nineties. The dynamic development of bilateral trade has resulted in a comprehensive and unseen rapid geographical reorientation of Czech foreign trade.

Growing Weight of the EU in the Foreign Trade of the Czech Republic (mil. USD)

	1990	1994	1995	1996	1997	1998
Exports						
Total	9,051.6	14,254.7	21,646.8	21,905.7	22,784.6	26,348.5
EU-15	3,473.0	7,709.6	13,191.4	12,755.2	13,654.3	16,908.6
Other developed	477.6	803.3	1,096.1	1,183.4	1,206.4	1,304.9
CEEC	1,143.2	3,379.5	4,479.4	4,855.2	4,830.2	5,061.7
Other	3,957.8	2,362.3	2,879.8	3,111.9	3,093.8	3,073.3
Imports						
Total	9,815.4	14,970.6	25,252.2	27,715.7	27,176.6	28,811.7
EU-15	3,971.0	8,331.7	15,423.1	17,296.5	16,706.6	18,233.2
Other developed	670.1	1,334.5	2,044.0	2,200.7	2,358.0	2,501.2
CEEC	1,215.6	2,752.6	3,914.2	3,771.6	3,545.8	3,525.3
Other	3,958.7	2,551.7	3,870.8	4,446.9	4,566.2	4,551.9
Trade balance						
Total	-763.7	-715.9	-3,605.4	-5,810.1	-4,392.0	-2,463.2
EU-15	-498.0	-622.0	-2,231.0	-4,541.4	-3,052.3	-1,324.6
Other developed	-192.5	-531.3	-948.6	-1,017.2	-1,151.7	-1,196.3
CEEC	-72.4	626.9	565.2	1,083.6	1,284.4	1,536.4
Other	-0.8	-189.5	-991.0	-1,335.1	-1,472.4	-1,478.6

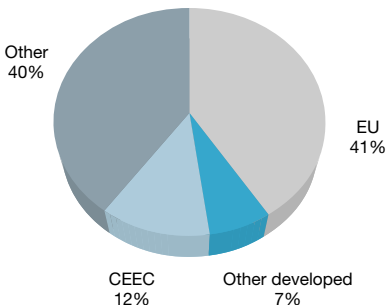
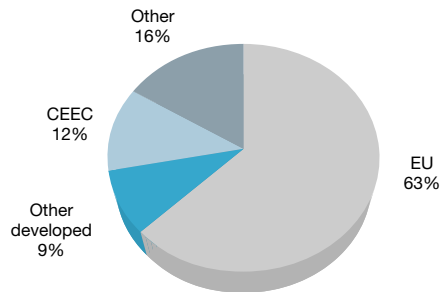
Source: *Countries in Transition 1999, WIIW*

Composition of Exports in 1990**Composition of Exports in 1998**

In 1998 exports from the Czech Republic to the 15 countries of the EU increased by more than 400 per cent, and imports increased by more than 420 per cent compared to 1990. While in 1990 goods exported to the EU accounted for 38 per cent of all Czech exports, in 1998 the EU share of Czech exports was 64.2 per cent. Likewise, imports from the EU represented 40 per cent of all Czech imports in 1990, but this share rose to 63.3 per cent in 1998.

The balance of trade has deteriorated since 1994. There are a number of explanations for this recent trend. First, the exchange rate has remained more or less

stable since 1991, but the Czech price level has risen so that the prices of Czech products have increased in relation to foreign goods. Second, contrary to original expectations, Czech firms have not been able to improve their overall performance and the process of restructuring has been very slow. A higher level of protection and export support in the EU compared to the Czech Republic, especially for agricultural commodities, has created some problems in bilateral trade relations; in fact trade deficits indicate that the EU has derived greater benefit from the trade liberalization of recent years.

Composition of Imports in 1990**Composition of Imports in 1998**

VIII.4 Regional Reform and European Regions in the Czech Republic

An increasingly relevant aspect of regional policy in the Czech Republic is its "European dimension." The regional reform, formally introduced in 1997, established 14 regions (so-called *vyšší územně-správní celky* (VÚSC), in English "higher level territorial administrative units") with regional self-administration. The new territorial division of the country should be implemented from the year 2000. The final decision of Czech legislators was reached as a result of many tradeoffs and compromises, and the new territorial structure is not compatible with European Union standards. Most of the newly established units are too small to participate in European regional programs and to be eligible for structural funds. To comply with the European standards (NUTS II), in October 1998 the government decided to design eight European regions (some of

them aggregating two or three administrative regions). The new administrative regions have not been enacted yet (they should be enacted before the elections for regional government in 2000) and it is not clear what mechanism will be developed to ensure interaction between these administrative and European regions. No self-administration at the European regional level in those new regions is anticipated.

The statistical data of the European regions in the Czech Republic indicate significant disparities among different regions. While the per capita GDP level in the Czech Republic (in PPP exchange rate) was 13,200 USD in 1998, representing 66.6 per cent of the EU average, the regional levels fluctuate between 123 per cent in Prague and 51 per cent in Central Bohemia.

Project of European Regions in the Czech Republic

European Region	Administrative Regions	Population, mil.	Size, km ²	per capita GDP*
Prague	Prague	1.193	496	113.9
Central Bohemia	Central Bohemia	1.105	11,014	49.0
North-West	Karlovy Vary Ústí nad Labem	1.130	8,650	57.0
South-West	České Budějovice			
	Plzeň	1.170	17,617	60.2
South-East	Jihlava Brno	1.661	13,991	58.9
North-East	Liberec Hradec Králové	1.490	12,440	55.1
	Pardubice			
Central Moravia	Olomouc Zlín	1.245	9,104	51.1
Northern Moravia	Ostrava	1.286	5,555	57.0

* PPP. % of EU average

Source: CSO