

## I. GENERAL INFORMATION

### I.1 Overview of the First Ten Years of Economic Transition

#### Early Transition Policies and Outcomes

The Czech Republic has awed observers of transition economies since within three years of the fall of communism, the government liberalized nearly all prices, privatized much of the economy, decentralized wage setting, and opened the country to world trade while maintaining a relatively balanced budget, low inflation, and low unemployment, below 4 % until 1995. The Czech GDP per capita level of over five thousand US\$, with PPP adjustment factor of about two, was (and remains) high in comparison to other transition countries. Furthermore, the economy appeared to be on an accelerating growth trajectory. By 1995, the initial transformation recession and the negative impact of the split of Czechoslovakia were over, and the economy grew by almost 6 %. While 1996 recorded still a robust 5 % growth rate, in 1997, it was becoming increasingly clear that the macroeconomic success was not based on solid microeconomic foundations.

In particular, mass privatization followed a tacit doctrine of economic nationalism as most property was transferred to local owners, either by offering loans to local buyers or through the voucher scheme. Privatization failed to generate sound corporate governance and often resulted in incestuous ownership relations. Large banks remained under government control in order to “fuel” transition with credit while

bankruptcy and foreclosure laws were weak, making room for lax financial discipline. As a result, while the economy was growing, banks were accumulating nonperforming loans at a distressing rate. While both Hungary and Poland lowered their share of nonperforming loans from about 28 % in 1994 to less than 10 % in 1998, the Czech share stood at 33 % in 1998, comparable to that of Romania.

The local owners of privatized firms were indebted from the start and lacked the managerial capital to restructure and operate firms, which faced fierce international competition due to a high degree of openness. The loose access to bank credit coupled with a weak legal and impotent judicial system resulted in massive asset stripping (tunneling) of privatized enterprises.

Clearly, privatization was only one method of creating private sector output. Throughout the early transition period new (de novo) private firms were also being created. While early on credit to small firms may have been generous, retained profit was a major determinant of new investment. Small firms were apparently the force behind low Czech unemployment. Survey evidence suggests that small new private firms were responsible for almost all of the vigorous Czech job creation during early reforms so that five years into transition de novo firms offered more jobs than the state and privatized firms combined.

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Year	1996	1997	1998	1999	2000	2001e
<b>GDP</b>						
GDP Growth	4.8	-1.0	-2.2	-0.4	2.9	3.4
<b>Foreign Trade</b>						
Exports, y/y %	9.2	8.1	10.7	6.6	18.8	14.8
Imports, y/y %	14.3	7.2	7.9	5.8	18.7	16.1
Trade Deficit as % of GDP	-10.0	-8.3	-4.4	-3.4	-6.3	-5.7
<b>Balance of Payments as % of GDP and Its Main Components</b>						
Current Account	-7.4	-6.2	-2.5	-3.0	-4.7	-4.8
Capital Account	7.2	2.1	5.2	4.7	6.8	n.a.
Inflow of FDI	2.5	2.4	6.6	11.9	9.3	9.2
Inflow of FDI (bln. USD)	1.4	1.3	3.7	6.3	4.6	4.5
<b>Inflation, interest and credit</b>						
CPI, y/y %	8.6	10.0	6.8	2.5	4.0	4.1
Prague Interbank Offer Rate (PRIBOR 3M, %)	12.0	16.0	14.3	6.8	5.4	5.2
Credit to Enterprises and Households, y/y %	10.6	9.4	-3.5	-3.9	-2.9	n.a.
<b>Labor Market</b>						
Unemployment, %	3.1	4.4	6.1	8.6	9.0	8.6
Nominal Wages, y/y %	18.0	11.9	9.3	8.2	6.6	8.9
Labor Productivity, y/y %	4.6	-0.3	-0.8	1.4	8.0	6.6
<b>Public Finances</b>						
General Government Balance as % GDP	-0.3	-1.2	-1.5	-0.6	-3.7	-4.9
Idem, Excluding Extraordinary Items	-1.9	-2.0	-1.5	-3.0	-4.3	-9.0
<b>Exchange Rates</b>						
CZK per USD	27.1	31.7	32.4	34.6	38.6	38.1
CZK per DEM	18.1	18.3	18.3	18.9	18.2	17.2

Source: CSO, CNB, Ministry of Finance, World Bank, various local sources.

### The Currency Crisis and Recession of 1997

Weak corporate governance allowed wages to grow two times faster than productivity, which led to higher demand for imports of consumer durables and increasing foreign trade and current account deficits. These were financed by an inflow of short-term foreign capital attracted by high interest rates locked in by the fixed exchange rate regime.

Eventually, however, the implicit liabilities of soft loans to large old firms became

explicit and the worsening performance of the economy led to an increase of the public budget deficit. Shortly after the current account deficit ballooned to 7.4 % of GDP in 1996, the imbalances—both internal and external—were noticed by capital markets and led to an attack on the Czech currency in May 1997. The attack forced the surrender of the fixed exchange rate regime and the crown depreciated by approximately 10 %. The Czech National Bank used high interest rates to stabilize the currency and also strengthened provisioning require-

ments, leading to a credit crunch. Meanwhile, the government was forced to implement a strict austerity program. All of this naturally sent the economy into a deep recession.

The recession was prolonged with GDP in the red for three consecutive years while other Visegrad countries enjoyed substantial growth. Registered unemployment increased from 3.9 in 1996 to 9% in 1999 and wage growth slowed down, hand in hand with government spending. The recession was driven by a decline in both private spending and investments, while net exports were mostly improving the overall picture – also thanks to the weaker currency.

The downturn shattered the illusion of successful reforms and contributed to the fall of the long-serving coalition government headed by Václav Klaus' Civic Democrats and the resulting early elections of 1998. Further, following party finance scandals, a significant number of Civic Democrats established a liberal right-center party. The early elections of 1998 were won by Social Democrats, who were unable to form a majority coalition. On the other hand, personal animosity among the leaders of the former right-center coalition partners blocked their majority coalition. The so-called "opposition agreement" between the Social and Civic Democrats opened a way out of the deadlock. The Civic Democrats committed themselves to tolerating a minority one-party government of ČSSD in exchange for a dominating role in the Lower and Upper Houses and participation in the sale of remaining large state firms.

### **Recent Macroeconomic Development**

Starting in 1998, the strict monetary policy was relaxed by the central bank. Fac-

ing the recession, the new government revived structural reform and privatization, this time relying on strategic foreign partners. Further, in April 1998, the government introduced an aggressive FDI incentive package for manufacturing investors, bringing more than USD 10 mln. Yet, 1999 GDP remained in the red.

Finally, in 2000 the economy took off. Investments started to grow, most of all thanks to the surge of foreign direct investments, but domestic firms started to invest more as well. Private consumption also accelerated so that only net exports exhibited mixed performance. While GDP statistics do not reveal the fast growth of public spending, part of the government spending is of course hidden in the private demand and investments components. Overall, GDP growth stood at 2.9% in 2000.

In the first half of 2001, GDP growth accelerated further to 4%, still driven mainly by investments and private consumption. Private consumption was fueled by increasing real wages (reaching an annual growth rate of over 4% in the second quarter of 2001) and robust consumer confidence. This makes one wonder about net exports, which indeed have recently had a negative effect on GDP growth.

The 1997-99 recession helped to limit imports and thus also the foreign trade deficit, the main cause of external imbalance, from almost 160 bln. CZK in 1996 to just above 60 bln. CZK in 1999. Yet, when the economy started to grow in 2000 the deficit doubled again, and it continued to widen in 2001. It should be noted, however, that not all of the increase is attributable to the revival of economic growth. Higher prices of oil and other raw materials have been among the significant factors behind

growing imports as the Czech economy is to a large extent dependent on imported raw materials. Further, it was often the case that foreign investors imported the major part of technology when investing in the country. Finally, the economic slowdown in the EU also limited the growth of exports. The EU is by far the largest trading partner of the Czech Republic. Thus, higher domestic demand was an important but far from exclusive factor behind the widening trade deficit.

When evaluating the current account deficit, one should acknowledge these external factors that deepened the trade deficit. Still, the current account now appears worrisome, reminding one of the 1997 crisis. The deficit narrowed from above 6 % of GDP in 1997 to around 3 % in 1998 and 1999, but the year 2000 saw it worsening to just below 5 % of GDP. This trend has been continuing through 2001, likely leading to an annual deficit in the vicinity of that of 1997.

The key difference from the 1997 situation, however, is in the financing of the current account deficit. While it was unstable short-term capital that financed the current account deficit prior to the 1997 crisis, the current deficit is now being financed by direct investments, which are long-term in nature. The inflow of FDI (as a share of GDP) is now four times higher compared to 1996-97 and appears to be able to safely finance the current account deficit.

A current account deficit caused by imports of technology and financed by inflow of direct investment is precisely the type of a deficit one would like to see in a transition economy; it implies a transfer of resources from abroad and should lead to higher economic activity and productivity. The potential problem of the Czech economy is that

only a part of the current account deficit is of this nature.

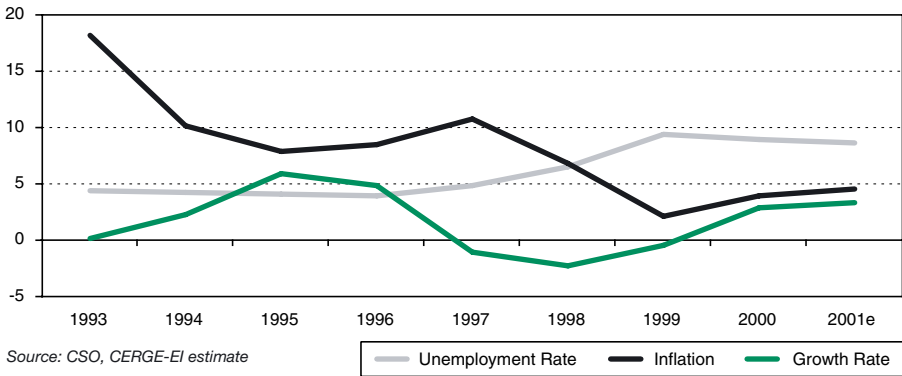
The one macroeconomic variable that has been under control throughout the whole Czech transition is inflation. Low domestic demand during the 1997-99 recession, combined with relatively strict monetary policy and low commodity prices lowered the average inflation rate to 2.5 % in 1999. It also helped that the government froze the upward adjustment of regulated prices of housing and utilities. Yet, starting in 2000 several important factors have been working to increase inflationary pressures. The revival of domestic demand, higher commodity prices (mainly oil) and several idiosyncratic factors (food prices, the impact of the BSE disease) increased average inflation to 3.9 % in 2000 and are likely to push it over the 5 % mark in 2001.

Interest rates followed the decline of inflation with a time lag, as did the central bank in its setting of official rates. Thus, in contrast to most of the 1997-99 period, real interest rates are currently quite low.

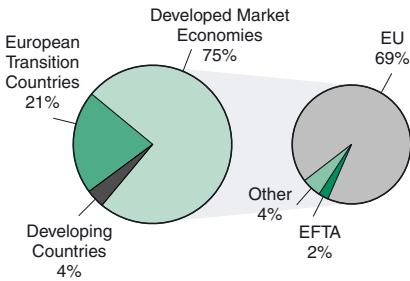
The exchange rate, after the marked depreciation of 1997, regained strength and remained relatively stable. The strong currency combines with low real interest rates and the limited growth of bank lending to cast a neutral to relaxed overall monetary policy. Recently, the privatization of banks and the planned privatization of the Czech telecom and utility monopolies led to an unhealthy rise in the value of the crown.

Yet, the main macroeconomic concern is the high and growing public finance deficit. The deficit only partly stems from temporary issues. Netting out extraordinary budget items including privatization receipts and the costs of bank restructuring, the overall balance of the general government mush-

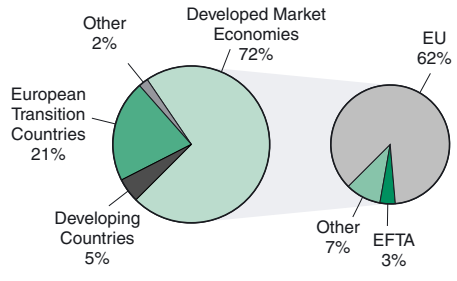
## Economic Growth, Inflation and Unemployment, 1993-2000



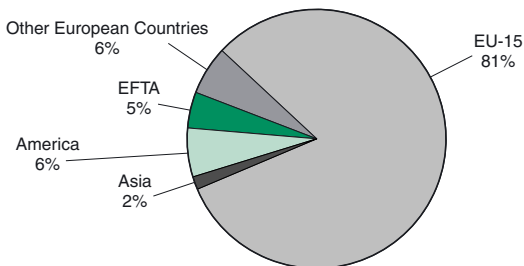
### Territorial Structure of Exports in 2000



### Territorial Structure of Imports in 2000



### FDI Inward Flows in 2000, %



roomed to 4.3 % of GDP in 2000 and is expected to grow by one percentage point in 2001. The ongoing economic recovery makes clear that the deficit is not merely cyclical.

Since fiscal revenue of the Czech government is already high as a fraction of GDP, the adjustment must come on the expenditure side. Yet, most categories of expenditure (including social welfare, housing, and transport) are currently locked in upward trajectories, even though maintenance activities have already been severely restricted in recent years.

Between 1994 and 1999, social security and welfare expenditures rose by 3.2 % of GDP. Public expenditure on social welfare persistently exceeds payroll revenues and the deficit is projected to grow even during the expected years of economic expansion. Worse, these deficits are occurring while the demographic situation has not yet deteriorated. Towards the end of the new decade it will (see Section 1.4 for details on demographic aging).

### **Summary and Outlook**

In sum, the economy is now successfully emerging from the recession with GDP growth rates around 4 %. The recovery is pulled by private investments, primarily FDI, which also finance the widening trade deficit. While inflation is low, real wage growth resumed after the recession and is, so far, in line with productivity growth.

Economic growth depends on the (sluggish) EU's performance, but a crisis similar to 1997 is unlikely if wage demands are curtailed in face of a substantial slowdown. Unfortunately, the external imbalance is again coupled with internal ones. The sordest part of the Czech economy is its fiscal

deficit. The general government deficit (netted of extraordinary budget items) is in the neighborhood of 5 % of GDP and presents alarming evidence of the needed reform of the public finance system. The looming aging of the population makes the fiscal outlook even more distressing.

Among the other main outstanding policy challenges are the inefficiency of public administration, the much-needed reform of the judicatory system, and the taming of corruption. An efficient solution of these problems requires majority support in the Parliament, yet consensus is hard to find. While future growth remains vulnerable to external shocks due to the rapidly deteriorating fiscal situation, the country awaits the closely contested parliamentary elections of 2002. The elections will likely affect the political feasibility of fiscal reform and are also important in that they can reestablish transparency of the Czech political scene.

The minority-government Social Democrats have made no headway in reforming mandatory spending, but are unconditional and active supporters of the EU accession. Their major achievement is the sale of all large semi-state banks to strategic foreign investors and harmonization of much of the Czech legislation with that of the EU. On the other hand, the opposition-agreement Civic Democrats may pose a threat to a rapid EU accession. The third major political player, the 4-coalition has been clearer in its intent to reform public expenditures and pursue EU accession. It is most unlikely that any of these three parties will be able to form a majority government. Yet, it is not at all clear how the future government coalition will be formed. According to a recent polling survey, the three main political subjects appear in a dead heat of statistical error.

## **The Czech Republic – An Economic Summary of 2001**

*Over the entire year, Czech GDP grew steadily and the overall year average is expected to be around 3.4 %. Unemployment decreased compared to the previous year (2000), and the de-seasonalized rate of unemployment remained stable around 8.7 %. The economy also benefited from previous FDI inflows that have continued in 2001 and could be slightly higher than the 4.6 bln. USD in 2000, although the peak of 6.3 bln. USD observed in 1999 won't be met. These figures confirm that the Czech Republic continues to attract long-term investors, partly due to new investment incentives and partly due to its expected accession to the EU.*

*These positive signals, however, should be interpreted in light of pro-growth governmental policy. The price of the growth is high and may limit future perspectives. In particular, the deficit of public finances rose dramatically. If we do not count the income from privatization, which is by definition exceptional and a one-shot game, but adopt a methodology recommended by the EU, the deficit rose from 4.3 % of GDP in 2000 to an unbelievable 9 % in 2001. The accepted state budget for the year 2002 brings no fundamental improvement and the public finances will stay in huge deficits. Such a rate of debt growth is not sustainable even in the medium-term horizon. Unlike past years, Europe is moving toward a recession and the overall world economic perspectives for the near future are gloomy. These facts put the achieved growth in a different perspective.*

*The existing agreement between the ruling minority Social-Democratic government and the major opposition party is strengthened and resembles a more classical coalition behavior. The government has acquired limited power to intervene in the economy and is able to push certain parts of its agenda ahead although it is forced to limit its legislation to those acceptable by the Parliament.*

*The European Commission's last yearly report on the Czech Republic was generally favorable, and the Czech Republic was ranked in the second group under economic criteria as "a market economy." The Commission appreciates the improvements made in the implementation of *acquis* and the re-attained macroeconomic growth. The major reason for the improvement is that the Czech Republic overcame recession and found acceptable compromises to meet EU requirements during the accession negotiation process.*

*On the other hand, the remaining reservations of the European Commission have not changed. The Commission criticizes the government for avoiding the use of public tenders and for the unsatisfactory state of corruption. The legal system and the rule of law have to be improved as well as the fiscal situation. The European Commission mentions the problematic state administration, the need for reform of the judiciary and fiscal systems, and the inadequate taming of corruption. These warnings are a clear message.*

*In 2000 the major parties agreed on controversial changes in the laws and constitutional changes that would limit the president's power and limit the independence of the national bank. A change of the electoral system in favor of large parties was made as well. The president vetoed these changes but the Parliament has overridden his vetoes. Challenges to the constitutionality of these new laws were filed with the Constitutional Court, which consequently nullified these changes in its rulings.*

### **Year 2001 in the Czech Republic – Major Political and Economic Events**

#### **January**

- *The year begins with the continuing crisis in Czech TV: public demonstrations lead to the resignation of the newly appointed general director, and Parliament passes a new law on public TV.*
- *Former minister of finance and current M.P. Ivan Pilip and human rights activist Jan Bubeník are arrested in Cuba on charges of anti-revolution activities.*
- *The Constitutional Court overturns several parts of a new election code.*

#### **February**

- *Mr. Pilip and Bubeník are released from Cuba.*
- *A temporary general director of Czech TV is appointed.*
- *Mr. Železný, owner of the license of the most popular commercial TV NOVA, loses his lawsuit against Lauder's CME and has to repay 1 bln. CZK (27 mln. USD).*
- *CNB cuts interest rates.*
- *The Constitutional Court overturns part of a new code on political parties.*

#### **March**

- *CSO conducts the decennial 2001 Population and Housing Census.*
- *The state is asked to buy out another 10 bln. CZK of non-performing loans from Česká Spořitelna (Erste Bank) as was agreed during privatization.*
- *CSO announces that the GDP rose by 3.1 % during 2000.*
- *World Bank recommends that the Czech Republic reduce its public finance deficits, and reform education, health and pension financing.*
- *The Senate vetoes the constitutional amendments that were designed to change the rights of the president.*

#### **April**

- *The EU classifies CR as a country where the discovery of BSE is possible. The Czech government protests.*



- *Parliament rejects a government proposal on rent regulation.*
- *The minister of finance resigns. New Minister Jiří Rusnok is appointed.*

### **May**

- *New Minister of Defense, Jaroslav Tvrdík, replaces Vladimír Vetchý.*
- *The government approves a new highway contract of 45 bln. CZK without a public tender.*
- *Lockheed Martin and Boeing withdraw from 100 bln. CZK tender on new fighters. Other competitors follow; only BAS (Gripen) stays in.*
- *In the tender for Internet connections for all schools of 4.4 bln. CZK only one competitor stays; other bids are rejected on formal bases.*

### **June**

- *The EU and Czech Republic agree on derogation from the EU's requirement concerning the real estate market. The market would be fully open 5 years after accession.*
- *The first case of BSE is discovered in the Czech Republic.*
- *Almost 4 mln. inhabitants receive some form of state social benefits (excluding pensions and unemployment benefits).*
- *Ireland rejects the Treaty of Nice in their referendum, the base of the future EU enlargement.*
- *The Constitutional Court overturns new amendments that were aimed to reduce the independence of the CNB.*
- *The Czech Republic GDP growth during the last two quarters is 3.9 and 3.8 %.*
- *Komerční Banka is sold to Société Générale for 40.2 bln. CZK.*

### **July**

- *The government approves so-called Big Bang, an economic package of 166.4 bln. CZK. The package, however, mainly consists of ongoing or regular programs.*
- *Annual UN report puts the Czech Republic in 21st place on the ladder of "technological advancement," the highest among post-communist countries.*
- *Cell phone use reaches 50 % of the population.*
- *UMTS (Universal Mobile Telecommunication System) tender starts; government wants 5 bln. CZK for each of the 4 granted licenses. Later, only 3 licenses are offered to the incumbents for 6.67 bln. CZK in the first round.*
- *BMW decides to build a new 1 bln. Euro plant (900 mil. USD) in former East Germany. Other considered locations were France and the Czech Republic.*
- *The city of Prague starts a public collection in order to secure the needed 400 mln. CZK for the reconstruction of Charles Bridge.*
- *CNB increases rates.*

- *Czech Telecom agrees to buy the remaining 49 % of cell operator Eurotel from AT&T Wireless and Verizon Communications for 1.475 bln. USD (57 bln. CZK). The government wants to increase the value of Czech Telecom before its privatization.*

### **August**

- *The first incumbent decides not to apply for the UMTS license.*
- *The Senate proposes a new law allowing public access to all documents in the archives of the former communist secret police.*
- *The first government draft of a 2002 state budget assumes a 53 bln. CZK deficit. The first estimates of the current 2001 budget show that a deficit could reach 95 bln. CZK instead of the approved 49 bln.*
- *CSA, the national air carrier, faces the threat of a total pilot strike; agreement achieved at the last minute.*

### **September**

- *Ronald Lauder loses his case against the Czech Republic in London.*
- *EC opposes the Big Bang plan.*
- *The government approves the sale of České Radiokomunikace, a major telecommunications firm.*
- *Terrorists attack in the USA.*
- *Government estimates of privatizing national and regional electricity and gas/oil utilities are as high as 300 bln. and 100 bln. CZK.*
- *The Czech Republic loses its case against Lauder's CME in Stockholm.*

### **October**

- *The Czech government decides to sell the major part (2.5 bln. USD) of the Russian debt (3.6 bln. USD) to an unknown firm Falcon Capital. Russia will repay the remaining 1.1 bln. USD in goods.*
- *Universities start to protest against financial conditions and government education policy. The government originally promised an increase in subsidy by an extra 2 bln. CZK in exchange for a substantial increase in the number of accepted students. After the students were accepted the government refused to increase the budget.*
- *A scenario resembling the CME-NOVA case appears in disputes concerning private TV3.*
- *EC refuses the scenario of restructuring the steel industry with state aid of 34 bln. CZK.*
- *Czech crown appreciates heavily, CNB intervenes against crown.*
- *The government publicly declares its intention to sue Respekt Weekly for 170 mln. CZK for its critique of the government's approach to economics and corruption.*

- *None of the current cellular phone operators is willing to pay 6.7 bln. CZK for the UMTS license.*

### **November**

- *The European Commission publishes its annual report on EU member candidate countries. The report is favorable in general, criticizes increased corruption.*
- *The Parliament approves the modified state budget in the first reading with 46 bln. CZK deficit*
- *Dispute on the amendment of the business code started, privatization could be affected.*

### **December**

- *Two UMTS licenses sold for 7.4 bln. CZK. in total.*
- *Agreement on Temelín reached; the issue becomes a part of the Czech accession obligation.*
- *Government agrees to buy Gripen fighters.*
- *Unipetrol is sold for the second highest bid 11.75 bln. CZK to domestic Agrofert. The government refuses the highest bid 14.5 bln. CZK submitted by British Roche.*
- *German RWE offers 133 bln. CZK for gas utilities and wins the call.*
- *The highest bid for ČEZ, 135 bln. CZK, by Italian Enel is not satisfactory. The government decides to allow Électricité de France and Enel into the second round of the call in spite of the fact that EdF missed the deadline and demanded changes in the contract, which should lead to the automatic refusal of the bid in the call.*
- *State budget for 2002 approved in final reading with deficit of 46.2 bln.*

### I.2 History

The first signs of people living in what is today the Czech Republic are as old as 1.6 – 1.7 mln. 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 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 negotiation 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.
- 2001** Last pre-accession report of the European Commission on the Czech Republic published.

### I.3 Geography



In terms of its area (76,867 square kilometers) 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 neighboring 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.

## I.4 Population

### Age Structure of Population (in %)

	1993	1994	1995	1996	1997	1998	1999	2000
0–14	20.0	19.5	18.8	18.3	17.9	17.7	17.0	16.2
15–64	67.1	67.6	68.0	68.4	68.7	69.0	69.3	69.0
65+	12.9	13.0	13.1	13.3	13.4	13.6	13.7	13.9
Average Age	36.6	36.8	37.0	37.3	37.6	37.9	38.3	38.8
Median Age	35.9	36.0	36.2	36.4	36.6	36.8	37.0	37.6
Index of Aging*	64.3	66.8	69.6	72.3	75.3	78.1	80.5	85.5

Sources: CSO Statistical Yearbook of the Czech Republic 2000, <http://popin.natur.cuni.cz>

\* Index of aging – number of persons aged 65 or over for 100 children aged 0–14

With a population of 10.292 mln. (2000), the Czech Republic is similar in size to Austria, Belgium or Hungary. Its ethnically homogeneous population with an overwhelming majority of Czechs (94.8%), a Slovak minority (3.1%) and small Polish (0.6%) and German (0.5%) 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 69% of total (2000). The population tends to be aging 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 population from 10.333 mln. in 1995 to 10.289 mln. in 2000.

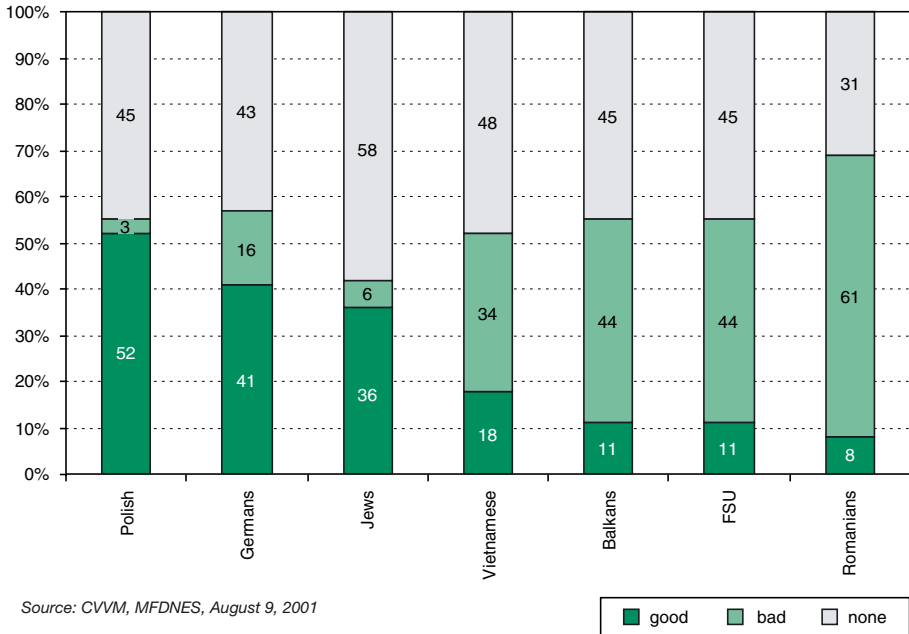
### Descriptive Statistics of Population

Year of Census	1961	1970	1980	1991	2001
Number of Municipalities	8,726	7,511	4,778	5,768	6,258
Total Population	9,571,531	9,807,697	10,291,927	10,302,215	10,292,933
Population – Men	4,640,631	4,749,511	4,988,095	4,999,935	5,019,381
Population – Women	total 4,930,900	5,058,186	5,303,832	5,302,280	5,273,552
	in % 51.5	51.6	51.5	51.5	51.2

Source: CSO

## I. GENERAL INFORMATION

### Relation to Other Nationalities, 2000



### Ethnic Minorities in the Czech Republic

	1991		1995		2001	
	Census	%	Estimate	%	Census	%
Slovak	314,877	3.1	300,000	2.9	183,749	1.8
Polish	59,383	0.6	60,000	0.6	50,971	0.5
German	48,556	0.5	48,000	0.5	38,321	0.5
Romany	32,903	0.3	300,000	2.9	11,716	0.1
Hungarian	19,932	0.2	21,000	0.2	n.a.	n.a.
Ukrainian	8,220	0.1	12,000	0.1	n.a.	n.a.
Russian	5,062	0.1	5,000	0.1	n.a.	n.a.
<b>Total</b>	<b>488,933</b>	<b>4.7</b>	<b>746,000</b>	<b>7.2</b>		

Source: Lidové noviny, May 5, 1998, CSO



## Aging of the Czech Population

Czech demographic development is not positive. During the nineties, the population of the Czech Republic stagnated, and even decreased (in 1990 10.363 mln.; in 1999 10.283 mln.; the last census taken in the first quarter of 2001 recorded 10.298 mln.).

Main factors influencing the demographic development have affected it in different ways: the number of deaths steadily sinks, from 129.2 thousand in 1990 to 109.0 thousand in 2000; the infant mortality rate is, together with Slovenia, the lowest among EU candidate countries (5.2 %); the net migration is positive. But the number of births declines very quickly (the number of live births in 1990 was 130,564, but since that year it constantly decreased until 1999, when it sank to 89,471. In 2000 the number of live births increased to 90,910 and in 2001 this positive tendency has seemed to continue. Nevertheless, the birth rate is very low. In 1992 it was 12.6, while in 2000 only 8.9. This will influence the aging of the population in the future.

Together with individual aging, i.e. steadily increasing life expectancy, the share of the population in older age groups has grown and shapes the dependency ratio, the share of the population aged 65+ on the group of "working age" population aged 15–64; the standard indicator of population aging. Even if at present the share of

### Age Structure Development and Projection (% of Total population)

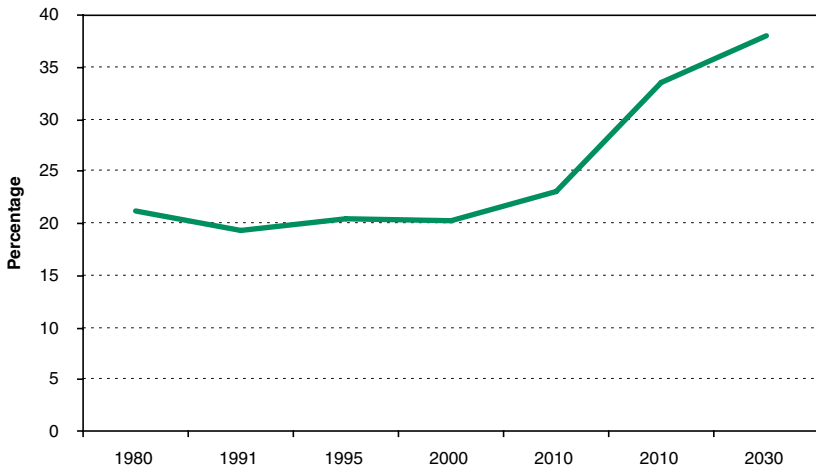
Age	1980	1991	1995	2000	2010	2010	2030
0 – 14	23.5	20.6	18.3	16.2	13.7	13.7	12.4
15 – 64	63.2	66.6	68.4	69	70.2	64.7	63.5
65 +	13.3	12.8	13.9	13.9	16.1	21.6	24.1

Source: Czech Republic Population Development (CSO, 2001), Projection: Statistical Yearbook 2000, CSO, middle variant

the elderly in the Czech Republic is lower than in most European countries (in the EU – 15 the average share of people aged 65 and over reached in 1998 16.2 % of the total population and in the Czech Republic 13.7 %), demographic projections show a high increase of this share in the future.

Demographic factors of aging influence deeply the number of people who benefit from age-related social programs, especially pensions. This is why many countries including the Czech Republic are advocating reforms that would modernize pension systems and strengthen private pensions savings. On the other hand, life expectancy will be increased by better living conditions of the elderly (the present Czech sexagenarian is much younger than sexagenarian twenty or more years ago). This is the true reason for prolonging the eligibility of pension age. These facts call for an active policy of offering to the elderly schooling programs, half time employment, etc. (In

### Old Age Dependency Ratio Development Projection



Source: Czech Republic Population Development (CSO, 2001), Projection: Statistical Yearbook 2000, CSO, middle variant

*the Czech Republic there has already existed for many years a “university of the third age”, with more than 30 branches of tuition, which is still not fully exploited by this generation in comparison with other countries).*

*Also the birth rate will begin to grow in those societies where many families have decided to postpone their first child for some years. The postponement should last about seven years in the Czech Republic. And for those families who decide to have fewer children or none at all, the adults will have relatively more means of providing for their own old age.*