

ECONOMIC GROWTH STRATEGY OF THE CZECH REPUBLIC 2005 – 2013

EXECUTIVE SUMMARY



**Institutional
Environment**



**Sources
of Financing**



Infrastructure



**Human Resource
Development**



**Research,
Development
and Innovation**



Smart Growth



Benefits of the Economic Growth Strategy

Looking back at our work, we can see a number of accomplishments. The growth of the Czech economy is approaching the five-percent mark, public finances are gradually recovering, and foreign direct investment into our country is increasing. The economic growth is healthy, driven by exports and investments. Employment trends are finally starting to change as well. What is then the reason for creating a new Strategy?

The instruments we use to steer the economic policy today will not be sufficient in the future. We must improve our education, language skills, and flexibility to adapt to new conditions to ensure continuing success on the global market. Our law system must provide a reliable guarantee, as opposed to playing the role of a risk factor. The fight against corruption must proceed from urgent calls to systemic changes. Further, additional incentives must be offered to workers and entrepreneurs.

The Strategy summarizes the general principles our country must follow to improve its economic performance in the framework of a European social state. I extend my sincere thanks for a job well done to the creators of this inspiring document. I sincerely hope that in several years time I will be able to express thanks for its implementation.

Jiří Paroubek
Prime Minister of Czech Republic





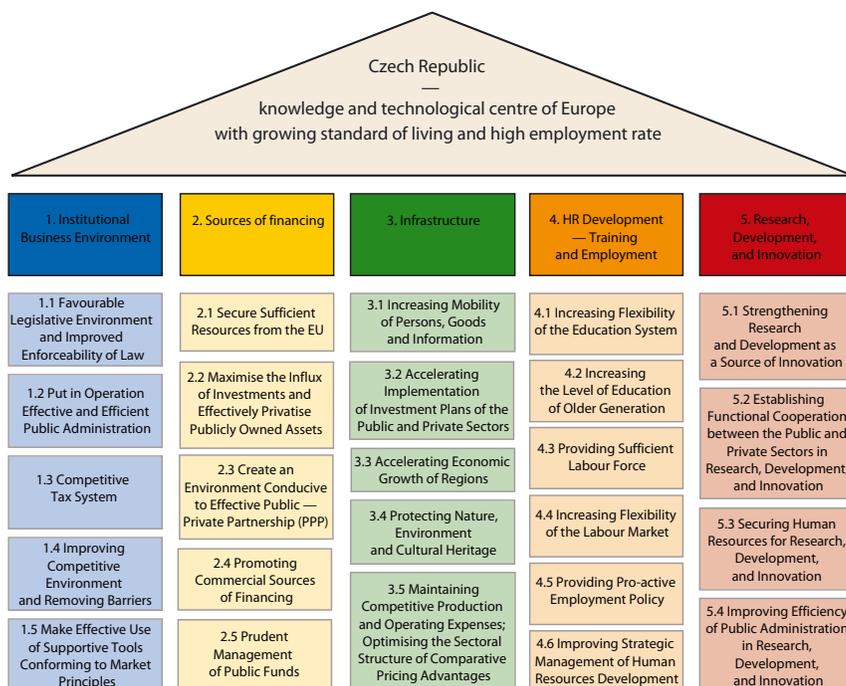


Introduction

VISION: Czech Republic—knowledge and technological centre of Europe with growing standard of living and high employment rate

The objective of the Economic Growth Strategy is to bring the Czech Republic as near as possible to the economic level of the developed EU member states while respecting the principles of sustainable development. Measured by GDP per capita, the country is capable of reaching the EU average level in 2013.

To attain this goal the Czech Republic should use public-sector resources in support of goods and services with high value added, and make the business environment more attractive in order to induce efficient local companies to remain and new foreign ones to arrive. The resulting new jobs and increased productivity will then positively influence the standard of living of the population.





Objectives of Economic Growth Strategy

The Economic Growth Strategy of the Czech Republic (EGS) elaborates the economic pillar of the Czech Republic Strategy for Sustainable Development, taking into account the objectives of the other two pillars of sustainable development, and comprises three main tasks. The first involves setting priorities for coordination of economic policy up to 2013 and directing assistance from the EU funds in the period 2007—2013. The second task is to create for clients of the state sector—citizens, entrepreneurs and corporations—optimum conditions for their economic activities. To this end it will be necessary to inform the public and individual businesses about the EGS priorities to improve their expectations. And the third task of the EGS is to contribute to maximum efficiency in directing limited public resources in areas of direct intervention.

Focus of the Strategy

EGS is a strategy of priorities and, as such, does not deal with all problems and deficiencies.

Several areas exist that affect, directly or indirectly, international competitiveness of business entities regardless of their size or number of employees. Legislation, the tax system and regulation constitute the rules of the game that apply in a given economy. The access to and price of funding affect the speed of undertakings' reaction to changing market environment. The transport, information, real estate and energy infrastructure influences the cost of production and services, which often rank among main inputs. No business can become competitive without an adequate number of workers possessing the necessary training and skills, available at the given place of business. Last but not least, practical utilisation of R&D results and the ability to innovate products and services are of fundamental importance for productivity of labour and for the standard of living. The ability of the state to influence the conditions in these areas varies—from setting up rules to the role of a sole provider of services and resources.

Therefore, the Economic Growth Strategy focuses on five priority areas—pillars that constitute the foundations on which competitiveness of the Czech economy rests. They include: Institutional Environment, Sources of Financing, Infrastructure, Human Resource Development, and Research, Development and Innovation.

Growth-promoting measures direct the Czech Republic towards areas and services with high value added, resting on a highly skilled workforce and active utilisation of the results of domestic as well as foreign research and development, thus increasing its competitiveness.

Czech Republic in a Globalised World and in the European Union



Opportunity for the Czech Republic

Progressive economic environment opens unexpected vistas to all citizens of free countries. Thanks to globalisation they now can offer labour, goods and services to all. As a result anybody can satisfy his or her needs by choosing not from an offer restricted to a certain area, but from the offer of the entire global economy.

Today, goods and services are not primarily the products of a given country, but rather the products of certain brands or standards. Goods can be conveyed on enormous distances with minimum unit cost. Products lose their material character. The ever-increasing proportion of intellectual work in combination with progressive means of communication virtually wipe render national and supranational borders irrelevant. A centre providing telephone services can be located on the other side of the globe without any change in quality. Even research centres are being established in regions recently considered backward. It is increasingly difficult to keep track of in which country products actually originate and where the corresponding tax is to be levied.

The contemporary financial sector enables mobilisation and transfer of funds at an extreme pace. Any information is immediately reflected in the market. The volume of financial transactions, their incidence, diversity and complexity continue to grow. In addition to the traditional core banking the role of capital markets is increasing. The capital managed by pension funds grows dynamically. Financial markets become increasingly integrated, and clients require a single centre for all services.

The huge rise in consumption has adverse impacts on the environment and in the long run will be limited by availability of raw material resources. We therefore stand up for the concept of sustainable development.

Risks of social character exist, too. Freedom, democracy or national identity are not values existing automatically, and society must guard them carefully. Equal access to fundamental conveniences such as education and mutual assistance in sickness or poverty ranks among incontrovertible values of modern European society.



Globalisation offers an enormous opportunity to our country. We live in a democratic society and are a member of formations such as United Nations, OECD, European Union, NATO, WTO, IMF, WB, EBRD and EIB. In practically all areas we have implemented standards securing our comparability with the rest of the world.

Czech labour has been greatly appreciated worldwide as highly skilled, flexible and adaptable, benefiting from forbearance in wage matters and collective bargaining. However, the progressing global competition may rapidly change our relative advantages. A universal key to bolstering our competitiveness is the Lisbon Strategy for improved economic growth.

Major changes will be necessary in our institutions. Czech law must be made more transparent, comprehensible and more predictable for the user. Its enforceability must not be formal. In addition to repressive measures attention should be paid to education for legal consciousness, creation and observance of ethical codes of conduct.

Focus on cheap labour is no key to economic growth. While less skilled labour is subject to enormous competition from new regions, demand for top-quality work increases at the same high rate as its price. To a much higher extent the system of university financing must reflect the quality of education and the rate of assertion of the graduates on the labour market. One can hardly disregard the fact that demand for graduates of some schools is enormous while unemployment looms high for others, or that the average salaries of graduates from similar schools differ considerably.

Although we can be in general satisfied with the quality of primary and secondary schools, the ability of the education system to develop creativity must be further promoted. Language skills are another weak point. Students should be offered a possibility to study abroad. People capable of working in international teams, with a high level of theoretical knowledge, are not endangered by unemployment and consistently earn the highest salaries. A high proportion of highly skilled experts is a prerequisite for launching progressive technologies and active participation in efficient research, which consequently raises the level of education.

Attractiveness of a country for economic activities depends, besides stable institutional environment and supply of highly skilled labour, on competitiveness of costs, including taxes. It is necessary to keep looking for new ways to increased motivation for work and business.

It is necessary at the right time to introduce the common European currency and to remove all barriers that still separate our market from other countries.

In addition to the presence of major international companies, increased



attention should focus on small and medium-sized enterprise as an important source of employment and innovation.

Social consensus constitutes a valuable benefit in the Czech Republic. Maintaining it ranks among major objectives of economic policy. Reinforcement of motivating elements cannot operate to the detriment of the fight against poverty and social exclusion. The unavoidable loosening of some outdated elements in labour relations cannot be replaced by blanket dissolution of elementary rights of the employees.

Dynamic development is indeed conditional on the development of sustainable transportation systems and information technologies, which substantially influence attractiveness of the country.

Within a long-term and efficient partnership of the private sector with the public administration and the relevant interest groups it is desirable to apply the principles of corporate social responsibility (e.g. respecting the existing legal framework and rules of fair trade, identification and integration of social and environmental aspects in the everyday decision-making process, investing in professional development of employees, or safety and protection of health of employees).

Appropriate environmental policy creates suitable conditions for innovation, development of new technologies and markets, increased competitiveness based on the principle of more effective utilisation of resources and new investment opportunities.

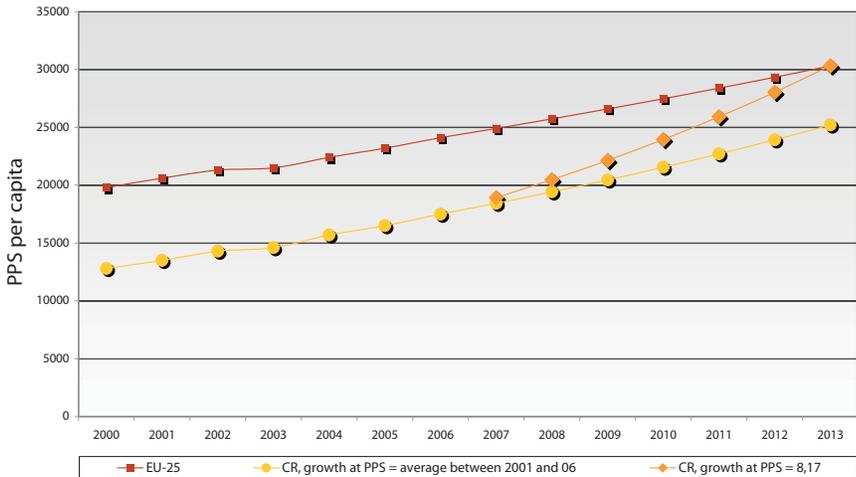
The modern world offers an unparalleled opportunity to the Czech Republic. We should not be afraid of it, but rather we should perceive it as a challenge to be faced actively. This Strategy constitutes a list of selected measures to be undertaken jointly by the government and the private sector on our way to further prosperity.

Main Objective: Attaining the Level of EU-25 by 2013

If the necessary growth-promoting measures proposed in the Strategy are implemented the Czech Republic will be indeed able to reach 100% of the EU-25 average level in 2013. The GDP per capita expressed in purchasing power units (PPS—the Purchasing Parity Standard), is an adequate indicator. The Czech Republic reached 70.1% of the EU-25 level in 2004. Eurostat predicts that the country should reach 72.6% in 2006. To reach 100% in 2013 the Czech GDP expressed in constant prices should grow between 2006 and 2013 at 6% a year. This calculation expects that between 2006 and 2013 the EU-25 economy will

grow at the same annual rate as between 2001 and 2006 and the rate of inflation in EU-25 will be in the region of 2 percent. The following chart shows the required acceleration in the rate of growth.¹

Attaining the EU-25 level in 2013



Source: 2001—2006: Eurostat, 2007—2013: our own calculation

Investments and exports have been the main driving force of the growth of GDP in the recent years. Compared with other countries the share of personal consumption is low and has continued to decrease.² Personal consumption should become the main driving force of future growth in order to achieve gradual approximation of the standard of living to that in developed countries. The relatively high rate of unemployment ranks among factors that have hampered a rise in personal consumption. The Strategy proposes measures aimed at increasing mobility of the workforce, improving its skills or reinforcing incentives in the tax system and the system of social benefits.

- 1 The figures up to 2006 are actual data and the Eurostat predictions, respectively. The period between 2007 and 2013 in the entire 2001—2013 series constitutes an extrapolation of the average growth as attained before 2006. The series covering only the period 2007 - 2013 depicts the rate of growth necessary for reaching 95% of the EU-25 level.
- 2 In 2004 the contribution of personal consumption to GDP was 49.7%; the corresponding EU-25 figure was 58.2% of GDP. The proportion of the government expenditures in purchased goods and services also decreased somewhat and amounted to 22.8% of GDP in 2004 (the EU-25 average was 20.8%). The contribution of investment to GDP has remained constant at a level considerably higher than in EU-25: in 2004 it reached 27.2% (the EU-25 average was 19.6%). Net export experienced the most dynamic growth over the last four years; its negative balance dropped from -3.1% of GDP in 2000 to -0.4% of GDP in 2004. Over the same period export denominated in growth by 64.7% (import grew by a mere 45.3% over the same period).



Macroeconomic stability constitutes an important factor prerequisite for kick starting and maintaining a high level of economic growth. At present, public finance constitutes the main potential source of instability, with deficit in excess of the Maastricht criteria for accession to the Eurozone. The deficit is of structural character and thus, without fundamental reform, we can hardly expect that it will be reduced substantially and the rising public debt arrested. Continuing budget deficits at the existing or even higher levels and a growing public debt could induce the central bank to raise interest rates with the ensuing adverse impact on both consumption and investments. Thus, reforms aimed at elimination of the fiscal imbalance will be necessary; in particular, a pension reform should be started.

Resolving the issue of deficits is a prerequisite for accession to the Euro, envisaged in 2010.³ Prior to the accession to the Eurozone a certain degree of real convergence must be attained to avoid the risk that the monetary policy of the European Central Bank would be either overly restrictive or overly expansive for the Czech Republic. Attention should be also paid to setting the exchange rate correctly. Undervaluation would de facto mean a transfer of a part of national assets abroad, while overvaluation would complicate the situation of Czech exporters. In connection with accession to the Eurozone it is also necessary to pay attention to the stability of the European currency itself, since international economic relations of the Czech Republic are not restricted to the Eurozone only. The principal risk involves budgetary deficits in individual member states, undermining confidence in the currency. Stress should therefore be laid on maintaining fiscal discipline in all member states.”

Czech Republic as part of the European Union and the Lisbon Strategy en route to enhanced competitiveness

In attempting to accelerate economic growth the Czech Republic is not alone. Already in March 2000, at the Lisbon meeting of the European Council, EU representatives declared an extremely ambitious objective: by 2010 make the EU the most competitive region in the world—a knowledge-based economy,⁴ capable of achieving sustainable growth, offering more high-quality jobs and capable of reaching social consensus. What has become known as the Lisbon Strategy also aims at raising the average annual rate of economic growth to 3% by 2010 and

3 *In this context, EGS fully conforms to the Strategy for Euro Accession.*
4 *A knowledge-based economy creates added value by making use of knowledge and not merely of manual production, and stresses education and utilisation of scientific knowledge to spur its overall competitiveness.*



creating additional 20 million jobs.⁵ From the point of view of economic policy the relations between the three objectives—economic, social and environmental—are competitive rather than complementary, at least in the short run.

In 2004 the European Commission established a team headed by the former Dutch Prime Minister Wim Kok. The team stated that the principle of the strategy is essentially correct, but the problem lies in a rather excessive number of priorities and in meeting them all. The discussion that took place in early 2005 resulted in the Lisbon Strategy having been redrafted; the new wording was approved by the European Council in March 2005. Growth and employment became the two principal objectives. Europe should become a place more attractive for investments and employment, and should enable the creation of more and better job opportunities. Moreover, Europe must focus consistently on knowledge and innovation as fundamental prerequisites for economic growth.

In March 2005 the European Council obliged member states to draft national reform programmes (the so-called Lisbon Programmes). The National Reform Programmes will be valid for three years and may be revised. The EGS will be the fundamental underlying material for the Czech programme. The EGS is a strategy prepared by a country that treasures European values and is aware of the fact that EU membership has contributed to its competitiveness. Its philosophy is based on the Lisbon Strategy. The Czech Republic assesses realistically its current position among the EU member states and strives to achieve convergence at the level of the most developed ones. The country is also aware of its comparative advantages established both in recent and more distant past and is determined to utilise them in full to strengthen its competitiveness and increase the standard of living of its population. At the same time the Czech Republic acknowledges its comparative disadvantages and is set to remedy them.

5 *The principle of sustainable development.*

Key measures under the Economic Growth Strategy



The text below summarises the key measures proposed by the Economic Growth Strategy that are in their full contained in the full unabridged version of the EGS.

1 Institutional Business Environment

The Czech Republic needs a more favourable legislative environment, and enforceability of law is a problem too. Many cases handled by Czech courts take inadequately long. The Czech Republic thus faces actions before the European Court of Human Rights. The transaction costs of the society are further raised by continuing amendments to fundamental legal regulations and adoption of new, poorly co-ordinated regulatory measures. Corruption in the Czech Republic is perceived as a serious problem that is not handled properly, and the fight against corruption should become one of the main priorities of the Czech government.

WE THEREFORE RECOMMEND:

- Reorganise the judiciary without delay and reduce the formal character of decisions adopted by courts. Recodify civil, commercial and labour law. In the newly conceived labour law promote the freedom of contract.
- Enact a new insolvency act enhancing the role of creditors, include in the legislative process an analysis of the impacts of new legislation, systematically eliminate opportunities for corruption in the public administration, and adopt new regulation of the conflicts of interests.

Acceleration of economic growth is conditional on better and more efficient public service (to be provided at a relatively low cost). This can be achieved by simplifying the communication between the state administration and private entities, in particular by more extensive use of information technology. The average rate of performance in the public administration is lower than in the private sector.

WE THEREFORE RECOMMEND:

- In all state administration bodies implement audits (dealing with organisation, functioning, processes and information). Implement a uniform, centralised procurement system for all state administration authorities.



- Modify the system of compensation in the civil service and strengthen the feedback between users and providers of public service. Promote electronic communication with the state administration and interconnect individual registers of the public administration.

There is no need to conceive the tax system of the Czech Republic so that it would at all costs compete with other countries by means of low taxes. The purpose of the measures proposed is to maintain and promote competitiveness of the Czech Republic.

WE THEREFORE RECOMMEND:

- Make use of the implemented environmental tax to reduce the rate of direct taxes. By changes in personal income tax support economically active citizens.
- Prevent the rates of social security and health insurance from becoming a factor reducing competitiveness. Set a cap on the assessment base for the mandatory social security and health insurance, equal initially to five times, then four times and finally three times the average wage.
- Beef up competitiveness of the Czech Republic through a value-added tax system. By means of the tax system motivate companies to reinvest profits in the Czech Republic.

Some sectors of the economy do not function effectively because of distorted competition. In particular, unbalanced demand and supply in some sectors may enable creation of local oligopolies or monopolies.

WE THEREFORE RECOMMEND:

- In justified cases privatise the remaining majority stakes owned by the state in "monopolistic" industries. Eliminate adverse effects of public support on competitive environment of the relevant market.

Entrepreneurs have to communicate with various public authorities and institutions, in particular when establishing a business, but this holds true also afterwards. Entrepreneurs are required to submit repeatedly either identical or very similar data. Excessive administration often represents a substantial amount in entrepreneurs' expenditures.



WE THEREFORE RECOMMEND:

- Introduce centralised contact places; these will be the single points of contact for entrepreneurs in their standard communication with the public administration. Unite or at least approximate forms used by various state administration authorities. By amending applicable laws, reduce administrative burden by at least 20%.

Small and medium-sized enterprises (SMEs) constitute the foundation of the economy, representing 99% of all firms and participating significantly in employment and exports. The support provided to SME in the Czech Republic has been insufficient, one of the main problems of SMEs being their isolation.

WE THEREFORE RECOMMEND:

- Support SME in sectors in which the Czech Republic and its regions are competitive. Direct financial support in a balanced way into business environment creation and direct support extended to firms. Place emphasis on creation of relationships between firms (clusters), implementation of optimised methods of corporate management and development, human resource development and co-operation with universities.



2 Sources of Financing

Full utilisation of the resources of European regional and structural policies has become possible after accession to the EU. These resources should be directed to areas with the highest multiplicative effect and should be utilised in full. Besides European funds, we should keep in mind the supportive instruments of international financial institutions.

■ WE THEREFORE RECOMMEND:

Operational programmes, their priorities and the allocated funds must respect the priority areas of development of the Czech Republic as laid down in this Strategy.

- Launch a special operational programme in support of the business sector, which would be the only programme providing assistance to entrepreneurs. Strengthen the information responsibilities of the responsible sponsors in respect of direct community programmes. Assign top priority to identification of resources for co-financing projects from EU funds.

Private sector resources of exclusively domestic character are insufficient to increase competitiveness of the Czech economy. Foreign direct investments offer support to financing new production, know-how and technologies.

WE THEREFORE RECOMMEND:

- Assess the results of foreign direct investments and, starting in 2007, replace the existing system of incentives by a new system taking into account the development of competition between countries and the needs of individual Czech regions.

Financing major projects in co-operation of the public and the private sector ranks among standard methods in securing public services and public projects worldwide.

WE THEREFORE RECOMMEND:

- Enact a licensing act. Ensure that the PPP Centre participates in all pilot projects so as to secure standard quality of preparation and effective transfer of information and experience. Establish effective co-operation with OECD countries focusing on sharing information and experience.



The conditions for the development of financing by means of increasing own capital can be improved primarily by effective regulation and legislation in the field of organised capital market. Development capital is a dynamically developing but still insignificant form of financing of business activities with a high value added.

WE THEREFORE RECOMMEND:

- Increase transparency and introduce as simple legal regulation of the capital market as possible. Strengthen tax competitiveness of institutional investors. Consider releasing investment limits imposed on institutional investors—in particular pension funds and insurance companies. Establish a central depository and implement transparent multi-level registration of securities. Integrate supervision of the finance sector into a single institution.

Uneconomical management of public funds results in a relatively expensive and low-quality public service. In addition, due to bad fiscal discipline, it also undermines the trust of investors in the Czech Republic and the medium-term schedule of the Czech Republic's entry to the Eurozone.

WE THEREFORE RECOMMEND:

- Consistently respect the rules setting out medium-term fiscal targeting. Perform expenditure audits in respect of all mandatory and quasi-mandatory expenditures with a view to finding potential savings.

Financing the health care system is demanding and expensive. Health care is marked by low transparency, difficult financial situation of many health facilities, wastefulness and inadequate service to patients—seen from the client's perspective. The school system, too, does not make full use of its potential, in particular with respect to pupils and students with above-average qualities and capabilities. The pension system fails altogether to reflect the future demographic developments.

WE THEREFORE RECOMMEND:

- Adopt relevant measures to increase efficiency and prevent abuse of the health care system, and provide continued financial stability of the health care system. Consolidate sickness and health insurance. Reform the pension system as soon as practicable.



3 Infrastructure

A high-quality transport infrastructure is a basic precondition for long-term economic growth. The problem is that one half of Czech Republic's regions still are not connected to the international highway network, and the plan of construction of highways and speedways often fails to be met. The highway, speedway and motorway network needs to be completed in the near future. It is also necessary to rehabilitate 50% of 1st class roads, and the condition of other roads does not meet the economic needs and safety requirements. Railroads are neglected the most. Modernisation of railway corridors was launched too late and keeps protracting.

WE THEREFORE RECOMMEND:

- Provide balance between financing needs and resources for maintenance and development of the transport infrastructure. Improve the process of preparation and construction of the transport infrastructure by state investors. Open talks with the European Commission with a view to strengthening financial assistance to the Czech Republic for 2007—2013 intended for investments in transport networks.

Access of undertakings businesses and households to the Internet is still insufficient. We still considerably lag behind developed countries in terms of high-speed access. This area requires most attention, and we need to keep abreast with latest technological trends. In terms of infrastructure, broadband connection is the most important precondition for knowledge-based economic growth.

WE THEREFORE RECOMMEND:

- Create conditions for the development of high-speed technologies by means of transparent regulation oriented towards support of investments in the development of data networks. Encourage demand of undertakings businesses and households for high-speed connection through a sufficient supply of public services. Stimulate the demand of undertakings businesses and in particular households for high-speed connection by waiving administrative fees for public services rendered electronically.

Sociologic surveys indicate that Czechs are little willing to move for jobs. Besides national mentality, this is mostly due to the regulation of rent for flats. Liberalisation of the housing market may help increase mobility of the labour force.



WE THEREFORE RECOMMEND:

- Gradually release regulation of rental payments in the housing sector.

The country's competitiveness will increase if implementation of business plans accelerates. The principal problem is the complicated construction based on capital investments.

WE THEREFORE RECOMMEND:

- Simplify and accelerate zoning and building procedures by adopting new legislation. Simplify and unify environmental legislation.
Integrate environmental impact assessment into zoning proceedings; issue integrated permits together with decisions under the Building Act.
- Ensure market principles of appraisals of land and buildings by creating pricing maps. Make use of the institute of overall land adjustments for the purposes of capital construction, and rehabilitate the institute of forced purchase of land in public interest.
- Liberalise specific actions of cadastral authorities, building authorities and land planning authorities.

A high-quality infrastructure facilitates economic development of regions. The financial resources of EU funds should be channelled mainly to the transport infrastructure, telecommunications and industrial zones.

WE THEREFORE RECOMMEND:

- Accelerate and complete connection of all Czech regions to the international highway network and to selected railway networks. Within the frame of modernisation and development of the transport infrastructure, prefer routes supporting the establishment and development of industrial zones and clusters.
- Subsidise development of the telecommunications infrastructure based on advanced technology in economically weak or structurally impaired regions.

The economic significance of the environment and cultural heritage will steeply increase in the next decades in connection with the boom of tourism. Protection of these values offers a great potential for future income.

WE THEREFORE RECOMMEND:

- Provide investment funding for environmental issues. Increase fees for the exemption of farmland from the farmland fund, and differentiate the amount



of such fees based on the type of investment. Intensify support of revitalisation of disused urban areas. Encourage the development of combined transport. Complete railway corridors, begin modernisation of railway tracks. Support generation of electricity and heat from renewable resources. Provide higher intensity of support to preserving cultural heritage.

From the point of view of the corporate sector, the price of infrastructure is substantially lower in the Czech Republic than in the EU-15 countries. This fact makes it possible for the Czech processing industry to produce at a substantially lower cost and, as a result, successfully place its products on international markets. The Czech Republic faces a difficult task of how this advantage could be preserved and accommodated to future needs.

WE THEREFORE RECOMMEND:

- Harmonise the amount of proposed taxes, charges and levies, or tax benefits and direct assistance, from the perspective of households, businesses undertakings, non-profit organisations and public budgets.



4 Human Resource Development

To provide its long-term economic growth, the Czech Republic will need a sufficient supply of skilled people. This requires an effectively functioning education system, which has thus far been extremely closed. Many talented people therefore cannot reach high-quality education. The probability that children of parents with a lower level of education will complete university studies is significantly lower than in the children of parents with higher education. It is necessary to ensure equal access to education so that low-income families, too, can afford university studies. Typically, these families with successful students who are granted scholarships from EU funds are no longer eligible for social allowances, as the amount of the scholarship counts as part of the family's income.

WE THEREFORE RECOMMEND:

- Facilitate access of groups threatened by social exclusion to vocational training and university education—by increasing the quality of primary and secondary education and by introducing social scholarships financed by the state. These scholarships would be harmonised with the system of state social support, or protection. Support loans for the costs associated with studies. Harmonise the system of scholarships with the system of social allowances. Ensure that low-income families do not cease to be eligible for social allowances guaranteed by the state as a result of the fact that scholarships count as part of the family's total income. Improve involvement of disadvantaged schoolchildren and students. Increase the offer of comprehensive secondary education and study programmes of secondary vocational schools.

The Czech Republic has too few people with higher vocational and tertiary education. This is due to the low number of people who completed university studies before 1989, and also to the relatively high number of people who fail to complete studies. This situation was satisfactory at the time when the Czech economy was oriented at less demanding sectors and its labour market was based on the low cost of work and relatively well skilled labour force. However, this cannot be sufficient if the Czech Republic intends to become a country with highly skilled labour force.

WE THEREFORE RECOMMEND:

- Expand the offer of programmes of vocational training and bachelor's studies. Consistently apply sanctions for exceeded standard term of study at public universities. Increase functional literacy of schoolchildren by changing teach-



ing methods. Modernise school equipment and improve computer skills and information literacy of teachers and students. Equip schools with ICT, basic applications and programmes and infrastructure, and improve work with information. Expand teaching of foreign languages, primarily English.

An important target group in the sector of education and training is comprised of people who had worse conditions for learning before 1989 and had to adapt themselves to new socio-economic setting. This applies particularly to people above 45 years of age, whether employed or not. It is necessary to develop a system of continued learning, including training in businesses, and acknowledge practical experience acquired in employment.

WE THEREFORE RECOMMEND:

- Expand the offer of programmes of continued professional learning, with an emphasis on language skills and ICT literacy, for the age group above 45 years. Prioritise training provided by employers as part of the overall system of perquisites.

The Czech Labour Code is frequently referred to as little flexible, mainly in the area of dismissals. This increases costs and limits creation of jobs. Another problem of the Czech labour market is the lack of skilled workers. Despite the positive changes introduced by the new act on employment, loss of work permit of a foreigner results in the obligation to leave the country. Dependence of foreigners on the Czech employer is high. On the other hand, young Czech experts often gain practical experience abroad. However, some of them do not return to the Czech Republic, mostly for financial reasons.

WE THEREFORE RECOMMEND:

- Extend contractual freedom in employment arrangements. Simplify the system of granting work and residence permits. Introduce development programmes focused on establishing top-level cooperating university centres that will increase attractiveness of continued work of graduates.

More than one third of all unemployed are in the age category of 45 years and above. The system of social protection (in particular state social support, social security and social care) insufficiently motivate this generation to seek jobs. Offer of active assistance is unsatisfactory as well. It is necessary to take steps that will reduce abuse of the system and improve actual assistance to those in need. The change will make it possible to achieve budget savings, at the same

time improving social protection of people and increasing active access to the labour market.

WE THEREFORE RECOMMEND:

- Assess functionality of the social protection system and subsequently carry out its reform to assure that all activities leading to taking a job will be advantaged. Further intensify sanctions for early retirement. Progressively increase the age limit for retirement. Reduce social security payments in respect of persons disadvantaged in the labour market, in particular above 55 years of age. Support targeted comprehensive retraining programmes.





5 Research, Development and Innovation

The Czech Republic is a country without any significant natural resources. Growth can only be ensured by developing and maintaining competitiveness, which requires regular innovation of products, technologies and services. This is conditional on the implementation and distribution of domestic results of research and development (R&D). In terms of R&D expenditure, the Czech Republic lags behind the average expenditure of EU member states. The target of achieving by 2010 the level of R&D expenditure in the amount of 3% of GDP, repeatedly confirmed in the updated Lisbon Strategy of March 2005, is thus very remote for the Czech Republic. Lower is both public and private expenditure. An increase in public R&D expenditure has demonstrable motivating effect on an increase in expenditure of the private sector.

WE THEREFORE RECOMMEND:

- Increasing annual public expenditures on R&D by 20 to 25% annually and by 2010 ensuring that R&D expenditures account for 1% of GDP.

The Czech Republic as a medium-sized country cannot support all R&D areas. The limited number of scientists and researchers, as well as the limited financial resources, must focus on a smaller number of fields and in fewer directions. Sufficient resources must be created for them, with a view to achieving any relevant results. Support should be provided in particular to those fields and direction of R&D that promise increased benefits for economy and the society.

WE THEREFORE RECOMMEND:

- Changing the structure for distribution of public expenditures on R&D, in particular by strengthening specific-purpose financing to the detriment of institutional financing; channelling increased public expenditures on R&D primarily into industrial research programmes.
- Basing the preparation of new programmes and activities primarily on long-term general research directions approved by the Government.

The Czech research, and not only basic research, underestimates the commercial value of the R&D results achieved. The results are published without protecting the intellectual property rights. One of the reasons for this is the fact that publication of R&D results and findings is preferred to their protection and commercial use. This is due to the bad evaluation system and also to the unsuitable career code in the public research sector. Another cause is the lack of



knowledge regarding the issue of the protection of copyrights and intellectual rights on the part of R&D workers.

WE THEREFORE RECOMMEND:

- Supporting effectively protection of currently unprotected results of R&D through a programme aimed at protecting intellectual property. Improving the knowledge of graduates from natural science and technical study programmes at universities with regard to protection of intellectual property and its economic use.

In respect of some R&D programmes, assistance of public funds is conditional on proportionate participation of private funding. Nonetheless, cooperation of the public R&D sector (universities, the Academy of Sciences of the Czech Republic, sectoral research institutes) with private companies is insufficient. Both sectors have different methods of planning their research work, and different methods of its implementation and evaluation. Numerous obstacles exist, hindering mobility of workers between the two sectors.

WE THEREFORE RECOMMEND:

- Setting up programmes supporting worker mobility between the academic and private sectors.
Setting up a programme of support for transfer of technologies and know-how developed with public assistance for R&D to a broad range of users.

Increasing the R&D expenditures must be accompanied by increasing the number of researchers, of whom the Czech Republic has shortage in comparison with developed countries. It is necessary to rejuvenate research teams and tackle the lack of graduates of natural science and technical study programmes of universities.

WE THEREFORE RECOMMEND:

- Motivating interest in enrolment in natural science and technical study programmes at universities, in particular by improving material and technical conditions for education and research as well as the relevant financial conditions (scholarships, etc.).

Graduates of post-graduate programmes at universities in the Czech Republic are relatively well prepared for research work. However, they lack knowledge



necessary for the management of research activities and for the use and dissemination of the R&D results achieved. Knowledge concerning the protection of intellectual property rights is insufficient as well.

WE THEREFORE RECOMMEND:

- Setting up education programmes targeting research and development workers and managers with the aim of improving their knowledge and qualifications for using and disseminating the results of R&D.

Compared to foreign countries, the support of R&D from public resources is dispersed in a substantially larger number of budget chapters and in a large number of minor programmes. This limits the ability to generate the necessary "critical amounts" of resources. Considerable differences also exist in administrative and methodological procedures. The diffusion of resources significantly increases the demands for coordination. Responsibilities of central administration authorities in the field of R&D are defined in the existing Competencies Act inconsistently and vaguely. Responsibility for drafting and implementing innovation policies is not defined in the Competencies Act at all.

WE THEREFORE RECOMMEND:

- Defining in a clear and specific manner the powers and responsibilities of individual central government authorities with regard to research, development and innovation; concentrating state budget funds allocated to R&D into a substantially lower number of budget chapters.

For the first time in history, the Czech Republic has a long-term Economic Growth Strategy. Its objective is to improve our country's living standard and economic growth.



The Strategy identifies the priorities of our economic policy and recommends the most effective ways for directing funds from the Government's budget and the European Union's structural funds. The Strategy is also intended to present these priorities to the public, the private and public sectors, and all other interested parties. This communication is necessary to allow corporations and households to formulate their plans correctly and make fundamental decisions. For this, they also need comprehensible government policies.

The Economic Growth Strategy is therefore about priorities. It does not aim to deal with or present solutions to problems or deficiencies. The Strategy focuses on five priority areas that are of essential importance for the competitiveness of the Czech economy. They are the pillars of our country's future prosperity. In upcoming years, both corporations and households can expect the Government to pay increased attention to the improvement of the institutional environment, financing sources, infrastructure, human resources, and research, development, and innovation.

I am convinced that the implementation of the Economic Growth Strategy will place the Czech Republic among the most advanced countries in Europe, helping us resume the tradition of economic prominence our First Republic had during the years 1918 to 1938.

Martin Jahn
Vice Prime Minister for Economic Affairs

Steering Group

- **Ing. Martin Jahn, MBA**
 - Vice Prime Minister for Economic Affairs, Steering Group Director
- **Ing. Karel Havlíček, Ph.D., MBA**
 - Deputy Chairman of the Board of Directors of the Association of Small and Medium-sized Enterprises and Private Entrepreneurs of the Czech Republic
- **Doc. Ing. Pavel Mertlík, CSc.**
 - Chief Economist, Raiffeisenbank, former Minister of Finance
- **Ing. Daniel Münich, Ph.D.**
 - Deputy Director for Development and Public Relations, CERGE-EI
- **Prof. Jan Švejnar, Ph.D.**
 - Economist, professor at the University of Michigan Business School, Chairman of the Supervisory Board of ČSOB

Guarantors

- **Ing. Petr Zahradník, Ph.D.**
 - Director of EU Office, Česká spořitelna, a.s.
 - Guarantor of the expert team for Sections 3.1 Institutional Conditions for Business and 3.2 Sources of Financing
 - Experts: **Jan Jedlička, Lukáš Vácha, Filip Hájek**
- **Ing. Hanuš Krejčí, CSc.**
 - Project Manager TCPA and Hyundai, CzechInvest
 - Experts: **Jana Dolejšová, Jan Mareček**
- **Ing. Lenka Míková**
 - Head of the Human Resource Development Policy Unit of the Government Office, and Secretary of the Government Council for Human Resource Development
 - Guarantor of the expert team for Section 3.4 Human Resource Development—Education and Employment
 - Experts: **Běla Hejtná, Jarmila Marešová, Aleš Vlk, Štěpán Jurajda**
- **RNDr. Marek Blažka, CSc.**
 - Director of the Research, Development and Innovation Department, Director of the Research, Development and Human Resources Section, Office of the Czech Republic Government
 - Guarantor of the expert team for Section 3.5 Research, Development, and Innovation



Integration Team

- **David Hofman**
 - Advisor to the Vice Prime Minister, Economic Growth Strategy Project Manager
- **Lukáš Texl**
 - Operations Director
- **Jiří Andrš**
 - Documentation Coordinator
- **Eva Brejchová**
 - Documentation Coordinator
- **Kamila Fialová**
 - Coordinator for Regions and Councils
- **Josef Ježek**
 - koordinátor procesu SEA
- **Kateřina Hadravová**
 - Project Assistant
- **Filip Hájek**
 - Project Coordinator

Economic Experts — Office of the Government of the Czech Republic

- **Doc. Ing. Jiří Havel, CSc.**
 - Advisor to the Prime Minister, Director of IES Department of Macro-Economics and Econometrics, Charles University
- **Prof. Ing. Valtr Komárek, DrSc.**
 - Advisor to the Prime Minister
- **Ing. Jan Mládek, CSc.**
 - Advisor to the Prime Minister

Other Co-Authors

- **Mgr. Petr Hájek**
 - Head of the Business Environment and Legislation Unit, Office of the Government of the Czech Republic, contributor for Section 3.1 (legislation and business conditions)
- **Ing. Ondřej Hartman**
 - Economic Analyses Department, Office of the Government of the Czech Republic, final editing



- **Doc. Ing. Eva Klvačová, CSc.**
 - Director of the Institute for Integration of the Czech Republic to the European and Global Economy, Faculty of International Relations, University of Economic in Prague, contributor to introductory sections
- **Mgr. Ondřej Knot**
 - Researcher, CERGE-EI, final editing
- **Ing. Luboš Lukasík, MBA**
 - Director of the Business Assistance Division, CzechInvest, contributor for Section 3.1.5 (assistance for SME)
- **Ing. Roman Pospíšil**
 - Managing Partner, Svengali Communications, editor
- **Marek Pražák**
 - Managing Partner, Headline Communication, editor
- **Radek Špicar, MPhil**
 - Deputy Vice Prime Minister for Economic Affairs, final editing
- **PhDr. Ondřej Vychodil, M.A.**
 - Researcher, CERGE-EI, final editing

Institutions

- **CzechInvest**
- **Czech Statistical Office**
- **University of Economics, Prague**
- **Technology Centre of the Academy of Sciences of the Czech Republic**

Useful links

- **Economic Growth Strategy:** www.hospodarskastrategie.org
- **Czech Civil Service Portal:** <http://portal.gov.cz>
- **Czech National Bank:** www.cnb.cz



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Published by Office of the Government
of the Czech Republic 2005

Czech Government: www.vlada.cz

ISBN 80-86734-85-4