Regulatory Reform in the Czech Republic

Enhancing Market Openness through Regulatory Reform

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FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *Enhancing Market Openness through Regulatory Reform* analyses the institutional set-up and use of policy instruments in the Czech Republic. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in the Czech Republic* published in 2001. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform*.

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was prepared by Sophie Bismut, Consultant, of the Trade Directorate of the OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in the Czech Republic. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

TABLE OF CONTENTS

Tables

Figure

ACRONYMS

CEFTA	Central European Free Trade Agreement
CEN	European Commission for Standardisation
CENELEC	European Committee for Electrotechnical Standards
CEZ	Ceske Energeticke Zavody (Czech Energy Enterprise)
CMEA	Council for Mutual Economic Assistance
COSMT	Czech Office for Standards, Metrology and Testing
CSFR	Czech and Slovak Federal Republic
CSK	Czech krona
CSNI	Czech Standards Institute
EA	European Co-operation for Accreditation
EC	European Commission
EFTA	European Free Trade Agreement
ETSI	European Telecommunications Standardisation Institute
EDI	Electronic Data Interchange
EU	European Union
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GSP	General System of Preferences
IAF	International Accreditation Forum
IEC	International Electrotechnical Commission
ILAC	International Laboratory Accreditation Co-operation
ISO	International Standardisation Organisation
MFN	Most Favoured Nation
MIT	Ministry of Industry and Trade
MRA	Mutual Recognition Agreement
NATO	North Atlantic Treaty Organisation
NSO	National Standardisation Organisation
OECD	Organisation of Economic Co-operation and Development
OPEC	Office for the Protection of Economic Competition
PECA	Protocol to the Europe Agreement on Conformity Assessment
RIA	Regulatory Impact Analysis
SPS	Agreement on the Application of Sanitary and Phytosanitary Measures
TABD	Transatlantic Business Dialogue
TBT	Agreement on Technical Barriers to Trade
UN-ECE	United Nations Economic Commission for Europe
WCO	World Customs Organisation
WTO	World Trade Organisation

Executive Summary

Background Report on Enhancing Market Openness through Regulatory Reform

As border barriers to trade fall, the impact of domestic regulations on international trade and investment becomes more apparent. While regulations aim at reaching objectives such as health, safety or the environment, that may be in the public interest, they may at the same time directly or indirectly distort international competition, and prevent market participants from taking full advantage of competitive markets. Maintaining an open world trading system requires that regulations do not put unnecessary restrictions on flows of goods and services, thereby promoting global competition and avoiding trade disputes. This chapter assesses to what extent regulations in the Czech Republic achive these objectives and how regulatory reform may contribute to enhancing market openness and the benefits which consumers and producers can reap from open markets.

Over the past decade, the Czech Republic has pursued an active policy to open its domestic market to international competition, and taken bold reforms to remove restrictions to trade and investment flows. It has thus developed a free-market oriented policy with low tariffs, limited non-tariff barriers and openness to foreign investors. This policy has been reinforced by commitments taken through multilateral, regional and bilateral agreements, including through the Czech Republic's endeavour to join the European Union. Foreign firms have made a significant contribution to the transformation of the Czech economy. They have supported employment and exports, and brought in capital, as well as management techniques and access to distribution networks.

The efficient regulation principles for market openness, which have been identified in the 1997 OECD report on regulatory reform, have been largely built into the regulatory framework. Domestic regulations in general give foreign market participants equivalent competitive opportunities. Competition policy and institutions have been developed. The process of accession to the EU has led to a quick implementation of international standards and development of mutual recognition in the area of conformity assessment.

Despite significant efforts to facilitate access to information on regulations and organise public consultation, including with foreign firms, more could be done to enhance the openness and transparency of the rulemaking process in the Czech Republic, and provide all affected parties with the capacity to assess and comment on upcoming regulations. The rulemaking process entails an adequate check of conformity of proposed regulations with international commitments, but does not provide for a systematic economic analysis of their impact on trade and investment. Shortcomings in the legal environment affecting the operation of firms, such as lengthy business registration, insufficient protection of creditors' rights, large discretion of officials in the implementation should also be addressed to create a more competitive Czech business environment and promote the integration of the Czech economy in the global economy.

The globalisation of production and the resulting deeper integration of national markets have reinforced the link between domestic policies and trade liberalisation. As border barriers to trade have fallen around the world, the impact of domestic regulations on international trade and investment has become more apparent than ever before. Although regulations aim at achieving objectives in a range of fields such as health, safety or the environment, that are in the public interest, they may at the same time directly or indirectly distort international competition and lead to negative effects on the economy. Thus regulations should be made in a way consistent with an open trading system and support international competition. This chapter considers how the Czech regulatory environment affects the access of foreign firms to the Czech markets, whether they do it through exporting goods or services, or through setting up their own presence to operate in the market. Another issue — whether and how inward trade and investment affect the fulfilment of legitimate policy objectives reflected in social regulation — is beyond the scope of this review.

1. MARKET OPENNESS AND REGULATION: THE POLICY ENVIRONMENT IN THE CZECH REPUBLIC

1.1. Structural reforms and market openness

Over the past decade, the Czech Republic has pursued an active policy to open its domestic market to international competition. The reform programme launched in 1991 by former Czechoslovakia and pursued by the Czech Republic after 1993 set the general framework for establishing a market economy and for integrating the domestic economy into the global economy. In the early years of the transition, the government adopted a radical approach to reforms, to move quickly from a command to market economy. The reform programme focused on the liberalisation of prices and foreign exchange, privatisation of state-owned companies, drastic cuts in state subsidies to firms, dismantling of the state monopoly over foreign trade and opening up to foreign investments. Commitments taken by the Czech Republic through multilateral, regional and bilateral agreements have further promoted the openness of the economy to international competition. The Czech Republic has developed a free-market oriented trade and investment policy, with low tariffs, limited non-tariff barriers, and openness to foreign investors.

The mass privatisation programme undertaken in the first half of the 1990s permitted a quick reallocation of assets into the private sector, which currently accounts for 77% of GDP against less than 5% in 1989. However, the influence of the State in the economy has remained significant. Through the National Property Fund, the state still holds significant stakes in 264 companies, in particular in the energy and telecommunications sector.[1] Privatisation of banks, which had been delayed, has speeded up since 1998 and is expected to be completed in 2001. Foreign firms were excluded from some of the privatisation projects undertaken in 1992-93 and 1994-95 as the government chose the voucher method. Foreign investors have however played a significant role in the privatisation programme, as they have been the source of over half of all proceeds from large-scale privatisation.

A wide range of reforms has been undertaken to create a regulatory framework for business operations on the basis of market mechanisms. The Commercial Code and the Trade Licensing Act, which were adopted in 1991 and subsequently frequently amended, lay out the conditions for the establishment of companies. Other laws affecting business have been adopted in the area of competition, bankruptcy, taxation, accounting, and property rights. The Foreign Exchange Law of 1995 provided full convertibility of the domestic currency for current account transactions and partial liberalisation for capital account transactions, in view of the economic condition at the time. Along with agreements on investment protection, it guarantees the transfer of profits and capital abroad. The bankruptcy legislation, despite a recent reform, and an inadequate functioning of the judicial system[2] do not allow for an efficient restructuring of firms (see Chapters 1 and 2), which increases the uncertainty of the business environment. The business regulatory environment is also influenced by the current decentralisation process undertaken by the Czech Republic, which entails growing prerogatives of local and regional governments. New regions were established in January 2000 and powers are being reallocated across the different level of the administration.[3]

1.2. Integration in regional and multilateral organisations

In January 1993, the authorities of the newly created Czech Republic stated that integration in the European Union (EU) was their primary objective. In October 1993, the Czech Republic and European Union concluded the Europe Agreement, the trade-related part of which provides for the establishment of free trade in industrial products between the EU and the Czech Republic by 2001. The Czech Republic submitted its membership application in 1996 and in July 1997, the European Commission recommended

that the EU start negotiations for accession with the Czech Republic. The accession process has entailed a huge amount of legislative activity to achieve adoption of the *acquis communautaire* and the approximation of Czech laws and regulations in a wide range of areas, including product regulation, competition policy, government procurement, property rights (see Box 1). At the end of 2000, the government prepared the so-called "euro-amendment" to the Constitution, according to which all international treaties ratified by the Parliament would be an integral part of the Czech legal system.

The Czech Republic, which as former Czechoslovakia had been an original contracting party to the GATT, became a founding member of the WTO in January 1995. It joined the OECD in December 1995, after having completed a number of significant changes in legislation to open gradually the capital account, including the adoption of the new Foreign Exchange Act. Entry into NATO in March 1999 was another major step towards integration in the western area. In the 1990s, the Czech Republic also concluded free trade agreements with non-EU countries, notably a customs union with the Slovak Republic, an agreement with the European Free Trade Association (EFTA) countries and an agreement with Central European countries (the Central European Free Trade Agreement or CEFTA).[4] In January 1997, the Czech Republic adopted the pan-European cumulation system of rules of origin, which means that it has become part of a multilateral free trade area encompassing the EU, EFTA and nine other Central and East European countries.

1.3. Trade liberalisation

In the early 1990s, Czech foreign trade was affected by two major shocks: the first one, similar to the rest of the region, resulted from the disintegration of the Council for Mutual Economic Assistance (CMEA) market, the second one intervened in the aftermath of the dissolution of Czechoslovakia in 1993. Well-developed infrastructure, proximity to western alternative markets and the radical reform strategy, including rapid trade liberalisation, have allowed the country to reorient successfully its trade flows and to adjust its commodity structure. Moreover, in the first years of the transition, the 50% devaluation of the national currency strongly boosted the competitiveness of Czech exports. The fast growth in trade (almost 18% a year between 1989 and 1999) has contributed to foster the external openness of the Czech economy. In 1999, the share of exports of goods and services amounted to 63.6% of GDP, compared to 50.5% in 1994, and the share of imports of goods and services amounted to 62% of GDP in 1999 against 53% in 1994.

Box 1. **EU accession**

In the early 1990s the European Union concluded trade and co-operation agreements with the countries of central Europe. In October 1993, it thus signed the Europe Agreement with the Czech Republic, which entered into force in February 1995. This association agreement can be considered as the first step in the Czech Republic's endeavour to join the European Union. It includes a range of commitments towards the establishment of a free-trade area as well as the promotion of political dialogue, economic, monetary and industrial co-operation, education and training, and harmonisation of legislation. The trade-related part of the agreement aims to gradually establish a free trade area, with a quicker liberalisation on the EU side than on the Czech side. It provides for:

- Elimination of tariffs and quantitative restrictions on imports of industrial goods, by 1/1/1997on the EU side and by 1/1/2001 on the Czech Republic's side.
- Reciprocal concessions in the form of lower tariffs and less restrictive quotas on agricultural imports.
- A prohibition against the introduction of new duties or quantitative restrictions, supplemented with exception mechanisms, some applicable by both sides (safeguard, anti-dumping, shortage, agricultural policy and balance-of-payment measures), and some by the Czech Republic only (infant industries, restructuring social problems).
- Progressive liberalisation of trade in services.

In June 1993, the European Council committed that the associated countries in Central Europe that so desire "shall become members of the EU as soon as they are able to assume the obligations of membership by satisfying the economic and political conditions". The Czech Republic officially applied for membership in the EU in January 1996. In July 1997, the Commission issued *Agenda 2000*, which established the basic framework for all subsequent discussion, preparations and pre-accession activities.

The accession process was formally launched in March 1998 for the Czech Republic and five other candidates on the basis of a set of criteria defined in Copenhagen. The Accession Partnership concluded at the same time between the Czech Republic and the EU set out the priorities for future work and the financial assistance available from the EU. It is complemented by the Czech Republic's National Program for the Adoption of the Acquis (NPAA), which constitutes the blueprint of all planned regulatory and institutional reforms. Priority areas for the approximation of laws have included customs law, company law, intellectual property, financial services, competition policy, government procurement, taxation, state aids, sectoral policies (agriculture, telecommunications, energy, transport), consumer protection including product liability, technical rules and standards, and environmental protection. Since the opening of accession negotiations in March 1998, 13 chapters out of 29 have been provisionally closed.[5]

Since 1998, the Commission has issued regular reports on progress made by the Czech Republic to conform to the Copenhagen criteria. The reports issued in 1998 and 1999 acknowledged the progress made by the Czech Republic, but criticised the slow pace in passing legislation necessary for harmonisation and insisted on the need to speed up legal and structural reforms. The latest report issued in November 2000 concluded that "*the Czech Republic can be regarded as a functioning market economy and should be able to cope with competitive pressure and market forces within the European Union in the near term, provided that it keeps up and completes the implementation of structural reforms*". While the European Commission highlighted the Czech Republic's successful harmonisation of its technical regulations and standards with those of the EU, it also insisted on the need to amend the commercial code, bankruptcy and accounting laws, to promote the development of an environment supportive of business activity.

In 1999, the Czech Republic traded mainly with OECD countries (75% of its total trade turnover), with the EU being its major trading partner (nearly 70% of exports). A relatively higher share of the CEFTA countries (17.5% of exports in 1999) in comparison with most other countries of the region is due to the still significant role of Slovakia, its Customs Union partner. In parallel, the country's commodity structure has also considerably evolved: after the initial decline in exports of manufactures (related to the loss of traditional CMEA markets), the trend has reversed since the mid-1990s. At present, the sales of machinery and equipment represent the most important export category (close to 45% of total exports in 2000). Similarly to most transition economies, the Czech Republic was confronted with growing trade and current account deficits during the 1990s. The situation has however recently improved as export growth has outpaced import growth. In 1999, the deficit of the trade account fell to US$ 2.1 billion (3.9% of GDP), down from 4.6 billion in 1997, and the current account deficit narrowed to 2% of GDP (against 6.1% in 1997).

Table 1. **Geographical structure of Czech foreign trade**

	Exports			Imports		
	1993	**1995**	**1999**	**1993**	**1995**	**1999**
Total trade of goods (in USD million)	14 465	21 329	26 855	14 615	25 080	28 824
Of which (%):						
— Developed market economies	54.3	66.0	74.7	60.7	69.5	73.6
— EU-15	49.4	60.5	69.2	52.3	61.0	64.0
— European transition economies[1]	35.0	28.3	21.6	33.7	25.5	19.7
— CEFTA	24.7	22.2	17.5	18.9	16.4	13.5
— Slovakia	19.5	13.8	8.2	17.5	11.9	6.1
— Other countries	10.7	5.7	3.7	5.6	5.0	6.7

1. Including the CIS.

Source: Ministry of Industry and Trade of the Czech Republic.

Table 2. **Commodity structure of Czech foreign trade**

	Exports			Imports		
	1994	**1999**	**Jan-Nov 2000**	**1994**	**1999**	**Jan-Nov 2000**
0 & 1. Food & live animals, beverage & tobacco	6.5	3.6	3.8[a]	8.2	5.4	4.8[a]
2. Crude materials, non-edible (except fuels)	6.8	3.7		4.9	3.1	
3. Mineral fuels & lubricants	5.7	2.8	3.1	10.0	6.5	9.6
4. Animal & vegetal oil & fats	0.3	0.1		0.4	0.3	
5. Chemicals & chemical products	10.0	7.2		13.1	12.0	
6. Basic manufactures classified by materials (*e.g.* paper, wood products, glass and steel products)	30.5	25.6	36.3[b]	16.5	20.6	35.4[b]
7. Machinery & transport equipment	25.9	43.2	44.1	35.0	40.4	39.9
8 & 9. Miscellaneous manufactured goods (*e.g.* medical equipment, clothing, footwear, furniture, arms, toys); and not specified commodities	14.3	13.8	12.7	11.9	11.7	10.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

a. Including SITC 4.

b. Including SITC 2 and 5.

Source: Czech Statistical Office.

Radical trade liberalisation, which was an integral part of the country's reform package, has been further consolidated by bilateral, plurilateral and multilateral commitments. The Czech Republic has one of the most liberal tariff regime in the region (bettered only by Estonia). All MFN tariffs are bound and in 1999, the average tariff amounted to 4.5% (9.3% on agricultural products, 4.1% on industrial goods). Given the large proportion of trade links with preferential partners, MFN rates apply to a limited share of Czech imports. In line with the Europe and CEFTA Agreements, all industrial goods have entered duty free since 1 January 2001. Following agreement with the EU, almost half of bilateral trade in agricultural products has benefited from mutual trade preference since July 2000. Upon accession to the EU, the Czech Republic will adopt the EU external tariff, without any transitional arrangements.

The Czech Republic has resorted to trade protection actions only exceptionally. Measures for balance of payment purpose were introduced only once and for a very limited period (20% deposit on the invoice price of imports in April-August 1997) and to date, the country has not applied countervailing duty and only a limited number of safeguard actions and anti-dumping investigations. Liberal trade policy, reinforced by significant commitments under the GATS, contributes to creating a favourable business climate for the private sector in general and for foreign operators in particular. The Czech Republic is a party to the Information Technology Agreement, but has not yet joined the plurilateral Agreements on Trade in Civil Aircraft and on Government Procurement.

Several important steps in adapting the country's legislation to the Uruguay Round requirements and bringing it closer to the EU procedures were undertaken recently, in particular the "Act on measures pertaining to import, export and re-export of goods infringing upon some intellectual property rights", the "Act on protecting against subsidised imports" and the "Act on some measures on exports or imports of products and on licensing procedures".[6] The latter Act codifies different procedures, especially regarding monitoring of imports under automatic licensing, protection against the surge of imports as well as protection of newly developing sectors and of state interests.

1.4. Foreign investment

The policy of the Czech government towards foreign investment has evolved significantly over the past decade. Following the 1992 election, the government sought to attract investors by providing a stable economic and political environment, and adopting key business-friendly regulations that give equal opportunity to all entrepreneurs, whether domestic or foreign. However, this did not put a complete end to the practice of case-by-case study of inward investment projects, an approach taken in the previous two years. In 1998, the government introduced the first programme of investment incentives. The programme is part of a broader policy to strengthen the competitiveness of the Czech industry. It promotes advanced technology-based activities, supports the development of industrial zones and tries to improve the links between Czech suppliers of components and services and foreign firms that are operating in the Czech Republic, through development of networks and consultancy and training support to suppliers (see Box 2).[7]

Since 1990, the Czech Republic has been the third largest recipient of FDI in the region following Hungary and Poland, and in terms of cumulated FDI per capita the second largest following Hungary. Until 1997, the annual flows of foreign investment in the economy were relatively small compared to Hungary and Poland, reflecting in part differences in the privatisation methods. Since 1998, inflows of FDI to the Czech Republic have increased dramatically, partly because of major privatisation projects, such as the sell-off of state-owned assets in the banking sector to foreign strategic investors in 1999. Inward FDI reached nearly US$ 5 billion in 1999, accounting for 9.6% of GDP, the highest annual figure since the start of the transition (Table 3). Proceeds from privatisation of state-owned firms have been a major source of foreign investment, reaching 80% of FDI revenues in 1990-96 and 50% in 1997-99.[8] Over 70 000 firms across all sectors are now partially or wholly owned by foreign investors. Foreign

firms have become paramount in many sectors of the economy, such as the banking sector (with over 40% of the assets of commercial banks), the automobile sector or the retail sector. With around 25% each of cumulated inflows since 1990, Germany and the Netherlands have been the major investors in the Czech Republic, followed by Austria and the United States with 10% each.

Box 2. **Investment incentives in the Czech Republic**

In April 1998, the Czech government introduced by decree an incentives package with a minimum investment level of 25 million US$ (Decree No. 298/98), which was reduced to 10 million US$ in December 1998. These decrees were replaced by the law on investment incentives adopted by the Parliament in February 2000 (Act No. 72/2000 Coll.). The law further reduced the minimum investment to 5 million US$ for specified areas experiencing high unemployment, and introduced the tax incentive for expansion projects (while it had been limited until then to newly-established legal entities without any prior business activities in the Czech Republic). Between April 1998 and December 2000, 46 companies were granted investment incentives. They have committed to invest over 2.2 billion US$ in the Czech Republic and create nearly 18 000 direct jobs.

Investment incentives:

- Tax relief on corporate tax for 10 years (newly established legal entities and natural persons) or partial relief from corporate tax for 5 years (already existing legal entities and natural persons).

- Financial support for creation of new jobs (up to approximately 5 300 US$ per job created).

- Financial support for training of employees (up to 35% of total training costs).

- Provision of low-cost building land and/or infrastructure support.

Eligibility criteria:

- The investment has to be made into manufacturing, either into high tech sectors listed in the law or into any other manufacturing sector provided that at least 50% of the cost of the production line consists of machinery listed on a government-approved list of high-tech machinery.

- The investment must be made into the acquisition or construction of a new production plant or into the expansion of modernisation of existing production facilities to launch a new production activity.

- The investor must invest at least CZK 350 million (approximately 10 million US$). In regions with high unemployment, the requirement is reduced to CZK 175 million (approximately 5 million US$).

- Investment of at least CZK 145 million (CZK 87.5 million in regions with high unemployment) must be covered by the equity of the investor.

- Investment into machinery has to account for at least 40% of total investment.

- The proposed production must meet all Czech environmental standards.

Application procedure:

CzechInvest, a government agency under the supervision of the Ministry of Industry and Trade (MIT), is charged with handling all applications for incentives. Upon receiving completed application, it must evaluate the application within 30 days and present its proposal to the MIT, which will forward the proposal to all other government bodies concerned. The MIT issues an offer of investment incentives through CzechInvest, which is valid for 6 months.

Source: CzechInvest.

Table 3. **Foreign Direct Investment**

	Annual inflows of FDI								Cumulated FDI 1990-1999	
	USD billion							% of GDP	Inflows in USD billion	Per capita
	1993	1994	1995	1996	1997	1998	1999	1999		
Czech Republic	0.6	0.9	2.6	1.4	1.2	2.5	4.9	9.1	15.2	1504
Hungary	2.3	1.1	4.5	2.0	2.1	2.0	1.9	3.9	19.6	1940
Poland	0.6	0.5	1.1	2.7	3.0	6.3	6.5	4.2	30.6	794

Source: OECD, International Direct Investment database and National Accounts.

Foreign investment has made a significant contribution to the transformation of the Czech economy. Foreign firms have brought in investment, clearer business strategy and access to distribution networks, leading to growth in exports and employment. Foreign investment has supported job creation and helped to offset part of the job losses due to the restructuring of the economy. The share of foreign firms in total profits in the manufacturing sector has steadily increased to reach over 90% in 1998, reflecting the large gap between domestic firms and foreign firms. In 1998, they contributed to nearly 50% of Czech manufacturing exports and employed 19% of the total manufacturing labour force.[9] The growth in exports has been largely dependent upon a relatively small number of foreign-owned firms in the automobile and electronics sectors.

2. THE POLICY FRAMEWORK FOR MARKET OPENNESS: THE APPLICATION OF THE SIX EFFICIENT REGULATION PRINCIPLES

In a global economy, regulations need to be market-oriented and friendly towards trade and investment. The 1997 OECD report on regulatory reform identified six "efficient regulation principles" for building these qualities in regulations: transparency and openness of decision-making, non-discrimination, avoidance of unnecessary trade restrictiveness, use of internationally harmonised measures, recognition of equivalence of regulatory measures taken by other countries, and application of competition principles.[10] They reflect the basic principles underpinning the multilateral trading system, for which many countries have taken obligations. The objective of this section is not to assess the extent to which the Czech Republic has lived up to international commitments relating directly or indirectly to those principles. It is rather to examine whether and how domestic regulatory procedures and practices give effect to the principles and can successfully contribute to market openness.

2.1. Transparency, openness of decision making and of appeal procedures

International market openness requires that all market participants, including foreign participants, be fully aware of the regulatory requirements so that they can base their decisions on an accurate assessment of potential costs and opportunities. Differences in business environment make the entry of foreign firms into national markets generally more difficult. Language barriers, specific consumer tastes and business practices entail additional learning costs. Regulations often create barriers for foreign firms not only because of differences in the substance of regulatory requirements, but also of difficulties to obtain information regarding the actual operation of regulations. Creating a transparent national regulatory framework for all market participants can thus facilitate access to the market and contribute to effective

competition. Transparency requires access to information on regulations, openness of the rulemaking process through consultation of concerned parties, as well as appropriate and clear access to appeal procedures for market participants wishing to voice concerns about the application of existing regulations. This section considers these three aspects and provides an insight on government procurement, in which transparency is essential for enhancing international competition.

Access to information

The legal framework in the Czech Republic provides for open access to information on regulations, which is primarily ensured through publication of regulation in the official journal. In accordance with the Constitution of the Czech Republic and the 1999 law on the Collection of Laws,[11] all regulations, including laws, decrees, orders and reports of the Constitutional Court, must be published in the "Collection of Laws" before they enter into effect. The date of entry into force is at least the 15th day of promulgation. In cases of urgent public interest, entry into force may be advanced, the date of publication being the earliest date of effect. Non official translations of regulations are also published in English. Information concerning the preparation of legislation is provided through the bi-annual publication by the government of the Plan of the Legislative Actions, which spells out the list of regulations to be enacted or amended in the coming two years. Meetings of the Legislative Council, the advisory body of the government charged with reviewing all draft laws prepared by ministries before their submission to the Cabinet, are announced on the Internet and open to the public upon request. By providing the right of access to administrative documents, the adoption of the Freedom of Access to Information Act[12] in 1999 has reinforced the integration of the principle of transparency in the legal framework laying out the conditions of functioning of the administration. This right applies to all legal entities and individuals, without any conditions of residence or nationality. The law also stipulates that all authorities must publish relevant information on adopted regulations at a place open to the public.

Public authorities have in recent years made an increasingly active use of the Internet to facilitate access to information on existing and upcoming regulations. The Parliament thus publishes draft regulations submitted by the government on its website (www.psp.cz). Laws that have been adopted in the previous three months are accessible on a specific website (www.sbirka.cz). In addition, ministries increasingly use the Internet to publish draft regulations or government decrees. These initiatives, which represent a positive step towards transparency, can however vary depending on the administration, and information in English is still limited. An electronic gateway is currently under development, which will offer a common access to all sources of information, by topic and not by institution, thereby making the whole system more user-friendly and efficient.

As part of a general policy to attract foreign investment, the authorities have also taken specific initiatives towards foreign firms. A specific government agency, CzechInvest, was set up by the Ministry of Industry and Trade in 1992 to promote and facilitate the inflow of direct investment to the Czech Republic. One of the missions of CzechInvest is to provide information on the business environment in the Czech Republic and assist foreign investors in dealing with all levels of administration. CzechInvest is also charged with handling applications for investment incentives. In this regard, it can be noted that the law on investment incentives adopted in 1997 has enhanced the transparency in the allocation of incentives. Prior to the enactment of the law, the Czech government had made little use of incentives to attract investors in the Czech Republic. However, the investment of foreign firms had given way to non-public negotiations. The 1998 Decrees, which were replaced by the law on investment incentives adopted in 2000,[13] established the first formal package of incentives, and clarified criteria for obtaining grants, the types and amount of incentives as well as the procedure for application (Box 2).

Consultation

The *Legislative Rules of the Government* and the *Government Rules of Procedures* set in details the steps to be followed for preparing regulations, and in particular for organising inter-ministerial consultation. According to the Legislative Rules (Section 5), all draft regulations must be sent to other ministries and the Central Bank for comments. In cases the draft affects the labour code, it must be sent for comments to the Tripartite Council, an advisory body created in 1990 that involves the government, trade unions and employers. In addition, some specific laws, such as the law on technical regulations and standardisation, require ministries to organise public consultation in the course of preparing regulations. The rules for preparing regulations also invite ministries to organise consultation of affected parties, when deemed relevant. In practice, this means that ministries usually consult the Economic Chamber, business associations, consumer groups and other non-governmental associations. The ministries have nevertheless discretion in selecting the parties to be consulted and the material to be communicated to these parties.

Technical regulations and standards is the area in which public consultation is the most systematic and open, mainly through the international discipline set under the WTO Agreements on Technical Barriers to Trade (TBT) and Agreement on the Application of Sanitary and Phytosanitary Measures (SPS). The 1997 Czech law on product regulations[14] contains specific provisions, which require consultation in the making process of technical regulations and standards. The Czech Office for Standards, Metrology and Testing (COSMT), which is an administrative body under the control of the Ministry of Industry and Trade, is charged with notifying draft technical regulations and standards to the WTO and providing copies upon request. The list of notifications is published monthly in its official journal and is available on its website (www.unmz.cz). In accordance with international commitments, a 60-day standstill period is provided for comments, and the draft must explain how comments were taken into account. There are no qualifying conditions, based on nationality or residence, to participate in the consultation process. Consultation has in some cases resulted in substantial changes to the draft law. In 1999, the government thus modified the technical requirements for pressure equipment laid out in a government order following a comment by the European Commission that they were creating unnecessary obstacles to trade.

Public consultation tends to concentrate on getting the views of domestic producers and employees representatives, despite recent efforts to reach other constituents. The participation of foreign firms in consultation processes largely depends on the specific efforts of each ministry. Foreign firms can take part in the tripartite consultation as long as they are members of associated business associations. In addition, they are also associated on an *ad hoc* basis in informal consultation carried out by ministries. In those cases, the choice of consulted firms is done at the discretion of the ministry. Some specific regulations provide for the opportunity of foreign firms to present comments. The 2000 law on measures in export or import of products and on the licensing procedures thus specifically stipulates that foreign parties have the opportunity to present their comments in the course of a safeguard investigation in accordance with the law.[15] Some ministries have also done efforts to get comments from the consumers' side. An important step in this direction was the creation of the Consumer Advisory Committee to the Government in April 2000. However, authorities have experienced some difficulties in identifying and involving parties, beyond the traditional social partners. These constituents are in many cases not well organised or have limited technical means to be active in the rulemaking process.

Many ministries have opened the process of making regulations, a progress that has been acknowledged by the business community as a positive step. Over the past two years, public consultation has become a more frequent practice in many ministries. A major gap is the frequently short timeframe provided by the government, sometimes only a couple of days, to present comments, which reduces the opportunity for meaningful interaction. The problem has partly arisen from the extensive legislative activities of recent years, in particular from the urgency to harmonise with European regulations. There is no legal requirement for making comments received and reaction to the comments publicly available, but

ministries have in recent years frequently published comments on the Internet, and draft legislation has given rise to broad debates in the media. The discretion of ministerial authorities remains nevertheless important in defining the scope of consultation and choosing consulted parties, which can undermine the transparency of the consultation process and limit the capacity to protect it from capture from vested interest, whether domestic or foreign.

Appeal procedures

Appeal procedures are in principle open to all market participants. Market participants can challenge administrative measures through appeal in a first instance to the relevant administrative authority, and then through appeal to the courts. Access to appeal procedures is provided irrespectively of nationality or residence. However, the efficiency of the system is in practice undermined by shortcomings in the judicial system and in particular the length of court litigation. It is also limited by the insufficiently wide competence of the courts, which can examine only issued administrative decisions.

Transparency in government procurement

The enactment of the law on public procurement in 1994 and of subsequent amendments has permitted increased transparency in public procurement in the Czech Republic, by defining criteria for the choice of procedures and laying out publication requirements.[16] The Czech Republic is not a member of the WTO Plurilateral Agreement on Government Procurement. The 1996 amendment to the law defines thresholds above which contracting authorities must use open tenders. It requires that public procurement of goods and services in excess of CZK 5 million (CZK 20 million in the case of real estate) be put up for open tenders. The tender notice must specify the criteria for evaluating the bids and time limits for submission of bids (36 calendar days), and be published in the Commercial Bulletin and on the Internet. Prior publication is not mandatory in the case of restricted tenders (tenders by invitation) or negotiated tenders.

The law also includes some transparency requirements on contract awards, which must be published in the Commercial Bulletin. The contracting authority must notify all applicants of its decision, including the information on the selected applicant and its bid. Applicants can request to view the report on the assessment of bids, and excluded bidders may also request that the contracting authority states the reasons for its decision to exclude it. Any participant in a tender can raise a complaint about the decision of the contracting authority to the statutory body of this authority. Complaints can also be brought with suspensive effect to the Czech Office for the Protection of Economic Competition (OPEC), which is charged with supervising compliance with the act. The decisions of the OPEC can be appealed to the Chairman of the Office, still with a suspensive effect. The last possibility of appeal is to challenge the decision to the High Court, but without any suspensive effect.

The amendment to the law on public procurement adopted in 2000[17] has introduced two major improvements towards transparency. First, it requires all public tenders and awards to be published on the Internet. Opportunities in the area of government procurement can thus be easily tracked on a free-of-charge website (www.centralni-adresa.cz), which has been under operation since August 2000. Another major improvement has been the extension of the law to utilities (water, energy, transport and telecommunications), which had been until then excluded from the law.

A significant difficulty in implementing the law has arisen from the lack of knowledge of rules among some officials. Some initiatives have been taken to address the issue. A national programme, co-financed by the European Commission, has thus been designed, with the objective of training 10 000 official in districts and municipalities. Such efforts will become even more important to ensure a proper implementation of the law, as the decentralisation process will give municipalities more scope of action. Close surveillance of the application of the law among all levels of administration is thus necessary to ensure an effective transparency in public procurement.

Overview

Overall, significant steps towards transparency have been taken in the Czech Republic, with stronger impetus in the past two years. Information on regulations is easier to get, and in future, the creation of a common electronic gateway should give stronger efficiency to the initiatives developed by each ministry. Holding public consultation during the preparation of regulations has become a more frequent practice among many ministries. The principle of transparency has been better implemented in the legal framework under which the administration functions with the adoption of the law on freedom of access to information. Progress can also be seen in specific examples, such as government procurement or allocation of investment incentives. However, more could be done to offer real opportunities for comments to all market players through a more systematic and formalised prior notice procedure.

2.2. Non-discrimination

The application of the non-discrimination principle, through most-favoured nation treatment (MFN) and national treatment, in making or implementing regulations aims at providing equal competitive opportunities between like products and services irrespective of origin, and thus at maximising efficient competition on the market. MFN treatment means that all foreign countries seeking entry to the national market are given equal opportunities, while national treatment means that imported products or services are granted a treatment that is no less favourable than the one granted to domestic products or services. The extent to which respect for these principles, which are among the central principles and objectives of the multilateral trading system, is actively promoted when developing and applying regulations is a helpful gauge of the overall efforts of a country to promote a trade-and-investment friendly regulatory system.

Integration of the non-discrimination principle into the Czech regulatory system

In the specific field of economic relations, the Czech Republic has subscribed to the MFN and national treatment principles in the context of its membership to the WTO. It has not however specifically incorporated non-discrimination as an overarching requirement into the regulatory decision-making process. The Legislative Council checks the application of non-discrimination in all new draft regulations. The Czech legislation applies equally to foreign and domestic investors, who can conduct business on equal terms, except in some exceptional cases when special provisions apply. Some laws thus establish specific exemptions from the principle of national treatment and favour companies that are established in the Czech Republic. The 1994 law on public procurement established discrimination in favour of local suppliers. In the case of an open tender, the contracting authority may consider the offer of a local firm equal to the offer of a foreign firm that offers a price up to 10% lower. Foreign firms are defined as firms that are not registered in the Czech Republic. If an offer is submitted jointly by a domestic firm and a foreign firm, their offer is considered as if submitted by a foreign firm.

Other cases of limitations to national treatment concentrate in several sub-sectors of professional services, air transport, and some banking and investment services. Acquisition of real estate is also limited for foreign individuals or legal entities. The Foreign Exchange Act provides that only residents in the Czech Republic may acquire ownership rights to real estate property. The law does not consider branch offices of foreign companies as residents. In a 1999 resolution, the government announced that it would

prepare an amendment by the end of March 2001, which would liberalise the acquisition of real estate by branches and agencies of non-resident investors carrying out their business activities in the Czech Republic, if it is necessary for their economic activities.

Preferential agreements

The Czech Republic participates in a number of preferential agreements (see above, Section 1), and is currently preparing for accession to the European Union. While preferential agreements give more favourable treatment to specified countries and imply departures from the non-discrimination principle, the extent of a country's participation in preferential agreements is not in itself indicative of a lack of commitment to non-discrimination. Assessing such commitment requires considering the situation of participant countries towards non-members and the potential for discriminatory effects. Third countries need access to information about the content and operation of preferential agreements in order to make informed assessments of any impact on their own commercial interests.

A 1995 government resolution[18] stipulates the principles for selection of states with which the Czech Republic is interested in entering into preferential agreements. These criteria include membership in the WTO and the existence of close trade relations. As regards agreements on the promotion and protection of investment, the approach applied to negotiations is the same for all countries, based on a model agreement approved by the government in 1993. An agreement with the United States, which was signed in 1991, is more specific and allows US investors to be involved in all economic sectors except insurance and real estate. This specific treatment will be brought in line with the treatment provided to investors from other countries upon accession of the Czech Republic to the EU. At the national level, information on preferential agreements is ensured through publication in the Collection of International Treaties. In addition, the Ministry of Trade and Industry notifies all preferential agreements to the WTO for information and examination in the relevant committee. There is no specific mechanism for receiving claims from third countries affected by a preferential agreement, apart from the dispute resolution mechanism available in the framework of the WTO.

Overview

The Czech regulatory environment contains few discriminatory elements, and therefore does not seem to create major market access problems for foreign firms. An exception to be noted is the legislation on public procurement, which still contains a discriminatory provision in favour of local suppliers. The non-discrimination principle is established as a general requirement through the incorporation into Czech legislation of the agreement establishing the WTO, and the rulemaking process includes checking the conformity of draft regulations with international commitments. In practice, the need to attract foreign investors has promoted the application of non-discrimination in the regulatory framework.

2.3. Measures to avoid unnecessary trade restrictiveness

Among the alternatives available for reaching a particular objective, policy makers should favour the regulatory measures that have the least restrictive effects on trade. This principle is included in several WTO agreements,[19] and applies accordingly in the Czech Republic. However, implementing the principle into the domestic regulatory system requires appropriate mechanisms. In this respect, assessing *ex ante* the impact of planned regulations on trade and investment and consulting trade experts and foreign business can help integrate an international dimension into the rulemaking process and prevent the creation of barriers to trade and investment. Streamlining procedures can also help facilitate access to the market, while maintaining the legitimate objective of the regulations. This section examines these two avenues, and focuses on the example of customs procedures, an area in which many countries have endeavoured to simplify procedures with a view to facilitating trade flows.

Assessing the impact of regulations on trade and investment

In the Czech Republic, the main mechanism for assessing the impact of draft regulations on trade and investment is the interdepartmental co-ordination that takes place during the preparation of draft regulations submitted to the Cabinet. According to the Legislative Rules of the Government, draft laws sent to the Cabinet for approval must spell out the "substantial intent of the law". This includes an overview of the regulations affected by the proposals, a justification of the necessity for the new law, a check of the conformity of the proposal with international treaties, including obligations stemming from the Europe Agreement, and an assessment of the economic and financial impact of the law, which focuses on the claims on the state budget. In this process, the ministry that initiates the new or amended law circulates the draft to other governmental authorities for comments.

The assessment of impact on trade thus mainly focuses on compliance with WTO commitments, including the provisions on avoiding unnecessary trade restrictiveness. This procedure, which is performed by the Ministry of Industry and Trade, can be effective in ruling out or amending regulations with clear effects on trade that would violate international obligations or cause restrictions on trade. A recent example was the modification, following comments by the Ministry of Industry of Trade, of a proposal of the Ministry of Agriculture relating to the administration of customs quotas for selected agricultural products, which would have created additional restrictions on trade. The government of the Czech Republic is currently considering implementation of a more formal system of regulatory impact analysis (RIA). In September 2000, the government adopted the OECD 1995 Recommendation on Improving the Quality of Government Regulation and made a commitment "to provide administrative capacity for impact analysis and regulation quality control" and to set up a central unit to supervise its implementation and offer assistance to the ministries in the making process of regulations.[20]

Reducing unnecessary administrative burdens

Despite a policy stance in the Czech Republic against unnecessary trade restrictiveness, the business environment in the Czech Republic is still affected by inadequate regulations or implementation of regulations that maintain barriers to the economic activities. The enactment of a comprehensive commercial code in 1992 simplified the legal framework for business activities as it replaced a large number of separate codes and regulations. However, legislation can be difficult to interpret and contain some inconsistencies and loopholes, which leaves a large room for interpretation. Some administrative procedures are not sufficiently streamlined, which can impose burdens on business. This is the case of inscription in the commercial register, which can be an uncertain and lengthy (more than three months) process, or of residency permits which are required for foreigners, apart from EU or US citizens, in a number of cases (such as being a member of a company board, or heading a branch office). In a government resolution on industrial policy,[21] the government raised the issue, pointing out the need to remove unnecessary legal and administrative barriers for companies, and in particular to simplify the conditions for starting and operating a business, by reducing the number of public administration authorities with which businesses have to communicate and by integrating information systems of the public administration authorities. The newly-introduced procedures for inscription in the Commercial Register[22] have gone in this direction, as they require authorities to respond to the applicant within two weeks in the case any additional documents are needed to complete the inscription. The development of an electronic gateway is underway (see Section 2.1), which could facilitate administrative procedures for businesses, but no comprehensive initiative has been so far designed and implemented with regard to the simplification of administrative procedures.

Although a basic body of legislation on business activity has been set up, gaps in the regulatory framework coupled in some cases with inadequate implementation can entail unpredictability of the Czech business environment. A major complaint concerns the inefficiencies of the judicial system. Lengthy procedures and insufficient expertise of judges in commercial areas have undermined the capacity of the system to operate efficiently and hindered the development of the rule of law. Despite recent reform, bankruptcy remains a lengthy process. In some cases, judges have large discretion in accepting a petition and lack the expertise necessary to interpret the law. Seizing collateral requires a court decision, which can take years, and is made even more difficult in the absence of a registry of collateral for movable assets. Two amendments to the Bankruptcy Law were adopted in 2000 with the view to accelerating bankruptcy proceedings and reinforcing creditors' rights, but still does not provide for creditor-driven restructuring of large firms. Moreover, its effective implementation will depend on improvement of the judicial system.[23] Further changes are expected, as the Legislative Action Plan of the government for 2001 includes the preparation of a new bankruptcy law. Another area of difficulty has been the unequal development of administrative structures for enforcing regulations. Added with the low pay of enforcement staff and the discretion of officials in interpreting some regulations, this has given way to delays and unpredictability in decision-making, and in some cases corruption. In 1999, the Czech government launched a programme for fighting corruption, which includes amendments to some laws and a commitment to publish an annual report on bribery committed by public officials.[24]

Facilitating trade: the case of customs procedures

In the area of customs, the Czech Republic has nearly achieved full compatibility of its legislation to EU rules. The commitment to harmonisation undertaken in the framework of the Europe Agreement has played a driving role in the reform of the customs institutions and regulations. The Czech Customs Act[25] is based on EU rules, mainly on the Customs Code of the Communities. On 1 July 1996, the Czech Republic became a contracting party to the EC/EFTA agreements on simplifying formalities for the exchange of goods and a common transit regime. These agreements allow goods transportation to any of the signatory countries using only customs documents issued in the Czech Republic, thereby reducing customs formalities and easing border crossing within the EC/EFTA area. Similar agreements have been signed with Slovakia, Hungary and Poland. In April 2000, the Czech Republic entered the EU system for transit (New Computerised Transit System). Simplified procedures currently cover around 25% of procedures, and are quickly expanding.

Trade facilitation has also been promoted by the modernisation of the technical capacities of Czech customs. A computerised customs declaration processing system has been set up, including electronic data interchange (EDI) for customs clearance, which virtually connects importers to customs authorities. However, the scope of the EDI system is still limited. In particular, the system does not permit basing the decision to inspect documents or perform physical inspection on an assessment of risk. Some legal obstacles to the development of an EDI system need to be overcome. While the adoption of a law on electronic signature in 2000 has met a major condition for its development, the tax legislation still requires that declarations be submitted in writing. Currently, a paper document needs to be submitted no later than 30 days after the electronic declaration was sent to the customs.

In addition to legal and technical changes, the Czech customs authorities have made efforts to increase the dialogue with users. In 1999, a consultative committee was established to consult with domestic and foreign trading companies, which has permitted users to make proposals for improvements. The modernisation of customs has been welcome by trading firms,[26] and progress made in this area need to be put in line with the rapid increase in the flows of goods across the border in the past decade. Some concerns however still remain about lax enforcement of customs regulation on some occasions and about the discretion of customs officials, which can give rise to abuse. In this area, the Czech authorities have

taken some initiatives to reinforce the ethics of officials and implement a training system, in co-operation with the European Union.[27] Further reform and modernisation, including the development of the EDI system, could in future help accelerate clearance process, target inspections, harmonise practices between different border points and facilitate information sharing. This would contribute to reducing red tape and limiting the discretion of customs officers, increasing the efficiency of controls, and enhancing the predictability of the system to operators.

Overview

Reforms in the Czech Republic have created a legal framework for open markets, and the rulemaking process provides for opportunities to remove any provisions which would contradict international commitments to the free movement of goods, services and capital. The decision of the government to implement a formal RIA system is a very positive signal in the direction of avoiding unnecessary trade restrictiveness of regulations. Despite recent progress in the bankruptcy legislation, the Czech regulatory system still holds some deficiencies which affect the entry and exit of firms, whether domestic or foreign, in and out of the market, and can undermine the capacity of the Czech Republic to attract foreign investors. A weak bankruptcy law and an inefficient judicial system appear as the major flaws to be addressed. More could also be done to review existing administrative procedures in order to streamline them and create a more business-friendly environment.

2.4. Measures to encourage use of internationally harmonised measures

Compliance with different regulations and standards can create significant and sometimes prohibitive costs for firms that operate in different national markets. The international business community has made repeated calls for reform to reduce the costs created by regulatory divergence.[28] One way to reduce these barriers is to use international standards, whenever they offer an appropriate answer to public concerns at the national level. The use of internationally harmonised standards has gained prominence in the world trading system with the entry into force of the WTO TBT agreement, which requires that countries should base their technical requirements on international standards.

Since the transition started, the general orientation of the Czech standardisation system has radically changed to make it compatible with a market economy and facilitate the access of Czech products to world markets. The policy has been largely shaped by the preparation for accession to the European Union, which has included achieving full conformity with the Community system of technical regulations and standards. In the framework of the Europe Agreement, the Czech Republic has committed to promote the use of Community technical regulations and European standards and conformity assessment procedures, to seek the conclusion of agreements on mutual recognition in these fields, and to participate in the work of European standardisation bodies. The European Union committed to provide technical assistance to help the Czech Republic reach these objectives.

The current framework for standardisation activities in the Czech Republic is laid down in the 1997 law on technical requirements.[29] In the period 1951-1989, Czech standards were legally binding and aimed at regulating the quality of products produced by state-owned companies under a non-competitive environment. The current legislation has brought a major change in the approach to product regulation, as it has established a clear distinction between voluntary standards, whose use is left to the judgement of consumers and producers, and legally binding regulations set by the government to protect the safety of people or the environment. Following the adoption of the 1997 law, the Ministry of Industry and Trade entrusted the Czech Standards Institute (CSNI) with the creation and publication of voluntary standards and participation in international co-operation in the field of standardisation.[30] The Czech Office for

Standardisation, Metrology and Testing (COSMT), which is under the control of the Ministry of Industry and Trade, has a general supervisory role in the area of technical regulations, standards and conformity assessment. It is in particular charged with co-ordinating the process of transposition of European technical legislation into the Czech Republic and ensuring the obligations of the Czech Republic in the field of technical harmonisation arising from its international commitments. It is also responsible for authorising entities to perform conformity assessment in cases where third party conformity assessment is mandatory. Another body of the Ministry of Industry and Trade, the Czech Trade Inspection Office is responsible for market surveillance.

The Czech Republic follows the European "New Approach" to product regulation under which regulation is limited to defining essential requirements in order to achieve specific objectives, such as safety, without specifying technical solutions. Public authorities mandate European standardisation bodies to draw up European standards that meet these requirements. Compliance with such standards is not mandatory, but provides a presumption of conformity with the requirement (Box 3). In a similar way to the EU New Approach, the 1997 Czech law on technical requirements defines "harmonised standards", which are standards that meet the requirements set in technical regulations and whose compliance with gives a presumption of conformity with these requirements. As under the European New Approach, manufacturers are in principle free to choose the appropriate solutions that comply with these requirements, but have a clear advantage in using harmonised standards. The parallel with the New Approach is reinforced by the introduction in the Czech legal system of the EC Directives, a process that is now well advanced.

Box 3. **Harmonisation in the European Union: The New Approach and the Global Approach**

The need to harmonise technical regulations when diverging rules from Member States impair the operation of the common market was recognised by the Treaty of Rome in Articles 100 to 102 on the approximation of laws. By 1985, it had become clear that relying only on the traditional harmonisation approach would not allow the achievement of the Single Market. As a matter of fact, this approach was encumbered by very detailed specifications that were difficult and time consuming to adopt, burdensome to implement and required frequent updates to adapt to technical innovation. The adoption of a new policy towards technical harmonisation and standardisation was thus necessary to actually ensure the free movement of goods instituted by the Single Market. The way to achieve this was opened by the European Court of Justice, which in its celebrated ruling on *Cassis de Dijon*[31] interpreted Article 30 of the Treaty as requiring that goods lawfully marketed in one Member State be accepted in other Member States, unless their national rules required a higher level of protection on one or more of a short list of overriding objectives. This opened the door to a policy based on mutual recognition of required levels of protection and to harmonisation focusing only on those levels, not the technical solution for meeting the level of protection.

In 1985, the Council adopted the "New Approach", according to which harmonisation would no longer result in detailed technical rules, but would be limited to defining the essential health, safety and other requirements[32] which industrial products must meet before they can be marketed. This "New Approach" to harmonisation was supplemented in 1989 by the "Global Approach" which established conformity assessment procedures, criteria relating to the independence and quality of certification bodies, mutual recognition and accreditation. Since the New Approach calls for essential requirements to be harmonised and made mandatory by directives, this approach is appropriate only where it is genuinely possible to distinguish between essential requirements and technical specifications; where a wide range of products is sufficiently homogenous or a horizontal risk identifiable to allow common essential requirements; and where the product area or risk concerned is suitable for standardisation. Furthermore, the New Approach has not been applied to sectors where Community legislation was well advanced prior to 1985.

On the basis of the New Approach manufacturers are only bound by essential requirements, which are written with a view to being generic, not requiring updating and not implying a unique technical solution. They are free to use any technical specification they deem appropriate to meet these requirements. Products, which conform to these essential requirements, are allowed free circulation in the European market.

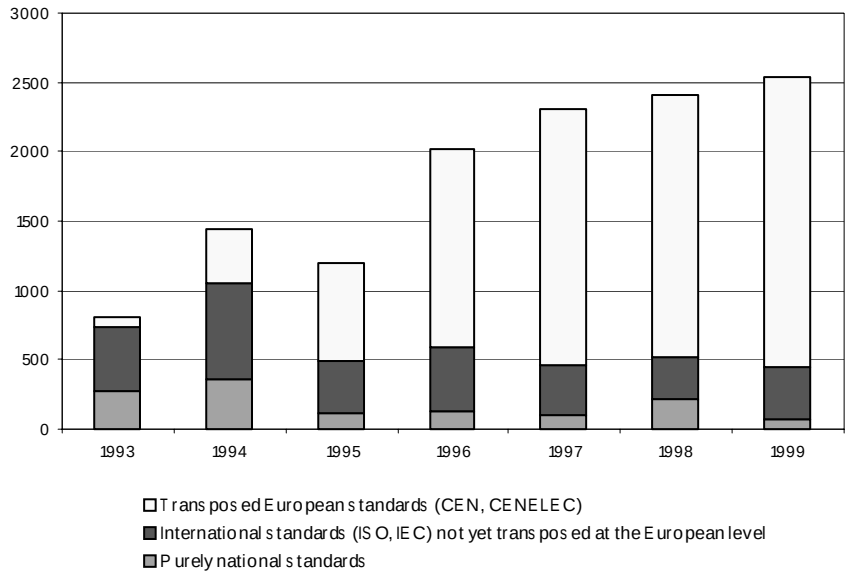
For the New Approach, detailed harmonised standards are not indispensable. However, they do offer a privileged route for demonstrating compliance with the essential requirements. The elaboration at the European level of technical specifications which meet those requirements is no longer the responsibility of the EU government bodies but has been entrusted to three European standardisation bodies mandated by the Commission on the basis of general orientations agreed between them and the Commission. The CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standards) and ETSI (European Telecommunications Standardization Institute) are all signatories to the WTO TBT Code of Good Practice. When harmonised standards produced by the CEN, CENELEC or ETSI are identified by the Commission as corresponding to a specific set of essential requirements, the references are published in the Official Journal. They become effective as soon as one Member State has transposed them at the national level and retracted any conflicting national standards. These standards are not mandatory. However, conformity with them confers a presumption of conformity with the essential requirements set by the New Approach Directives in all Member States.

The manufacturer can always choose to demonstrate conformity with the essential requirements by other means. This is clearly necessary where harmonised European standards are not (or not yet) available. Each New Approach directive specifies the conformity assessment procedures to be used. These are chosen among the list of equivalent procedures established by the Global Approach (the so-called "modules"), and respond to different needs in specific situations. They range from the supplier's declaration of conformity, through third party type examination, to full product quality assurance. National public authorities are responsible for identifying and notifying competent bodies entitled to perform the conformity assessment, but do not intervene in the conformity assessment. When third party intervention is required, suppliers may address any of the notified bodies within the European Union. Products which have successfully undergone the appropriate assessment procedures are then affixed the CE marking, which grants free circulation in all Member States, but also implies that the producer accepts full liability for the product.[33]

The strength of the New Approach and the Global Approach lies in limiting legal requirements to what is essential and leaving to the producer the choice of the technical solution to meet this requirement. At the same time, by introducing EU-wide competition between notified bodies and by building confidence in their competence through accreditation, conformity assessment is distanced from national control. The standardisation system, rather than being a means of imposing requirements set by the government, is put at the service of industry to offer viable solutions to the need to meet essential requirements, which however are not in principle binding. The success of the New and Global Approaches in creating a more flexible and efficient harmonised standardisation process in the European Union heavily depends on the reliability of the European standardisation and certification bodies and on the actual efficiency of control by Member States. First, European standardisation and certification bodies need to have a high degree of technical competence, impartiality and independence from vested interests, as well as to be able to elaborate the standards necessary for giving concrete expression to the essential requirements in an expeditious manner. Second, each Member State has the responsibility to ensure that the CE marking is respected and that only products conforming to the essential requirements are sold on its market. If tests carried out by a notified body are cast in doubt, the supervisory authorities of the Member State concerned should follow this up.

In recent years, the activities of the Czech standardisation body have focused on the adoption of European and related international standards. Since 1993, the number of standards adopted each year has continuously increased, mainly due to the adoption of European standards. In the same time, the number of purely national standards has continuously decreased, from 33% of new standards in 1993 to 3% in 1999 (Figure 1). By the end of 1999, the CSNI had adopted over 90% of European standards. In December 2000, the number of purely national standards amounted to 45% of the total stock of standards, against 54% in December 1999. The still relatively large proportion of purely national standards may signal a need for focusing on reviewing existing standards to check their necessity and potential overlap with other standards. The adoption of international standards goes in line with an active involvement in the international standardisation bodies. In 1997, the CSNI obtained full membership in CEN and CENELEC. It is also a regular member of the ISO and IEC. On average, it participates actively in half of the working committees of these organisations. The CSNI, which has a status of observer in the ETSI, organises public enquiries on proposals of European standards in the area of telecommunications and implements ETSI standards into the Czech standardisation system.

Figure 1. **Annual production of standards by the CSNI**



Source: CSNI.

The Czech Republic has made considerable progress in relying on internationally harmonised measures, mainly through the momentum of the EU accession process. In its yearly review of Czech progress to accession, the European Commission has acknowledged the successful harmonisation of the Czech Republic's technical regulations and standards with those of the EU.[34] The adoption of European and international standards has gone in line with a radical change in the nature of product regulation, which has favoured a more flexible and market-oriented approach. Once the protocol on conformity assessment signed with the European Union enters into force (see below), the process of harmonisation will be facilitated since harmonised standards produced by the European standardisation bodies and transposed in any of the EU member states will be directly applicable in the Czech Republic too.

2.5. Recognition of equivalence of other countries' regulatory measures

In cases where internationally harmonised measures are not available, trade barriers due to divergent regulatory requirements can be reduced when trading partners mutually agree to accept their regulatory measures as equivalent. Despite the development of international standards, there are still many specific national rules that prevent full access to global markets. In addition, producers are increasingly required to demonstrate compliance of their products with national rules, which creates additional costs and possible redundant conformity testing when selling in different markets. When the objectives of the regulation are substantially equivalent among countries, mutual recognition can significantly reduce these costs. Mutual recognition agreements (MRA) can cover product regulations themselves or procedures used to assess the conformity of given products or services to applicable regulatory requirements.

The Czech legislation on product regulation establishes the basis for the negotiation of mutual recognition agreements in the area of standardisation and conformity assessment. The 1997 framework law on product regulations[35] thus stipulates that the COSMT may recognise foreign documents as a proof of the conformity assessment or as background documents for the delivery of conformity assessment, and foreign marks as equivalent to the Czech conformity mark.[36] This recognition is based on the principle of reciprocity and requires a same level of protection of the legitimate objective. Authorised bodies in charge of conformity assessment procedures may under the same conditions recognise the results of tests and findings carried out in other countries.

On the basis of the Europe Agreement, the Czech Republic and the European Union started negotiations in September 1997 on a protocol on conformity assessment (PECA),[37] which extends certain benefits of the internal market in sectors for which the Czech Republic has aligned its rules with Community legislation. The European Union has developed PECAs as a MRA specifically designed for supporting the progressive alignment of the legislation in applicant countries with the *acquis communautaire* and the facilitation of trade and market access. The PECA is made up of a framework agreement that establishes general principles and procedures for the mutual recognition of results of conformity assessment procedures and for the mutual acceptance of industrial products, and of sectoral annexes. In the case of the Czech Republic, these sectoral annexes cover 10 billion euro of the trade of the European Union with the Czech Republic (for details of sectors, see Table 4) and will enter into force in June 2001, once adopted by the European Council and the Czech Parliament. The preparation of the agreement has involved representatives of the business sector, which has been associated by government authorities in the course of the negotiation. The PECA will allow exporters from EU countries (but not from non EU countries) to test and certify their industrial products to EU harmonised requirements, and then gain access to the Czech market without any further conformity assessment requirements, thereby reducing costs and delays involved in having a product approved for placing on the market. The PECA offers similar advantages to Czech firms, and facilitate their access to the European market.

Table 4. **Mutual Recognition Agreements concluded or negotiated by the Czech Republic**

As of December 2000

Partner	Sectors	Date of entry into force	Type of recognition
Slovakia	All, except foodstuff, tobacco products, cosmetics	September 1997 (May 1999 for construction products)	Recognition of certificates, acceptance of test results
Slovenia	Some low voltage electrical equipment, machinery, toys, personal protective equipment, construction products	February 1996	Acceptance of test results
Poland	Electromagnetic compatibility, low voltage electrical equipment, machinery, toys, personal protective equipment, specified products, simple pressure vessels, equipment and protective systems intended for use in potentially explosive atmosphere, gas appliances, construction products	January 1997	Acceptance of test results
Russia	Not specified	April 1999	Acceptance of test results
Ukraine	Not specified	December 1996	Acceptance of test results
European Union	Machinery, electrical safety, electromagnetic compatibility, low voltage equipment, simple pressure vessels, pressure equipment, gas appliances, personal protective equipment, lifts, hot water boilers, good manufacturing practices for medicinal products, equipment and protective systems intended for use in potentially explosive atmosphere. Other sectors under negotiation.	June 2001	Recognition of conformity assessment results, acceptance of products

Source: Communication of the Czech Republic to the OECD, December 2000.

The Czech Republic has also concluded some mutual recognition agreements with some of its trading partners of the Central European area. It has thus concluded an MRA with Slovakia, which covers a wide range of sectors and include the results of conformity assessments. Other agreements reached with Poland, Slovenia, the Russian Federation and Ukraine are more limited in scope, as they only cover the acceptance of test results for conformity assessment performed in the Czech Republic. As Poland and Hungary also progress towards accession to the European Union, the benefits of approximated product regulations and mutual recognition of products will also facilitate trade between applicant countries. As the Czech Republic adopts the European standardisation system, costs associated with diverging standards and conformity assessment requirements may however constitute a new obstacle for some of its former trading partners of the CMEA which have not followed the same integration process, such as Russia or Ukraine.

The Czech Republic has taken some initiatives to reinforce the institutional framework for quality control, certification and accreditation, a necessary step for building the confidence of market participants in the Czech certification system and reaping the benefits of mutual recognition agreements. Once the PECA enters into force, a network of conformity assessment bodies should act as notified bodies in the sectors covered by the agreement. The Czech Republic also participates in international forums, which aim at building up mutual confidence in the accreditation and certification systems. The Czech Accreditation Institute, which is responsible for the accreditation of testing facilities, calibration laboratories and certification bodies, is a full member of the European Co-operation for Accreditation (EA) and the international accreditation organisations ILAC and IAF.

These bodies aim at promoting confidence in the accreditation systems and at reducing obstacles to trade by supporting the development and implementation of ISO/IEC standards and guides, exchanging information and establishing multilateral agreements on the equivalence of accreditation programmes operated by their members. Under these agreements, based on peer evaluation, accreditation bodies accept each other's accreditation systems, recognise and promote the equivalence of each others' certificates and reports issued by bodies accredited under these systems. The need for multiple assessments is thereby reduced or eliminated, as a supplier will only need one certificate or report to satisfy several markets. In September 1999, the Czech Accreditation Institute became a party to the IAF sponsored multilateral agreement on the accreditation of bodies certifying quality systems.

2.6. Application of competition principles from an international perspective

The benefits of market access may be reduced by regulatory action condoning anti-competitive conduct or by failure to correct anti-competitive private actions that have the same effect. It is therefore important that regulatory institutions make it possible for both domestic and foreign firms affected by anti-competitive practices to present their positions effectively. The existence of procedures for hearing and deciding complaints about regulatory or private actions that impair market access and effective competition, the nature of the institutions that hear such complaints, and adherence to deadlines (if they exist) are thus key issues from an international perspective.

In the Czech Republic, complaints about perceived anti-competitive business practices can be filed with the Czech Office for the Protection of the Economic Competition (OPEC). This independent body is charged with support to and protection of economic competition against unauthorised restriction, as well as supervision of public procurement and further activities stipulated by the relevant legal regulations (such as co-operation with the Ministry of Industry and Trade in anti-dumping proceedings). The Czech legislation on the protection of competition applies not only for activities that have taken place in the Czech Republic, but also for activities that have taken place in other countries but have effects in the Czech Republic. A new competition act is under preparation and should enter into force on 1 July 2001. The purpose of the new law is to reach full compatibility with EU law, in particular with regard to criteria for the approval of mergers and acquisitions.[38]

Procedures for lodging complaints apply equally to domestic and foreign firms. The complainant has no legal power to ensure that the OPEC deals with its case, but the Office must provide it with a report on the outcome of its complaint and proceed under deadlines. The OPEC must decide over the justification of the complaint within 10 days for simple cases, and 30 days in other cases. Decisions over the case itself must be made within 60 days for the most complex cases. The deadlines may be extended, but the parties must be informed. Decisions can be appealed to the Chairman of the OPEC, and then to the High Court. The OPEC makes it works available to the public, by publishing all its decisions in its Collection of Decisions as well as on its website (www.compet.cz).

Firms affected by anti-competitive practices may sue in court for damages. As only the OPEC has jurisdiction to determine whether a conduct violates the prohibition of the Competition Act, private actions depend upon the OPEC's establishing the predicate violation, such as the existence of dominance and abuse. Few private cases about competition law violations have been filed.

Procedures for initiating and advancing complaints about alleged anticompetitive actions in the Czech Republic are broadly satisfactory, although the effectiveness of private rights of action is jeopardised by inefficiencies in the judicial system. Foreign firms are given equal opportunities for action as domestic firms and the independence of the OPEC offers guarantees for an application of competition principles which is supportive of a market open to global competition.

3. SELECTED SECTORS

This section examines the implications for international market openness arising from Czech regulations in four sectors: automobiles, retail, telecommunications services and equipment, and electricity. For each sector, an attempt is made to draw out the effects of sector-specific regulations on international trade and investment and the extent to which the six efficient regulation principles are applied. Particular attention is paid to product regulations where relevant.

3.1. Automobiles

Foreign investment has played a key role in the development of the Czech automobile sector over the past decade. The Volkswagen group bought 70% of *Automobilka Skoda Mlada Boleslav*, the national state-owned car manufacturer, in 1991 and the remaining 30% in June 2000. This acquisition has been the second largest investment of a foreign firm in the Czech Republic, representing nearly 20% of total inflows of FDI. It has been an example of how foreign investment can bring capital, management techniques, technology and access to marketing networks. Since its privatisation, Skoda has steadily increased its production from 188 000 cars a year in 1991 to over 400 000 in 1998. Production capacities and organisation have been completely overhauled, with emphasis on quality and flexibility to adapt to customers' specifications. Skoda exports two-thirds of its production (against less than one third at the time of Volkswagen's take-over). With 6% of total Czech exports and 5% of imports, it has become one of the largest participants in Czech foreign trade.

The take-over of Skoda by Volkswagen has gone along with the development of the car component sector. The investment by Volkswagen in the Czech Republic has been followed by investment of many of the manufacturer's suppliers. Since the early 1990s, foreign component manufacturers have set up over 120 joint ventures and greenfields in the Czech Republic. Under coaching by Skoda, quality and timeliness of local car component suppliers has steadily increased, and the sector has become more competitive. Czech component firms supply Volkswagen plants in the Czech Republic and abroad, as well as other car manufacturers all over Europe.

Table 5. **Foreign trade in the automobile sector**

In thousand USD

	Imports			Exports		
	Passenger vehicle[1]	Transport vehicle[2]	Parts and components[3]	Passenger vehicle[1]	Transport vehicle[2]	Parts and components[3]
1993	274 123	86 572	207 569	560 192	254 166	179 052
1994	413 561	116 231	185 453	538 517	207 723	218 497
1995	627 485	204 331	316 414	707 642	154 034	363 270
1996	816 960	269 717	576 897	938 123	189 700	658 400
1997	779 909	285 601	769 171	1 357 142	322 197	899 085
1998	625 701	221 226	923 287	2 053 736	286 195	1 171 668

1. SITC 781.
2. SITC 782.
3. SITC 184.

Source: OECD.

The Czech Republic takes part in the multilateral efforts in favour of international harmonisation in the automotive sector developed by the World Forum for Harmonisation of Vehicle Registration of the United Nations Economic Commission for Europe (UN-ECE).[39] The participation of the Czech Republic in this forum has produced tangible results in terms of international harmonisation of standards and mutual recognition. The Czech Republic has adopted 102 out of 112 UN-ECE regulations. Internal specifications for vehicle approval, which are thus currently mainly based on UNE-ECE regulations, will be further harmonised with international standards and will be fully based on ECE regulations as well as EC directives, once the new act on the conditions of vehicle operation on roads enters into force in 2001. The Czech Republic has not subscribed the agreement, negotiated in 1998 under the UN-ECE, "concerning the establishment of global technical regulations for wheeled vehicles, equipment and parts which can be fitted and/or used on wheeled vehicles", but intends to do so. This agreement widens the scope of the 1958 agreement as it allows the participation of new countries.

Czech trade regulations do not impose restrictions on imports of cars and their components, other than import duties. Following the Europe Agreement, import duties are being reduced for products originating in the European Communities, and mutual trade is free of duty as of 1 January 2001. Imported car components must be approved by the Ministry of Transportation and Communications before their marketing in the Czech Republic. The approval is issued automatically if the parts meet EU standards or approved by an administrative body of a country signatory to the 1958 UN-ECE Agreement.

3.2. Retail sector

The Czech retail sector has undergone dramatic changes over the past decade, which were initially driven by rapid privatisation. In 1991-93, stores were sold through public auction as part of small-scale privatisation or returned to previous owners. This process entailed a rapid increase in the number of retail units. Since the mid-1990s, the trend has reversed and the sector has gone through a process of concentration, partly due to the entry of foreign investors in the sector. Compared to western European countries, the number of shops per thousand inhabitants is still however larger (3.21 compared to 0.88 in Germany) and the average surface of shops is smaller ($72m^2$ against $339m^2$ in Germany). The development of international chains in the Czech Republic has radically changed the pattern of the sector. The entry of foreign firms has not only increased competition and led to lower prices for consumers, but also introduced more efficient distribution and management methods and increased the scope of available goods.

The regulatory framework imposes limited constraints on the development of the sector. For example, no authorisation from a ministry is needed for opening a store, and opening hours are not regulated. The main constraint for opening a store stems from urban planning, which is under the responsibility of municipalities. The Construction Act that requires preliminary public consultations in case of a new project of a large retail unit, establishes a large number of technical and urban standards (such as required parking place) and defines time limits for authorities to respond to submitted requests. With the ongoing reform of regional administration, the role of local governments in the sector is likely to become more important. The government has issued a guideline for municipalities to assist them in this area. In practice, there does not seem to have been any constraint from local governments on the opening of new stores, as municipalities have competed for the creation of new jobs.

The rapid extension of competitive multinational chains since 1997 has forced many local firms out of the market. Small but also large domestic retailers have faced difficulties. Several big domestically-owned retailers have gone bankrupt, including Interkontakt Group, which until 1998 was the biggest retail firm in the Czech Republic. Increased competition has given rise to some pressure on the government to intervene. Domestic stores have faced increased competition from hypermarkets, and local suppliers have experienced difficulties in inserting in the network of multinational chains. The government has so far resisted calls for more regulations, and its action has mainly consisted in supporting the development of associations of independent suppliers through its action programme for small-and-medium-sized enterprises. The proposal of a new competition act also includes an enlarged definition of dominant position to include a firm on which suppliers are dependent because they do not have any alternative outlets. It thus introduces a prohibition against "abuse of economic dependence", as a kind of abuse of dominant position. The aim of this proposal is to help suppliers in bargaining with large suppliers, in a similar way to other European countries.

3.3. Telecommunications

From the outset of the transition period, the modernisation of the country's outdated telecommunications network and improvement of telecommunications services appeared as an essential condition for the development of the economy and its international competitiveness. The privatisation of Cesky Telecom constituted a major element of the expansion of the Czech telecommunications system in the 1990s. Concurrently with distribution of vouchers amounting to 24% of the capital, the government sold a 27% stake in the company through tender to Telsource, a consortium representing KPN, the Dutch telecommunication operator, and Swisscom. The sale to Telsource not only infused cash, but also brought in substantial expertise, management skills and emphasis on customer service. Cesky Telecom's monopoly over the provision of long-distance and international fixed telephony services was maintained. Competition in mobile telephony has developed more quickly and has recently stiffened, as the regulator granted a third cellular telephone network license in March 2000. Mobile telephony has quickly expanded in recent years and become a competitor to Cesky Telecom. In 1999, over 40% of telecommunications revenues resulted from wireless markets (against 11% in 1995), above the OECD average.[40] The number of cellular mobile subscribers has increased from less than 50 000 in 1995 to 965 000 in 1998, 4 millions at the end of 2000 (38% of the population against less than 1% in 1995).

The new Act on Telecommunication,[41] which entered into force in July 2000, aims at liberalising the market for basic telecommunications services and transposing the European Communities telecommunications directives. The law abolishes the exclusive rights enjoyed by Cesky Telecom and re-establishes the Czech Telecommunications Office as a separate legal body with greater independence from the government to regulate the sector. The law sets up a new licensing regime which applies equally to domestic and foreign firms The prospect of liberalisation has given way to a growth of FDI in the sector, and several foreign firms have announced plans to invest in the Czech Republic over the next couple of years.

During the 1990s, the inflow of foreign investment has promoted the development of the telecommunication equipment sector in the Czech Republic and supported a strong growth in foreign trade (Table 6). Czech standards applicable to telecommunications equipment are mainly the transposition of ETSI, CEN and CENELEC standards. The Act on Telecommunications[42] adopted in 2000 lays out the conditions and procedures for approval of telecommunication equipment in the Czech Republic. Selected kinds of equipment are subject to type approval by the Department of Certification of the Czech Telecommunication Office. The list, which is published on the Office's website (www.ctu.cz) includes terminal equipment to be connected directly or indirectly to the public telecommunication network and radio equipment. The Department of Certification must issue the decision within 30 days upon receiving the application for approval. Tests are performed by laboratories accredited by the Czech Accreditation Institute. The Czech Republic recognises the approval of terminal equipment carried out in EU countries. Authorities are considering extending this recognition to other types of equipment.

Table 6. Foreign trade in telecommunication equipment

In thousand USD

	1993	1994	1995	1996	1997	1998
Imports	328 062	431 248	573 666	901 305	821 536	751 763
Exports	49 709	74 059	51 472	160 554	159 628	190 767

Note: Telecommunication equipment includes television receivers (SITC 761), radio receivers (SITC 762) and other equipment (SITC 764), including telephone and switching equipment, microphones, transmission equipment, and parts.

Source: OECD.

3.4. Electricity

As in most other utilities, liberalisation of the electricity sector has been delayed until recently. At the beginning of the 1990s, the electricity sector, which was organised as a single and vertically integrated utility, was unbundled and partially privatised, but the state kept it under its control (with currently 67% of total shares). Eight regional and independent state electricity distribution companies were created in 1990 and partially privatised (the state still currently holding approximately 50% of the shares in each of the companies). In the following two years, the combined heat and power units were separated and established as independent producers. The remaining power stations and the high voltage grid were placed in a newly created and single company, CEZ (Ceske Energeticke Zavody), in which the state kept a majority share. Since then, CEZ has held a dominant position for generation and a monopoly for transmission, import and export of electricity. In 1999, the transmission activities of CEZ were established as a subsidiary of CEZ.

The Czech government has undertaken to harmonise its legislation with EU rules, and identified 2003 as the date to reach the EU level regarding the opening of the market. The EU Directive on Energy 96/92/EC sets up common rules for generation, transmission and distribution of electricity, and offers alternative ways of meeting these rules. In accordance with the EU rules, the Czech government prepared a new Energy Act, which became operational on 1 January 2001. It incorporates principles set in the EU Directive on Energy 96/92/EC, such as third party access to networks, functional unbundling of transmission from generation and distribution, and provides for the gradual opening of the market. By January 2002, end-users with a consumption of over 40 GWh/year will be authorised consumers (estimated opening is over 30% of the market). Liberalisation will be extended to end-users with an annual

consumption higher than 9 GWh by January 2003 (estimated opening of 40%), and to end-users with an annual consumption higher than 100 MWh by January 2005 (estimated opening of 50%). The government has suggested that liberalisation of all consumers be considered for 2006. A gradual process of price liberalisation is underway, with the aim of eliminating cross-subsidies by 2002.

The energy law intends to open only gradually the domestic market to imports. It provides the Ministry of Industry and Trade with the possibility to limit imports in case of direct or indirect threat to persons and objects in the territory of the Czech Republic, and if the rights and obligations of electricity producers in the exporting country are not comparable to the rights and obligations of domestic electricity producers. The energy law implicitly introduces the principle of reciprocity, both in quantitative terms (*i.e.* the degree of liberalisation of the market of the exporting country should be similar to the degree achieved in the Czech Republic) and in qualitative terms (*i.e.* the organisation of the electricity market should not introduce discriminatory treatment against Czech electricity producers). In addition, the law provides for reciprocity conditions with regard to environmental regulations.

Forthcoming liberalisation requires privatisation of the energy sector as power companies need foreign strategic investors to prepare for a liberalised market. There has already been significant entry of foreign firms in the sector, which have invested in distribution companies and some generation capacities. In fall 2000, after some delays, the government announced its decision to sell its shares in six of the eight power distribution companies and 64% of its shares in CEZ (leaving 3% of the shares in its control), as a package. The decision has raised some concern as the reintegration of distributors into CEZ would protect the dominant position of CEZ and impede the development of competition. Several foreign companies, which had invested in regional distributors, have protested against the scheme, which forces them to bid for nearly the whole of the country's power industry to protect their investment.[43]

With the entry into force of the new Energy Act in January 2001, the electricity sector in the Czech Republic is regulated by an independent body, the Energy Regulatory Office, and no longer by the Ministry of Industry and Trade. The role and independent status of the regulator have been established by the new energy act and a government resolution.[44] Rules and decisions of the regulator must be published in the Energy Regulation Bulletin of the Authority, as well as license-holders. The new law removes the condition of permanent residence for obtaining an authorisation, but the applicant must demonstrate financial and technical prerequisites to ensure the performance of the licensed activities and ownership or lease of power facilities to perform the licensed activities.

The preparation of the new act on energy has given rise to a wide consultation. The Ministry of Industry and Trade has published the draft law on its website and asked for comments from a large number of parties. Not only representatives of the industry and trade unions have been consulted, but also consumers associations and environmental associations. Foreign generation and distribution companies have also been consulted. The scope of the consultation has thus been larger than is often the case in the preparation of laws. However, the choice of consulted parties has been done at the discretion of authorities and comments of consulted parties have not been made public. In addition, the participation of consumers associations in the consultation procedure has been limited by their limited institutional capacities. As for all draft regulations, all ministerial departments as well as the competition authority have been consulted through the interdepartmental amendment procedure. In addition, the draft law has been subject to screening by the European Commission.

4. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

4.1. General assessment of current strengths and weaknesses

Over the past decade, the Czech Republic has accomplished remarkable progress towards market openness to international competition through regulatory reform. The country has moved from a closed planned economy to a market-led economy in which foreign trade and investment play a major role. Successive Czech governments have committed to integrating the Czech economy in the world economy, and taken high-standard multinational commitments in the context of the Uruguay Round. They have in the same time endeavoured to build an open investment climate. The prospect of accession to the EU has also acted as a strong impetus towards pro-competitive reforms.

Reforms have contributed to building market openness principles into the regulatory framework. Regulations largely give foreign market participants equal competitive opportunities through observance of non-discrimination principles. Competition policy has been developed and an independent regulator charged with its enforcement. Achievements in harmonisation of product regulations have reduced the impact of non-tariff barriers induced by diverging standards. Progress made in the field of mutual recognition, in particular with the protocol on conformity assessment signed with the EU, will also in future reduce obstacles to trade stemming from certification requirements.

Significant progress has been made to integrate the efficient regulation principles in the rulemaking process. In the past two years, many ministries have made more active use of the Internet to disseminate information and have resorted more frequently to public consultation during the preparation of draft regulations, which is an encouraging step towards a more transparent legislative process. Although transparency has significantly improved, the consultation process still leaves room for ministries' discretion, frequently offers limited time to comment and does not take enough account of constituents other than producers and trade unions. The rulemaking process permits to remove any provision that would contradict international commitments in the area of trade and investment. However, the impact of regulations on trade and investment is not systematically or fully assessed. Better involvement of stakeholders in the rulemaking process and integration of trade and investment in the current proposal for regulatory impact analysis could be critical in creating more business friendly regulations and strengthening the implementation of regulations.

With regard to regulations affecting the operation of business, there are still significant weaknesses in the Czech regulatory framework. Some deficiencies in the legal environment still undermine the entry and exit mechanisms in and out of the market. The recent reform of the bankruptcy legislation has been a positive step, but will not produce tangible results without an improvement of the judicial system. Streamlining administrative procedures, such as business registration, could also largely contribute to building a more efficient business environment, which could both promote the development of local firms and permit to attract and retain foreign investors.

Ensuring that awareness of and respect for the efficient regulation principles are better embedded in domestic regulations and in their application may also further enhance market openness. The implementation of rules does not always seem to match the commitment of Czech policy to an open market. The predictability of the business environment has been undermined to some extent by the discretion with which officials can apply regulations. Reinforced monitoring on administrative actions is necessary to foster a consistent application of rules and prevent any abuse of this discretionary power.

4.2. The dynamic view: challenges for future reform

The progressive dismantling or lowering of traditional barriers to trade and investment have increased the relevance of "behind the border" measures to effective market access and national regulatory regimes have been exposed to an unprecedented international scrutiny by trade and investment partners. Regulation is no longer, if ever it was, a purely domestic affair. In the case of the Czech Republic, international scrutiny has been topped by the assessment of Czech regulations undertaken by the European Commission in the context of the Czech Republic's accession to the European Union. The accession process has acted as a strong impetus for reform. However, reforms in future should not be limited to meeting with EU standards and the Czech Republic will need to commit itself to consolidating the integration of the efficient regulation principles in its regulatory framework. Such commitment will also have to be ensured at the level of regions and municipalities as local administrations gain more powers through the decentralisation process.

The Czech Republic has so far resisted pressures for protectionist measures in the face of increased competition in the domestic market. With the elimination of tariff rates on industrial products from the EU, progress in technical harmonisation, entry of foreign firms, domestic firms are facing increasing competition, which could give rise to some calls for government intervention. A large number of private domestically-owned firms have undergone insufficient restructuring and their competitiveness has lagged behind the most efficient and export-oriented foreign-dominated firms. An important task in future will be to improve the business environment in the Czech Republic in order to foster the integration of domestic small-and-medium-sized firms in the global economy.

Pressures for protection can also come from incumbent firms, whether domestic or foreign, that will try to prevent other firms from entering the market. Further trade-opening and increased competition risk to intensify calls for protection or actions of specific interests in the administration. Promoting transparency and non-discrimination in the regulatory framework will thus be crucial to avoid establishing "privileged" links between some firms and national or local authorities.

Foreign investment has played and will continue to play a major role in the development of the economy. While the investment incentives programme does not include any formal discriminatory elements, in practice it mostly targets foreign investors. A challenge in future will be to avoid any discrimination in favour of foreign firms in the endeavour to attract and retain foreign investors.

4.3. Policy options

The following recommendations are based on the assessment presented above and the policy recommendations set out in the 1997 OECD report on regulatory reform. Considering the potential benefits of market openness that could be induced by further regulatory reform, the Czech government is encouraged to consider the following options:

Further enhance the transparency of the rulemaking process and widen the opportunities of concerned stakeholders to provide input to the decision making process.

Efforts to increase the access to regulations should be reinforced and extended to all administrations, including ministries, local authorities and independent regulators. The projected electronic gateway to the administration should provide a common access to existing and draft regulations. Extending "notice-and-comment" procedures, in particular those affecting business operations, would enhance the predictability of the regulatory framework and provide regulators with input from market players allowing them to better adapt regulations to the need of the market.

Consultation with respect to proposed regulations should be organised in a timely manner so as to allow meaningful interaction between concerned constituencies and the administration. Sufficient time needs to be provided for comments and the process should take place at an early stage so that the comments can effectively be taken into account.

Specific efforts need to be made to ensure the transparency of the consultation system, so as to ensure that the administration is accountable for its effective implementation, and to avoid it being captured by special interests. It is therefore important that each stage of the process be made public, including notification of regulations, comments received and responses of the administration. Advisory groups may continue to be needed to establish dialogue with experts and interest groups. Standard procedures for their establishment could enhance the transparency of the consultation, for example by providing for the publication of the list of consulted parties.

Develop a consistent practice for the assessment of the impact of proposed regulations on business and on trade and investment.

The Czech government has announced its intention to implement a formal regulatory impact analysis. The development of this tool should specifically include trade and investment, so that any possible restrictive effects of envisaged regulations on trade and investment can be identified and less restrictive actions can be considered. Such assessment should not be limited to regulations that directly affect trade and investment. It should refer to the six efficient regulation principles, including avoidance of unnecessary trade restrictiveness and non-discrimination (whether in favour of foreign firms or of domestic firms). Publication of the assessment would contribute to enhancing the transparency of the rulemaking process.

The regulatory impact analysis should be built on the existing procedure for preparing regulations, so as to avoid any duplication of procedures and increased complexity of the process for making regulations, which is already thoroughly defined by law. The RIA should also include an initial screening stage whereby regulation warranting further scrutiny would be identified on the basis of predetermined criteria.

Improve the business environment by streamlining administrative procedures affecting the operation of firms and strengthening the administrative and judicial capacity for the enforcement of regulations.

Efforts should be pursued to review and streamline administrative procedures that affect business, in particular business registration, and to promote the transparency of the existing regulatory framework, for example with the creation of a registry of administrative procedures affecting business operation (such as licensing procedures, conformity assessment requirements, conditions for entry and exit out of the market), available on the Internet.

Existing weaknesses often stem not from regulations themselves, but rather from their inadequate implementation. Consequently, the main emphasis should be on better training of staff responsible for the application of regulatory measures. This will be particular important at the local level, as municipalities and regions are getting more powers. Training of the judiciary in the field of commercial, bankruptcy and competition is also necessary for a better enforcement of regulations. The creation of specialised courts to deal with bankruptcy and competition could be considered.

Promote the application of transparency principles in government procurement.

The training of officials at all levels of administration on government procurement rules should be pursued to ensure a clear understanding by all prospective bidders of the transparency requirements, including the criteria used for the evaluation of public procurement bids and for the selection of bidders. A regular publicly available report on the implementation of the rules at all levels of administration could also promote a better application of the transparency and non-discrimination principles in this area.

Enhance the transparency and the uniform application of customs procedures.

Further development of the EDI system, in particular with the integration of risk analysis, in the system, would help reduce the discretion of customs officials and ensure a more transparent, uniform, predictable operation of customs procedures.

Maintain the commitment to international standardisation.

The Czech Republic has made considerable progress in the adoption of international standards. Further efforts should be done to review and streamline existing technical regulations and standards.

NOTES

1. As of 31/12/2000.

2. The Czech government has recognised the need for a major reform in the judiciary system. In summer 2000, the Parliament rejected some parts of the reform of the judiciary system prepared by the government. The government is preparing a new version of the law to be submitted to the Parliament.

3. Along with economic reforms, the Czech Republic has undertaken a reform of its administrative system, in particular through decentralisation. The government launched a first territorial reform in 1990 to overhaul the extremely centralised organisation inherited from the communist regime. In 1999, the government adopted a resolution on the concept of public administrative reform, outlining three elements for improving the transparency and efficiency of the public administration (Government Resolution No. 258/1999 of 30 March 1999). These elements include continued decentralisation with the creation of regions and devolution of powers from the central state to these regions, improved horizontal co-ordination between ministries, and introduction of new public management techniques.

4. The Czech and Slovak customs union came into effect at the time of dissolution of the Czech and Slovak Federal Republic on 1 January 1993. The agreement ensures free trade between the two countries, with only few exceptions. The Czech Republic and the Slovak Republic apply a common customs tariff, co-ordinate their trade policy towards third countries and must adopt the same regulations with regard to customs procedures, statistics, import and export licensing, intellectual property and countervailing and antidumping. The Free Trade Agreement between the EFTA states and the CSFR came into force on 1 July 1992. Following the dissolution of the CSFR, the Czech Republic succeeded to the Agreement. The Central Free Trade Agreement with Hungary, Poland and Slovakia entered into force on 1 July 1994. Slovenia, Romania and Bulgaria, with which the Czech Republic had negotiated bilateral free trade agreements, joined the CEFTA in 1997, 1998 and 1999 respectively. The Czech Republic has also signed bilateral free trade agreements with Latvia, Estonia, Lithuania, Israel and Turkey. A free trade agreement with Croatia is currently considered, and consultations with Morocco have started.

5. These chapters are: science and research, education and training, small and medium-sized enterprises, statistics, industrial policy, telecommunications, fisheries, consumer protection, free movement of goods, customs union, external relations, common foreign and security policy, EMU.

6. Act 62/2000 Coll.

7. CzechInvest, the government agency charged for handling applications for incentives, also provides help in finding local suppliers and joint-venture partners. It has thus built a database of Czech component suppliers, which is available on the Internet (www.czechinvest.org).

8. Hunya (2000).

9. Hunya (2000).

10. OECD (1997).

11. Constitutional Act No. 1/1993 Coll., and Act No. 309/1999 on the Collection of Laws and the Collection of International Treaties.

12. Act No. 106/1999 Coll.

13. Act No. 72/2000 Coll on investment incentives.

14. Act No. 22/1997 Coll. on technical requirements for products and on amendments to some Acts as amended by Act No. 71/2000 Coll.

15. According to the Act No. 62/2000 on some measures related to exports and imports, licensing procedures and modifications in some laws of February 2000, the Ministry of Industry and Trade must publish requests for measures related to exports and imports (including quantitative limitations, bans, adjustment of tariffs, import surcharge, and other safeguard measures) in the Commercial Bulletin and on its Internet website. A 30-day period for comments is provided to affected parties. The law defines "affected parties" as producers, exporters, importers of the product concerned and "other subjects which have the direct legal interest in the matter".

16. Legislation on government procurement is set by Act No. 199/1994 Coll., as amended by Act No. 148/1996, Act No. 93/1998 Coll., Act No. 28/2000 Coll., and Act No. 256/2000.

17. Act No. 28/2000 Coll of 18 January 2000.

18. Resolution of the Government of the Czech Republic No. 437 of 9 August 1995.

19. By virtue of the TBT and SPS Agreements, countries should not use regulations that are more trade restrictive than necessary to fulfil a legitimate objective. In addition, article VI of the GATS stipulates that measures applied to supplies of services such as qualification or licensing requirements should "not constitute unnecessary barriers to trade".

20. Resolution of the Government of the Czech Republic No. 950 of 27 September 2000.

21. Resolution of the Government of the Czech Republic No. 51/2000 of 21 January 2000.

22. Act No. 30/2000 Coll. that came into force on 1 January 2001.

23. For more on bankruptcy legislation, see Chapter 1.

24. For more on the Czech programme for fighting corruption, see Box 7 in Background report to Chapter 2.

25. Act No. 13/1993 Coll, which entered into force on 1 January 1993, as amended by Act No. 113/1993 Coll, which entered into force on 1 July 1997.

26. According to the survey conducted by DHL in 1999, the Czech Republic has the most straight-forward customs procedures in the Central and Eastern European region. Nearly half of western multinationals considered the Czech Republic has having straight-forward customs procedures (up from 41% in the previous survey of 1997), ahead of other countries of the region. However, some multinational firms complained about delays and frequent changes in rules. The DHL report is based on a survey about business perception of customs procedures in Central and Eastern Europe, which involved 100 multinational firms. ("Red Tape Curtain Only Partially Raised Over Central/Eastern Europe", April 1999).

27. In its annual report on progress of the Czech Republic towards accession, the European Commission acknowledged the progress made in the Czech administrative and operational capacity to implement the *acquis communautaire* in the area of customs. However, the report also pointed the need for reinforcing ethics of customs officials and developing an efficient training system.

28. This call has been made for example by the European and American business communities in the context of the TABD (Transatlantic Business Dialogue). The TABD has advocated governments to overcome diverging positions at an early stage of the making process of regulations and to give more emphasis on international standards in the regulatory framework, with a view to promoting global competitiveness.

29. Act No. 22/1997 Coll. of 24 January 1997, on technical requirements for products and on amendments to some Acts as amended by Act No. 71/2000 Coll.

30. Decision of the Ministry of Industry and Trade No. 203/1997 Coll.

31. Decision of 20 February 1979, Cassis de Dijon, Case 120/78.

32. Energy-efficiency, labelling, environment, noise.

33. See the Council Directive 85/734/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the liability for defective products.

34. European Commission (1999 and 2000).

35. Act No. 22/1997 Coll. on technical requirements for products and on amendments to some Acts as amended by Act No. 71/2000 Coll.

36. Article 17 of law no. 22/1997 Coll.

37. Protocol to the Europe Agreement establishing an Association between the European Communities and their Member States, of the one part, and the Czech Republic, of the other part, on Conformity Assessment and Acceptance of Industrial Products.

38. The current legislation on the protection of economic competition is governed by Act No. 63/1991 Coll. as amended by Act No. 495/1992 Coll. and Act No. 28/1993 Coll.

39. Formerly, Working Party on the Construction of Vehicles, usually referred to as WP29.

40. OECD (2001).

41. Act No. 151/2000 Coll. on Telecommunications.

42. Act No. 151/2000 Coll. on Telecommunications.

43. See *Financial Times*, "Foreigners flee Czech power", 23 November 2000.

44. Resolution of the Government of the Czech Republic No. 1330/2000 of 18 December 2000.

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