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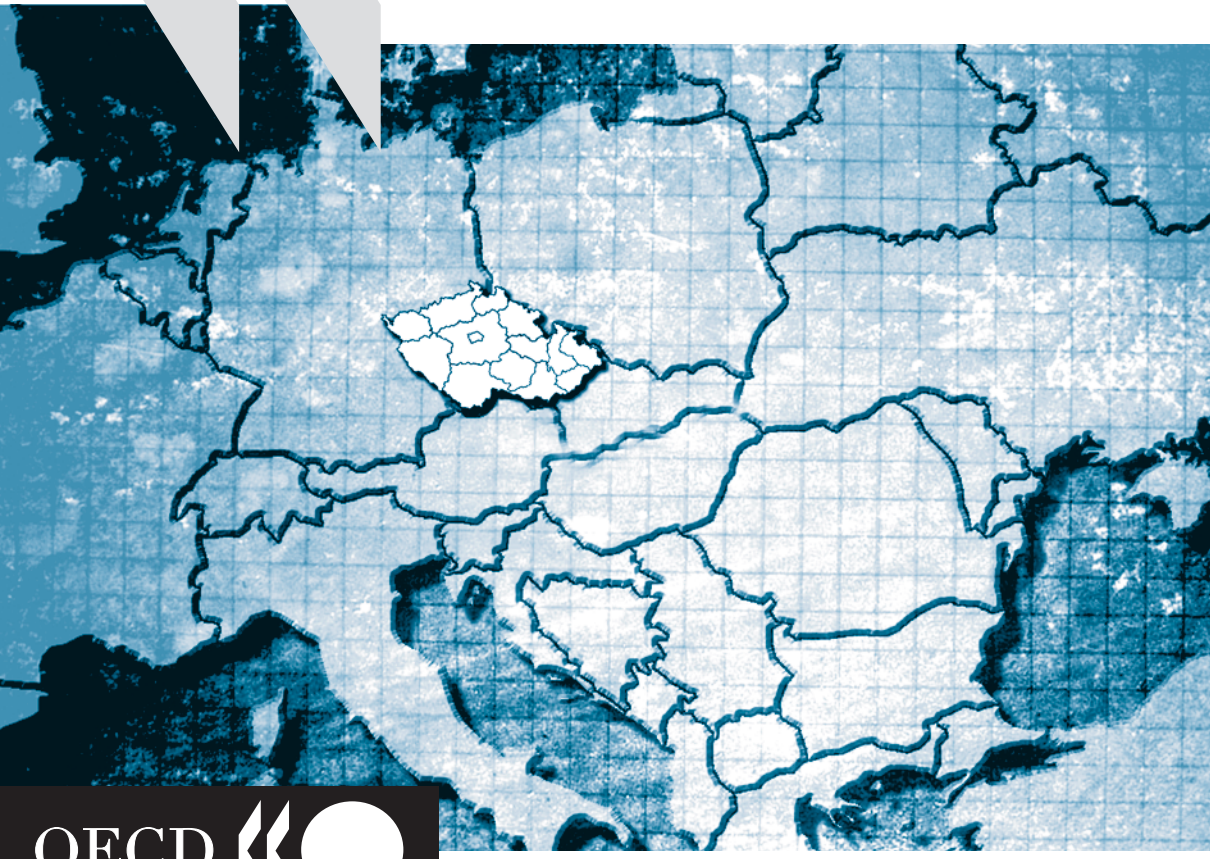

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Assessment and recommendations

Economic trends reflect overall good performances but many firms need to enhance their competitiveness…

Since 1993, year of creation of the Czech Republic, the new country registered a yearly average GDP per capita growth rate of 2.1% (with the exception of 1997 and 1998), with inflation having decreased from the high levels of the beginning of the transition period to 1.8% in 2002 (4.7% in 2001). On the other hand, unemployment rose from 3.5% in 1993 to 9.8% in 2002 and there remains an important number of insufficiently productive companies, with many, representing more than half of total manufacturing employment, needing to improve their competitiveness. Unemployment rates reflect the differences in economic performance: whilst the national average stood at 9.8% in 2002 that of Prague was of only 3.7%, the highest levels remaining in the former regions of heavy industry, such as Usti in the northwest at 17.1% and Moravia Silesia in the northeast at 15.9%.

… while the territorial distribution of growth has reinforced Prague that is largely ahead of other regions.

The geography of economic growth has widened the gap between the Capital City Region of Prague, including part of the surrounding Central Bohemian region benefiting from Prague dynamism, and the rest of the country. Disparities between other regions are also growing. Prague, which accounts today for 10% of the national population produces around one-quarter of national GDP, with GDP per capita being at least twice that of other regions, and the only one superior to the EU 15 average. For all other regions the growth rate was far slower since 1997 and even negative in some cases.

Four different types of areas emerge in terms of economic and social development.

These contrasted economic performances can be explained by differences in accessibility, educational attainment or quality of the regional economic environment, with impacts on entrepreneurship and FDI levels. Four main district types emerge within regions (dynamic, lagging, declining traditional specialisation and non-dynamic suburban). The first type comprises growth poles (such as Prague and Central Bohemian districts but also the cities of Brno and Plzen) capitalising on industrial tradition and innovation as well as emerging districts (like Ceske Budejovice on the southwest border, Hradec Kralove in the Northeast and Zlin in the Southeast) characterised by significant FDI shares, a qualified labour force, a high degree of social capital and generally adequate infrastructure. The second type comprises industrial areas undergoing restructuring (situated mostly in north western Bohemia, and in the depressed areas of Moravia-Silesia) and particularly ageing districts. Their common characteristics are a degraded environment and higher than average unemployment, often a lowly qualified workforce and a local labour market that offers few opportunities for young people. Thirdly, districts with a higher share of agriculture and lower population density form an almost continuous east-west belt through the middle of the country. Fourthly, Non-Dynamic Suburban Areas are located mostly around Prague.

The Czech Republic possesses strong assets, beginning with its position in the heart of Europe, but these are often underused…

In order to ensure further and more balanced development, the Czech Republic can better exploit several underused potentials, the first of which is its unique position in the centre of the new Europe. It is the only accession country sharing borders exclusively with present (Germany, Austria) and future (Poland and Slovakia) EU members, putting it within reasonable distances of many European capitals and major cities. This favourable location on the map of the EU 25 puts the Czech Republic in the potential position of a commercial, logistics and tourism hub in Central and Eastern Europe, on the condition that it be endowed with an efficient transport infrastructure requiring in particular land-use reform to facilitate and accelerate expropriation in the public interest under fair compensation terms. Major efforts need to be made to bring main routes but also secondary ones, mostly road and rail, up to standards. Identified investment priorities and commitments with time frames need to be established, in particular to offer

soon adequate highway access to Ostrava, third city in the country and capital of Moravia-Silesia.

Success already achieved in attracting FDI needs to be consolidated and to better benefit the overall economy, particularly SMEs.

A second potential concerns attractiveness for foreign direct investment (FDI). The Czech Republic has been successful in this area over the past 10 years, with the highest level of FDI per capita in the region, spurred by a pro-active incentive policy. The consolidation of this achievement supposes an increase in the share of high-tech investment like ICTs that a new framework programme adopted mid-2002 should facilitate. It also requires proper attention to accessibility, the improvement of which, in certain regions, could lead to a better geographical spread of FDI, now concentrated around Prague, in Central Bohemia and, to a lesser degree, in urban hubs such as Brno. Availability of specialised suppliers complying with quality standards is also crucial, so the Supplier Development Programme should be stepped up to include a larger share of SMEs. Such an effort could procure overall benefits as the future performance of the Czech economy is going to be affected by the measures that will be taken to prevent a "dual economy", divided between a performing FDI sector and the majority of small and medium sized domestic firms. In spite of various credit and support programmes, accompanied by actions to better disseminate business information and innovative technological and managerial approaches through a Business Development Agency network, SMEs are losing to bigger firms in terms of productivity, added-value per employee and export shares.

The relatively high level of educational attainment of the population is under-exploited…

Thirdly, the Czech Republic boasts a high level of educational attainment. The proportion of the adult population having completed secondary school (86% of the population in the 24-64 age bracket in 1999, against an OECD average of 62%) was the highest in Europe. The percentage of scientific and technical graduates was second only to Germany the same year. Major Czech universities, located in Prague, Brno and Ostrava enjoy an international reputation. On the other hand, the number of PCs per student is still far from the OECD average. The Operational Programme for Human Resources Development recognises that lack of such key skills in secondary education leads to employment problems among graduates. To reduce and eliminate the

mismatch between educational output and the labour market, which can contribute to increasing regional disparities, training efforts in these areas need to be stepped up.

As is the unique cultural and natural heritage.

Finally, the Czech Republic possesses by far the highest number of UNESCO World Heritage sites in Central Europe (12), but it receives fewer foreign tourists (6.9 million in 2001) than Hungary or Poland (respectively 15.3 and 15 million). This tourism mostly benefits Prague (47.6% of guests in 2001), although the rest of the country has many major cultural and natural sites to offer besides its world renowned spas. Lack of sufficient and adequate lodging infrastructure in most regions, partly due to difficult access to credit for family businesses, absence of a reliable hotel classification system and insufficient promotion as compared to neighbouring countries, explain these shortcomings. Increased efforts are necessary to overcome these barriers, as the tourism industry, which already represents around 7% of GDP, can greatly contribute to economic development, with tourism sites evenly spread over the country.

Sectoral policies with unintended territorial effects need to be reviewed… housing is in the forefront.

Sectoral policies have not been capable of fully exploiting existing assets and have even created unintended negative effects as is the case of housing, brownfield regeneration and restructuring of industrial areas. The transfer of State owned housing to municipalities, the subsequent sale of certain real estate to private owners and restitution have been accompanied by increases in rent levels insufficient to cover maintenance costs by owners. The existing housing stock, whether municipal or private, remains subject to tight rent control benefiting all social categories, thus missing its intended compensatory effect in favour of low income families. A certain "freeze" in tenant's mobility explains the important slow-down in the construction industry over the past ten years, with new housing developments, not subject to rent control, mostly limited to the luxury segment. The lack of a truly liberalised housing market entails huge rent differentials between old and new housing, inner and outer city areas, particularly in and around the capital and between regions. Constitutional court decisions concerning a progressive liberalisation have not yet been followed by a change in legislation that would have the effect of abolishing one of the major obstacles to labour force mobility, the improvement of which could help to prevent further increases in

regional disparities. Progressive introduction of a transparent housing market is key to better balanced regional development, offering more true opportunities for job-seekers.

Brownfield regeneration requires a new focus…

Great efforts have been made in the Czech Republic to improve environmental conditions and remarkable results have been achieved over the past ten years. However, "development shortcuts" are more readily taken by the creation of Greenfield sites contributing to urban sprawl rather than the lengthy process of clean-up of damaged sites in view of new use. The reasons that can be invoked are numerous: Greenfields are available more rapidly, unsolved property and restitution issues, cost of clean-up and difficulty in complying with environmental rules. The intervention of several administrations (Environment, Industry and Trade, Regional Development) has amounted up to now to lack of Brownfield leadership and strategy. It is suggested that the overall situation be reviewed so as to simplify procedures, better cover clean-up costs, and facilitate co-ordination between different authorities, including regions (now invested with responsibilities concerning the environment) and municipalities. A systematic inventory of Brownfield sites, classified by category with indication of potential use for investors should be established and environmental rules should be modulated to better take into account the final use of regenerated land.

… As well as policies applied in regions undergoing industrial restructuring.

Policies applied in regions undergoing restructuring (like the North West and in Moravia-Silesia) that have received massive state aid, have shown their limits: unemployment has grown faster than job creation, often boosted by direct subsidies to existing firms and public works programmes more than by development of new sustainable activities. Many administrations and agencies intervene in this area and it is not clear whether there is a clearly defined strategy. Now that regional authorities are in place, proper co-ordination with these bodies is essential in these industrial regions still plagued by high unemployment, to ensure delivery of the Joint Regional Operational Programme, with a shared vision of priorities and linkages at different levels of government. In these structurally affected regions, parallel action needs to be taken for transportation infrastructure and "softer" measures such as education, training and improvement of the business environment.

Globalisation implies stepped-up use of ICTs…

Together with restructuring existing endowments in certain areas (housing, brownfields and heavy industry), more emphasis should be put on innovation. Dissemination of ICTs, particularly among small firms, requires not only proper training but reasonable Internet access costs. From this point of view, cost of access to the Internet in the Czech Republic remains very high and is one of the costliest among OECD member countries. Remaining barriers to competition ought to be removed to diminish user fees, thus permitting increased penetration. Particularly in areas experiencing high unemployment, sustainable SME creation and development are essential to economic growth, supposing cost-affordable access to the business portals now set up by public agencies for these firms. Also, foreign investors would more easily find strategic information on potential locations and partners if regional development agency websites were all totally multilingual.

… and support to innovation.

Science and Technology Parks, key tools in the adoption and dissemination of technological innovation, are supported by the Ministry of Industry and Trade and the most important ones in the country, often established through co-operation between regional and municipal authorities, Academia and the private sector, are conveniently located in Prague, Plzen, Brno and Ostrava. Their role in R&D, business incubation and implementation of new technologies and management methods is essential. Also, the Framework Programmes for the Support of Strategic Services Projects and the Establishment and Expansion of Technology Centres, launched in 2002 aim at attracting hi-tech investment to the country. Pursuit of these policies should be narrowly co-ordinated with sectoral policies that can have an impact on their deployment (transportation, brownfields). In parallel, firm clustering and specialisation, on these sites and on others, needs to be encouraged, on the basis of a strategy in this area that remains to be defined.

EU accession opens new opportunities for more efficient implementation of regional development projects.

The current process of change in the Czech Republic, in the context of transition, has certainly been accelerated and deepened with the perspective of EU accession, as in other Eastern European countries. Pre-accession funding, with its rules concerning project definition and conception and

application of partnership principles, has helped to prepare public officials at the national, local and regional level to co-operate more efficiently in view of project implementation and to integrate civil society in these. To further promote sustainable regional development, continued and systematic dissemination of information on EU programmes towards all potential beneficiaries is necessary. Training efforts concerning procedures and project management need to be pursued at all levels to ensure that the "absorption capacity" concerning EU funding is adequate for all programmes, following the recent example of SAPARD (Special Accession Programme for Agriculture and Rural Development), with the Czech Republic leading all accession countries mid-2003 in the number of projects approved and in the level of financial commitment agreed by the EU.

Major transfers of responsibility are taking place at all levels of government in parallel to civil service reform.

Far-reaching administrative reform has been taking place in the Czech Republic. Fourteen "self-governing" NUTS III level regions were created, with the first elections to the regional assemblies held in November 2000, while eight cohesion regions at the NUTS II level assumed main development responsibilities in the context of EU structural funds. In parallel, the 73 districts exercising state responsibilities at the local level, have ceased to exist since January 2003, with their powers divided between the NUTS III level regions (environment, secondary education, second class roads, health institutions in particular) and 205 municipalities with "state delegated tasks" (such as civil registry, building permits…). To complete this process, civil service reform has been on top of the agenda: two acts passed in 2002 concerning the national civil service and territorial self government officials lay the necessary foundations in terms of recruitment, status, career and training with a clear distinction of roles between each level of government.

But the new regions need adequate financial resources…

The new "self-governing" regions need the proper resources to ensure the accomplishment of tasks devolved by the state. Persistence of a temporary system of annual allocations from the state budget, unpredictable in their amounts and delayed in their payment, constitutes a hindrance for the implementation of the Regional Operational Programmes defined at the

NUTS II level, while creating a potential problem for mobilisation of matching funds. Development strategies of the "self-governing regions" at the NUTS III level need to be based on a long-term vision requiring stable multi-annual funding coming in part from their own resources, thanks to an increase in their own tax base. Also, proper solutions to identified unfunded mandates, such as in the health sector (regional hospitals) should be sought, not only for purely financial reasons but to foster good governance across levels of government.

… While the purpose and status of Regional Development Agencies needs to be clarified.

Regional Development Agencies were created in the Czech Republic before the new regions. Thus, many appear today to have an unclear status and purpose, although they continue to prove their usefulness and represent a capital of expertise: the situation should be clarified by proper legislation, both to avoid duplication with staff in NUTS III regions and ensure their contribution to efficient use of EU pre-accession and structural funds. Their present commercial status could be a problem and a Public Private Partnership approach, bringing together the major public and private actors in each region, as main shareholders of a non-profit organisation acting in the public interest, but without substituting itself to private sector consultancies, should be sought. This could be accomplished by a clear definition of mission (guarantor of the regional development strategy) that would enable these organisations to prepare and launch public calls for tender to be answered by private sector consultancies. The Regional Development Agencies would thus become full-fledged advisors to their regions.

The strategic position of the Ministry of Regional Development needs to be better defined.

The Ministry of Regional Development is a tool for dialogue on territorial development issues with other ministerial bodies and with regions. It is the co-ordinator at the national level on matters relating to the conception, evolution and implementation of regional development programmes in the context of the Regional Development Strategy of the Czech Republic (July 2000) and the National Development Plan (June 2001). It is a partner for EU pre-accession and structural funds, with implementation based on the preceding frameworks. To better carry out these tasks and ensure co-ordination more efficiently, the ministry is undergoing restructuring, including stepped-up presence in the regions. This administration needs to a play central role as a

link with other ministries and with the "self-governing regions" in matters of territorial development. Accomplishment of its fundamental tasks by proper representation in regions and effective co-ordination are key to a more balanced regional development. The success of decentralisation, on the basis of the reforms promoted by the Ministry of the Interior in the field of the national and territorial civil service, is also linked to the efficiency of the multi-level governance practices that the Ministry of Regional Development can initiate: its structure, organisation, staffing and resources need to be conceived as an answer to this challenge.

Municipal reform is part of the overall process of improved governance but it needs to be completed in terms of local development policies…

Municipal fragmentation in the Czech Republic can be an obstacle to better governance and efficient delivery of policies if recently acquired "municipal freedom" is not accompanied by measures based on the principle of "functional areas" around one or two small to medium sized towns. Service delivery of public administration is now organised around this concept, with 205 municipalities holding delegated state powers that they exercise for a wider area. In terms of economic development strategies, micro-regions (voluntary groupings of municipalities without administrative powers) are encouraged by the delivery of certain grants based more and more on a "critical mass" of population. Nonetheless, the proper framework for their organisation, stronger resources and more active participation of citizens in the local decision-making process still does not exist. It is recommended that the proposals made by OECD in 2002 in the Territorial Review of Moravska Trebova-Jevicko be debated with the micro-regions in view of their adoption and implementation (permanent own staffing, sustainable development charter, consultative body for civil society) along lines comparable to the EU LEADER type approach, characterised by strong support to local initiative.

… Whilst Non-Governmental Organisations need to be better associated to the on-going reform process to which they can usefully contribute

To respond to the challenges lying ahead (globalisation, EU accession, territorial development), the civil service and public sector alone, whether at the national, regional or local levels, cannot suffice and adequate responses suppose more and more effective participation of civil society. The burgeoning NGO sector in the Czech Republic should be allowed, by the expression of a

strong political will and proper support to partnership creation, to participate more fully in undergoing economic and social development processes. The risk, without an adequate mobilisation of these actors, is that of the persistence of a certain distrust of the public sector by citizens, heritage of a past era, and also the loss of precious competencies for achieving sustainable development. Good governance also implies an active participation of NGOs in the development process. To achieve this, it is suggested that national authorities engage in a dialogue with the NGO sector, with a view to removing the remaining obstacles to implementation of Public and Private Partnerships, whether legal or in terms of capacity building, both in the public sector and amongst NGOs themselves.

Anticipating the challenges ahead.

To sum up, the Czech Republic, in the first ten years of its existence has followed a steady path towards translating democratic principles into practice while becoming a market economy that has registered relatively regular growth. At the dawn of EU accession, these results need to be consolidated by further reform, particularly in terms of territorial development, so that the new regions and local government can be efficient partners to national authorities in efforts deployed to ensure balanced economic growth and social cohesion. Trends of the past ten years need to be reflected upon so that each region can fully exploit its assets while overcoming its difficulties. Persistence of high and concentrated unemployment, particularly in structurally affected old industrial regions, is a major problem that requires a mix of traditional policies (infrastructure priorities to facilitate access) and innovation (development of human capital, support to entrepreneurship, adoption of new technologies and processes). Likewise, indirect obstacles to labour-force mobility such as the lack of a liberalised housing market need to be removed, with adoption of proper measures to preserve and develop social housing.

It is under these conditions that the Czech Republic can face the future with confidence and play an important role at the cross-roads of the new Europe.

Introduction

The Czech Republic is a fairly urbanised country, with 70% of the population living in towns (but only 33% in municipalities with 50 000 or more inhabitants) in 2001, following an increase of this percentage* since the beginning of the transition period. The country also possesses an old industrial tradition from the times of the Austro-Hungarian Empire, which was reinforced after independence and was the main economic basis of the preceding socialist system. This heritage is reflected in the still important share of industry today, representing 40.4% of employment, in spite of massive losses in industrial jobs

Figure 1. **The Czech Republic in Europe**



Source: OECD Secretariat.

* This increase concerns mainly suburban areas and also small towns and villages.

since the beginning of the 1990s, *versus* 54.8% for an expanding service sector and only 4.8% for a declining agriculture (OECD, 2003).

The introduction to this review first presents basic elements of the territorial organisation and land use in the Czech Republic, before proceeding with regional performances and underused potentials in Chapter 1. This is followed by an analysis of the strategies and policies implemented to support the areas hardest hit by the transition to a market economy while seeking to ensure balanced territorial development in Chapter 2. Territorial Governance in a time of deep change is than dealt with in Chapter 3.

The Czech Republic at a glance – territorial organisation and land use

The Czech Republic, independent State as of 1 January 1993 (Box 1), is situated in the heart of Europe, at the crossroads of East and West. The country is surrounded on its western borders by Germany (810 km of common borders), Austria (466 km) and on its eastern borders by Slovakia (251 km) and Poland (762 km). The overall territory covers 78 866 square kilometres, (fifth largest country of the 12 EU accession candidates (CC-12) with a population of 10 230 060 inhabitants in March 2001 (Population and Housing Census, Czech Statistical Office). The density reaches 130 inhabitants per km^2, ranking the country in the 13th place in Europe and third amongst the CC-12. There is an above average concentration of people around the main cities. In the West, the capital, Prague, exhibits a density of 2 382 inhabitants per km^2 and hosts 12% of the total population. Other high-density cities are Brno in the Southeast (1 659), Ostrava in the East (1 494), Plzen (1 337) in the West and Zlin (669) at about 100 kilometres to the east of Brno. It should be noted that, in 1997, the Southwest had the lowest density.

The territory is divided into eight cohesion regions (NUTS II) regrouping 14 statistical regions (NUTS III) since 1 January 2001, bringing together 73 former districts and 6 244 municipalities of which 27% have fewer than 200 inhabitants. One hundred thirty-one cities and towns have more than 10 000 inhabitants. Prague is the largest with 1 160 118 inhabitants in 2001, whilst the population census of March 2001 established that there are 13 municipalities with fewer than 30 inhabitants. In addition, there exist more than 200 micro-regions, voluntary associations of municipalities that first appeared at the beginning of the 1990s. Districts have disappeared since January 2003 as one of the consequences of the regional reform decided to prepare EU accession, their administrative responsibilities being redistributed to main towns and regions. This process, currently underway in most eastern European countries, aims at establishing a modern governance framework in which there exists a single intermediate level between the national administration and local government. It is also an attempt to foster regional

Box 1. **The break up of Czechoslovakia**

The "Velvet Divorce" came as a result of the failure of the new democratic regime to deal simultaneously with the problem of finding a new common framework for the Czech and the Slovak States while at the same time reforming society by discarding the socialist model. Three primary and inter dependant explanations can be given for the break up of the state: Ethnic, Political and Economic.

First of all, the "Economic Reform Scenario" hit the Slovak economy more severely than the Czech. The main reason is to be found in the socialist economic policy implemented in the country. Indeed, the Slovak part was endowed with an important share of heavy industries, that, in most cases did not survive the privatisation process or that, in the best cases implied significant cuts in employment. Also, the post-communist situation was differently evaluated by the average Slovak and Czech regarding the costs and the benefits of the transition period for the Federation and about the way to go forward. Second, most of the Slovaks were looking for a more equal and visible position in the Federation rather than secession (only 10 to 20% of Slovaks were in favour of independence according to opinion polls conducted between 1990 and 1992). In an October 1990 survey, 62% of respondents claimed that the Czechs did not consider the Slovaks equal partners. Regional and cultural identities were strong, Slovaks were likely to consider themselves separate from Czechs in political but also in cultural terms.* Indeed, Czechs voted mainly for Czech parties, Slovaks for Slovak parties, Czech newspapers were read by Czechs and Slovaks had their owns media. These diverging opinions created the difficult political situation resulting from the 1992 election. The overall situation led to the break-up the Federation in spite of the efforts to the contrary of Vaclav Havel, President of Czechoslovakia since December 1989 and President of the Czech Republic from January 1993 to January 2003.

* The former Communist leadership promoted Slovak culture through various events. The creation in 1969 of the Federation institutionalised the division in which the minority veto accorded to the Slovaks outlined their specificity.

initiatives in the management of EU pre-accession and structural funds by defining administrative territorial units eligible for such assistance.**

About 67% of the country is situated at an altitude not exceeding 500 meters, 32% between 500 and 1 000 meters, the highest point (Snezka in the district of Trutnov on the Polish Border) culminating at 1 602 meters. Of the 7 886 525 ha (total land), 4 279 876 ha are agricultural land (54%), mainly arable (72% of total agricultural land), the remaining 3 606 649 ha being non-

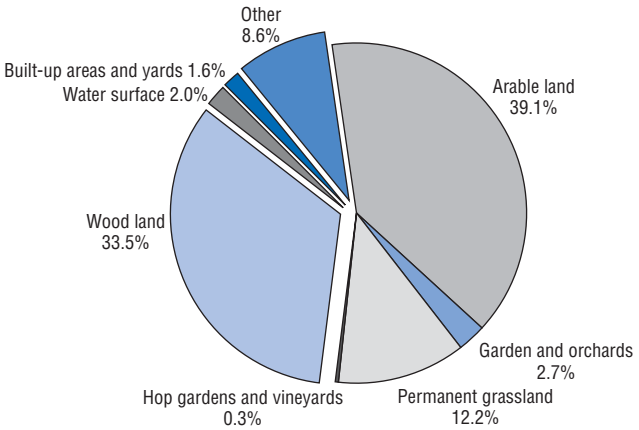
** The Czech Republic, Bulgaria and Slovakia were asked to establish the administrative structure and budgetary procedures of a regional policy that would allow them to participate in EU structural policy.

Figure 2. **Territorial units, breakdown at district and regional level**
NUTS II regions and former NUTS IV districts



Notes: 1: Karlovy Vary, 2: Usti, 3: Liberec, 4: Hradec Kralove, 5: Pardubice, 6: Olomouc, 7: Zlin, 8: Moravia-Silesia, 9: South Moravia, 10: Vysocina, 11: South Bohemia, 12: Plzen, 13: Central Bohemia 14: Prague.
Source: OECD Secretariat.

Figure 3. **Land structure of the Czech Republic**



Source: Czech Statistical Office (2001).

agricultural land, of which 73.1% is woodland. Since 1999, agricultural land is continuing to decrease (conversion into grass-land or non-agricultural uses supported by grants), whereas the share of forests is increasing. The country is endowed with large portions of preserved land including four National Parks (110 300 ha) and over 130 protected landscapes and national nature reserves, which, in addition to a rich architectural heritage, offer good opportunities for the development of rural tourism.

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Chapter 1

Regional performances and underused potentials

Introduction

The 1990s have been years of major changes for the Czech Republic: the split of the Federal Republic of Czechoslovakia into two new independent republics that gave birth in 1993 to the Czech Republic and to the Slovak Republic, and the transition to a market economy. These two events, far beyond profound economic changes, characterise a systemic change that affects deeply the political and socio-economic structure of the country. Furthermore, this process has also led to the creation of a new country (albeit with a longstanding history) facing new challenges and opportunities, of which EU accession is a driving force underlying ongoing reforms. The following sections present the main economic trends at the national level before and after the break-up of Czechoslovakia and examine the socio-economic performances of Czech regions.

1.1. Major macroeconomic trends

Trends in Czechoslovakia – the pre-1993 period

According to the figures,[1] the economic performance of the former Czechoslovakia was relatively weak, given its potential in terms of economic fundamentals and endowments (strong industrial base, relative stability of prices, highly educated and skilled labour force). Since the 1970s the growth rate of the GDP at constant prices had been declining. The World Bank provides estimates of the GDP at constant prices since 1990 and before 1993 for the Czech part of the country that unambiguously prove that the growth rate of GDP at constant prices for 1991 and 1992 is negative (respectively – 11% and – 0.5%). Despite methodological problems relating to data, prices (consumer goods, land and capital) do not reflect economic costs and/or are under-evaluated (this is a common situation in former socialist countries), leading to an over-evaluation of GDP (whether or not per capita) at constant prices. Thus, it is likely that GDP growth rates have been substantially negative for several years in the former Czechoslovakia. In any case, these rates have been, according to the World Bank, at least 30% below the OECD average from 1970 to 1990. In addition, misallocation of resources through central planning has resulted in a long-term decline in productivity (average labour productivity dropped from 4.3% a year between 1970 and 1980 to 1.5% a year between 1980 and 1988). Simultaneously, variety and quality of goods were stagnating and overall economic and social development was falling behind Western Europe, but

exhibiting better performances compared to other centrally planned economies (Doyle, Kuijs and Jiang, 2001). Indeed, income per capita slightly increased during the 1980s with some price stability, unemployment was "officially zero", and the provision of social services such as public transportation and education was good.

The situation was aggravated by adverse external shocks, *e.g.* reduced delays for payment of fuel deliveries from the former Soviet Union coupled with significantly increased energy prices. At the same time recession in the market economies contributed to the decline of trade resources. To cope with these problems, following the "Velvet Revolution" of 1989, Parliament adopted in 1990 the "Economic Reform Scenario" emphasising the need for a radical transformation of the economic system. This new policy framework included an anti-inflationary stabilisation policy, extensive privatisation of state-owned enterprises and banks, and liberalisation of prices. More generally it aimed at shifting the economy from a socialist to a market framework. This sudden change in the economic environment resulted in a sharp economic decline, the GDP dropping about 16% and industrial production by more than 19% (UNIDO, 1992). Real income declined by 27% while the cost of living index rose by 53.6%. Economic decline continued up to 1993 when the country split between the Czech and the Slovak Republics. Compared to Western European countries the new Czech economy was partially obsolete, mainly endowed with heavy industry, while modern technologies and services were under-developed or lacking.

Trends in the Czech Republic – the post-1993 period

Since 1993, GDP per capita grew at a yearly average of 2.1% with two years of recession in 1997 and 1998 resulting from internal and external shocks: the currency crisis and the Asian and Russian crises that accelerated the shift towards a market economy. Indeed, the currency crisis took roots in the provision of credit by state-controlled banks with insufficient collateral and confused corporate governance. The main consequences were, on the positive side, the restructuring of the banking sector (mainly through privatisation and adoption of European regulations) and simultaneously, on the negative side, the bankruptcy or loss of competitiveness of a vast majority of banks. The resulting shortage in credits weakened even more the performances of exporting firms that were not able to finance necessary investment in order to sustain foreign market share gains. This in turn reduced exports and the trade deficit reached 10% of GDP in 1997. Nevertheless, activity remained strong, industrial output rising by 3% between 1993 and 2000 (yearly average), exception made of the year 1999 (industrial production failed by about 4.5%).

Industrial productivity slightly increased (5.2% yearly average) but wages grew at a higher rate (13% yearly average) during the same time. Inflation,

Table 1.1. **Main economic indicators of the Czech Republic**

	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth	0.1	2.2	5.9	4.3	–0.8	–1.0	0.5	3.3	3.3
GDP per capita growth	–0.1	2.1	6.0	4.4	–0.6	–0.9	0.6	3.3	–
Inflation		9.9	9.2	8.8	8.6	10.6	2.1	3.9	4.7

Source: Czech Statistical Office, IMF (2002).

measured by yearly change in the consumer price index, decreased from 20.8% in 1993 to 3.9% in 2000 and was driven mainly by external factors such as imported fuel costs and appreciation of the Czech Crown. On the other hand, unemployment rose significantly to 8.8% in 2000 from 3.5% in 1993. The external balance deteriorated to 6.6% of GDP in 2000 (0.4% in 1993) despite substantial improvement since 1998, while financial accounts progressed, thanks to considerable foreign direct investment inflows that simultaneously strengthened the Czech Crown (CZK) against the Euro, with most FDI related to the Euro Zone (11.6% of GDP in 1999 and 9% in 2000, of which 85% comes from the EU-15). Since 2000, economic growth is mainly supported by private household demand influenced by increasing real income, a decrease in the savings rate and by consumer credit. To sum up, since 1993, the Czech economy is facing opposite trends in its major macroeconomic indicators but the overall situation is improving (lowered inflation and positive rate of growth for the GDP). Two major issues remain a challenge for the economy: worrisome

Table 1.2. **Key indicators CEEC, 2000**

	Real GDP growth	Inflation	Current account deficit, % GDP	Unemployment
Euro zone	2.8	2.7		8.5
EU	3.4	2.2		7.7
OECD	3.8	2.4		6.3
Albania	7.8	0.0	4.2	16.9
Bulgaria	5.4	11.8	5.6	18.0
Czech Republic	3.3	3.9	4.4	8.8
Estonia	6.9	4.0	6.3	13.6
Hungary	5.2	9.8	3.3	6.4
Latvia	6.6	2.7	6.9	7.8
Lithuania	3.8	1.4	6.0	11.5
Poland	4.0	8.5	6.3	14.4
Romania	1.8	40.7	3.7	10.5
Slovak Republic	2.2	8.3	3.3	17.8
Slovenia	4.6	8.9	3.4	12.2

Source: Economist Intelligence Unit, OECD main economic indicators.

trends on the labour market, with registered unemployment increasing to 9.8% in 2002 (it is likely that the situation will worsen because of ongoing industrial restructuring) and the sustainability of high government budget deficits. Also, the economy needs to absorb the high cost of the August 2002 floods: USD 2.5 billion in estimated damage (Radio Prague, 2003), corresponding to approximately 3.8% of GDP, with insurance coverage estimated at USD 1 billion (OECD, 2003).

1.2. Regional trends

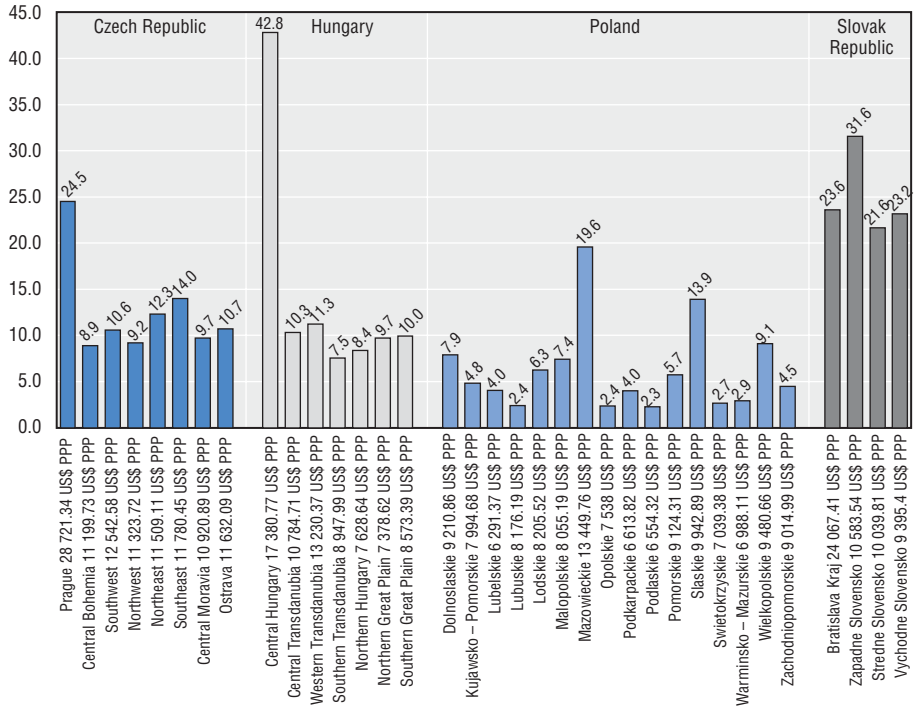
GDP per capita

The main characteristics of transition countries, in particular OECD Central European Countries, are on one hand the above average contribution to GDP of one region, most of the time the one that includes the capital. On the other hand, there is a gap between GDP per capita in the "dominant" region compared to other regions (by a scale factor of about 2 in the case of the Czech Republic). Even if GDP and GDP per capita can not adequately measure well-being and also economic, social and environmental disparities, its underlying role cannot be denied. Since 1995, GDP per capita in PPP grew about 4% per year at the regional level but with temporal and regional variations. While GDP grew continuously in Prague and in Central Bohemia, for all other regions the growth rate was far slower since 1997 and even negative in some cases. In 1998, all regions, except the capital and the surrounding region, experienced negative growth rates. With 7.5% (yearly average), Prague exhibits the highest growth rate whereas the North West NUTS II region grew at only 1.6% a year.

In Moravia-Silesia the growth rate was negative from 1997 to 1999. Since 1995, disparities between regions are increasing: in six years the standard deviation of regional GDP per capita almost doubled (scale factor of about 1.7, lack of sigma convergence, *i.e.* the dispersion of income per capita around the mean is increasing). If Prague is excluded from the previous calculus, the standard deviation tends to decrease over time leading to the conclusion of convergence. In other words, it is likely that all regions are converging with the exception of the leading capital region, with which the gap is widening. In spite of this trend, disparities between the capital region and others remain far less pronounced in the Czech Republic than in Hungary or the Slovak Republic, but somewhat higher than in Poland. In 1999 the capital city region of the Czech Republic represented close to one-quarter of national GDP for around 10% of the population.

Figure 1.1. **Contribution in % to GDP, NUTS II regions, OECD central European countries, 1999**

And GDP, in %, per capita PPP



Source: OECD Territorial Database.

Table 1.3. **GDP per capita PPP growth rate, NUTS II level**

	1996	1997	1998	1999	2000
Central Bohemia	9.1	3.2	2.4	4.7	9.9
Central Moravia	8.6	3.2	–4.5	0.5	8.0
Moravia-Silesia	13.6	–2.0	–5.9	–1.4	5.7
Northeast	8.3	3.8	–3.1	1.7	9.6
Northwest	9.1	–3.6	–3.9	0.2	6.0
Prague	6.5	8.4	7.2	6.0	9.5
Southeast	10.2	0.8	–1.4	1.2	8.6
Southwest	10.9	1.0	–2.8	1.6	8.9
Czech Republic	9.3	2.4	–0.7	2.2	8.4

Source: Czech Statistical Office.

Unemployment

Similar disparities exist on the labour market. At the national level, the number of unemployed people exhibits a significant seasonal effect, increasing the unemployment level each second quarter of the year and early in the third quarter but also the last quarter of the year.[2] Since 1995, this seasonal effect is decreasing and is negligible since 1999. Moreover variations in unemployment are highly correlated with trends in industrial production (past and present with a positive correlation over 0.8 at each time horizon). This reflects the transition process in which unemployment and total output are often growing at very fast rates. At the NUTS III level, regarding seasonal effects, three different evolutions emerge. Regions with a large industrial share and important restructuring exhibit a decreasing seasonal effect since 1993, which becomes negligible in the middle of the 1990s. This is the case for Moravia-Silesia, Usti, Karlovy Vary, Liberec and Hradec Kralove. Regions in which agriculture and agro-industries are still predominant are characterised by an increasing seasonal effect between 1993 and 1995, then a decrease but since 1997 it remains significant and stable. The corresponding regions are Vysocina, South Moravia, Olomouc, South Bohemia and Pardubice. Lastly, regions that present signs of economic diversification show an increasing seasonal effect between 1993 and 1995, then it decreases and becomes negligible after 1997.

Whereas trends are similar between regions, with a decrease between 1993 and 1995 or at least a slower increase in unemployment then a large increase of unemployment between 1995 and 1999, followed by a slight decrease since 1999, levels are very dissimilar. Again Prague exhibits a better situation with a low unemployment rate of 3.4% compared to 9.5% at the national level in 2002. On the opposite, Moravia-Silesia has a level of unemployment of over 15%. Nonetheless the contribution of Prague to total unemployment is slowly increasing. This has long been the case for the Northwest region, undergoing severe restructuring. On the converse, for other NUTS II regions the contribution to total unemployment is decreasing.

At the NUTS III level, regions that contribute the most to total unemployment are Usti, Moravia-Silesia, Olomouc and South Moravia. These four regions contribute to over 50% of total unemployment. In addition with the explosion of unemployment in the Czech Republic, the unemployment to vacancy ratio dramatically increased from 3.4 at the national level in 1993 to 10.5 in October 2002. Another matter of concern is the wide disparity that exists in terms of regional long-term unemployment. Regions with above average unemployment are also the most afflicted areas. In 2000, 72.6% of unemployed people in the district of Most were job seekers for over six months, 53.8% of them for more than 12 months and this is also the case

Table 1.4. **Unemployment, basic indicators by NUTS III region**
2002

	Unemployment	Youth employment[1]	Long-term unemployed[2]	Unemployment – vacancy ratio
	%			
Central Bohemia (Středočeský)	7.2	19.4	45.5	6.2
Hradec Kralove (Královéhradecký)	7.3	28.3	42.9	7.6
Karlovy Vary (Karlovarský)	10.1	26.4	54.0	10.9
Liberec (Liberecký)	8.7	26.4	51.6	8.7
Moravia-Silesia (Moravskoslezský)	15.9	23.4	58.9	35.7
Olomouc (Olomoucký)	12.2	28.2	53.3	11.5
Pardubice (Pardubický)	8.7	25.6	41.0	8.1
Plzen (Plzeňský)	7.1	18.9	51.9	6.4
Prague (Praha)	3.7	20.9	28.0	2.5
South Bohemia (Jihočeský)	6.7	22.0	37.3	7.1
South Moravia (Jihomoravský)	11.2	28.0	49.8	19.8
Usti (Ústecký)	17.1	28.3	59.9	25.2
Vysocina (Vysočina)	8.3	27.3	39.3	8.0
Zlin (Zlínský)	10.2	25.7	49.4	18.1
Czech Republic	9.8	25.0	50.6	10.5

Note: Czech names in parentheses.
1. Less than 25 years old.
2. One year and more.

Source: OECD Territorial Database, Czech Statistical Office.

for Teplice, Karvina and Ostrava. On the converse districts with low unemployment have low long-term unemployment.

Territorial performances at the former district level

Behind overall economic performance at the national and regional levels, most OECD countries and especially transition economies show large differences in social, economic and environmental terms. In order to compare regional performances, districts[3] have been grouped together on the basis of similar socio-economic development features and environmental performances. The methodology used for clustering similar districts is described in the Appendix.[4] Forty-three variables have been selected to describe several aspects of districts: land and infrastructure, economic structure, the environment, social capital, human capital and demography. A classical approach is to make a clear distinction between urban and rural districts. In this line of work: population density, the share of urban population, youth ratios, dwellings under construction, the share of agricultural land, number of farmers and labour force in agriculture as a share of total employment and yields per hectare are used. These variables jointly

assess trends in urbanisation and the share of rural areas in the districts. Also the density of roads, the number of physicians and the number of hospital beds per 10 000 inhabitants are used as proxies of infrastructures.

As pinpointed by the new growth theories, the labour force is a key factor. The latest developments of the endogenous growth theory emphasise the fact that the productivity of workers heavily relies on their health and knowledge. Data has been compiled on death rates, infant mortality, days of incapacity for work and work accidents to assess the health of the labour force. To take into account the level of human capital, the share of the working population with an upper secondary degree, a secondary level technical training or a university degree is used. Another important aspect of economic and social development, but also a source for future growth, is the level of social capital. The major difficulty is to proxy this stock. Following previous studies (*e.g.* Korbin and Coulton, 1997), crime rates are used as proxies of low social capital stock, whereas on the opposite the high rate of participation in elections corresponds to a good level of social capital.

The economic structure is best reflected, albeit incompletely, in the share of the working population in the different sectors. The following breakdown has been kept: industry – construction – hotels and restaurants – finance and real estate – social services and education and finally services to households. In addition, the level of unemployment and its breakdown in terms of age (less than 25 years, more than 45 years) and by training (basic and no education, secondary and university) is also referred to. The average wage is also used. Lastly, the number of enterprises of more than 100 employees seemed relevant as a proxy for entrepreneurship. In between economic structure and human capital two variables related to FDI are used: foreign capital in firms and the level of foreign investment in the districts (considered as a composite bundle of capital goods, know-how and technology).

Finally, a key aspect of sustainable development is the level of pollution. Several variables have been used: emission of solid pollutants, sulphate, nitrate, carbon-monoxide and hydrocarbon emissions. In each category and for the sake of comparability variables have been scaled in terms of number of inhabitants, land area or as a percentage of the total. On these bases four main types of districts appear: dynamic, lagging, declining traditional specialisation and non-dynamic suburban districts.[5]

Amongst the most **Dynamic Districts**, three, located in Central Bohemia, unambiguously emerge as growth poles, besides the capital city itself: Mlada Boleslav[6] to the northeast of Prague, Prague West and Prague East. They exhibit a higher concentration of FDI and wages as well as low unemployment. As in most OECD countries they tend to be geographically concentrated in and around the capital (*e.g.* Ile de France region, the region of Budapest, Dublin

Metropolitan Area, etc.). Notwithstanding this, certain other urban areas can also be growth poles, albeit to a lesser degree. In the Czech Republic this is the case of Brno, and Plzen. Dynamic districts also include emerging districts that are characterised by significant FDI, an important number of large enterprises, a qualified labour force, a high level of social capital and a good level of infrastructure. They are often historically strong industrial centres such as Ceske Budejovice on the South-western border or Hradec Kralove in the Northeast and Zlin, home of the Bata shoe industry, on the South-eastern border.

Lagging Districts comprise those undergoing severe industrial restructuring but also stagnating and ageing districts. Industrial districts undergoing restructuring are at the crossroads of economic development with uncertainty in their future. On one hand, some of these districts, such as those located on the western and North-western borders (*e.g.*, the districts of Cheb, Sokolov and Karlovy Vary[7] in the west) present an average level of unemployment (but higher for low-skilled workers) and some pockets of pollution. Others, still associated with extensive ecological problems (mainly caused by former mining activity and/or major chemical industry companies),[8] exhibit a high level of unemployment and a low stock of social capital but a significant level of FDI. This is the case of depressed areas located in the Usti region in the Northwest, such as Most, and in the region of Moravia-Silesia, particularly Karvina.

On the other hand, certain lagging districts also exhibit high unemployment of people with no or only basic qualification, a low level of FDI, lack large enterprises and sufficient infrastructure. A good example is Znojmo (in the Southeast NUTS II region) with an insufficient number of new job opportunities. Lastly, some lagging districts are ageing, with high levels of mortality and a relatively low share of young people. Their large enterprises are declining in importance. This is the case of parts of the Kladno district (Central Bohemia, west of Prague) in which major firms are continuously phased out (in particular in coal and steel production). Frydek-Mistek, on the eastern border, one of the main industrial centres in the region of Moravia-Silesia and Rakovnik in Central Bohemia, although host to a major multinational household goods company, are typical of this profile.

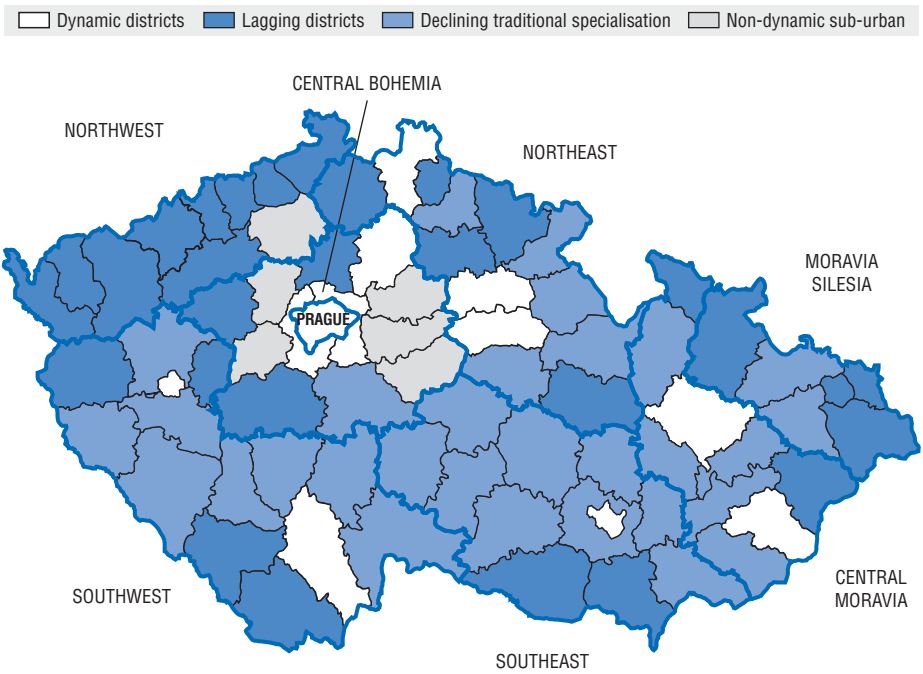
Declining Traditional Specialisation districts are characterised by low population density, a significant share of the agricultural sector – including agro-industries and wood processing – a low level of FDI and infrastructure. Interestingly, this group constitutes almost a continuous block from the west to the east through the middle of the country (exception made of Semily in the north). In some way there is a distinction between inner districts consisting of mainly rural areas and border districts exhibiting a higher degree of economic diversification. This corridor includes in particular the Southeast NUTS II region that is among the most fertile areas within the Czech Republic, but also

the traditionally agricultural area in the Southwest NUTS II region close to the German border.

Non-Dynamic Suburban Districts are characterised by low unemployment of low-skilled people, a low level of social capital, a small number of large enterprises and a significant share of public services. This type of district corresponds to suburban areas located mostly around the capital city.[9] The districts surrounding Prague ("Prague Sphere of Influence" and also the "Prague-Central Bohemia Conurbation") constitute a group that clearly benefits from its proximity (each district is less than 50 kilometres from the capital and its surroundings). As before transition, they remain in a certain way the "dormitory" of the labour force for Prague and its immediate vicinity. On average, 48% of the labour force in these districts commutes every day compared to 37% at the national level (the share of commuters reaches 53% when only the six closest districts to Prague are considered).

At the NUTS II level, looking at the aggregation of districts as previously analysed, there is no similar situation faced by the eight cohesion regions.

Figure 1.2. **Classification of districts in the Czech Republic by profile (NUTS II regions), 2000**



Source: OECD Territorial Database.

Besides the geographical position, three factors of differentiation emerge: the economic structure and its diversification, entrepreneurial activity and human resources and the quality of the environment. These three factors belong to those quoted by Blazek (1998) as the main factors to explain the economic performance of regions. This justifies the implementation of a regional policy with selective instruments and targets.

Prague, due to its GDP per capita, which is higher than the EU-15 average,[10] is not eligible for pre-accession and structural funds or national investment incentives. With its low unemployment rate and high concentration of services it would seem not to experience any specific difficulty, as compared to other regions of the country. This is not the case. As the major growth pole in the Czech Republic, and because of the high level of rents in the city, it witnesses intense daily automobile commuting, contributing to congestion and high levels of pollution (carbon-monoxide) in spite of the progressive modernisation of the public transportation system (although bus network density has dropped and fares remain expensive). Rendering services to a wider area, its tax base is not in proportion with its situation, in spite of corrective measures. Greenfield sites at the limit of the city and residence out of Prague illustrate this.

The **Central Bohemia region**[11] suffers in part from the fact that it encloses Prague: districts surrounding Prague are densely populated and attract people working in the capital while other districts with a lower population density are declining due to an unfavourable age structure. Despite the proximity of the capital the region still has a significant share of rural areas. Exception made of Mlada Boleslav, the region lacks of activity centres, although new greenfield sites are emerging in other locations like Ruzyne, Nymburk and Kolin for instance.

The **Southwest region**, which enjoys an overall good quality environment, has many of the characteristics of rural settlements such as a low population density. Being the border to the West, the region is strongly affected by the forty years of socialism which resulted in the territory being strongly undervalued as regards infrastructure (Ministry for Regional Development, 2001a). The exceptions are the city of Plzen and the district of Ceske Budejovice, with international links. The region is equipped both with industry and agriculture but relying on a low number of enterprises. Mostly, there is a lack of spill-over effects from the two dynamic activity centres within the region.

Another region with a similar pattern appears to be **Central Moravia**. Indeed, most of its districts are endowed with a significant share of agricultural land. The region also includes two more dynamic districts: Zlin in the South with its technical faculty fostering the development of an SME

cluster based on movie production, electronic media and ICT and Olomouc to the North endowed with several faculties and other higher professional schools of technical and economic orientation.

In between the situation of Central Bohemia and Central Moravia is the **Northeast region**. A considerable part of this territory is rural or endowed with a National Park. Besides, districts such as Hradec Kralove are equipped with industries, as is also the case for border districts. One of the particularities of these districts is the sharp decrease in employment both in agriculture and in industry (mainly textiles).

The **Southeast region**, in comparison to other regions, is characterised by a low intensity of private businesses and a high share of the working force in the primary sector (exception made of Brno). Moreover, 60% of the land is agricultural (this region is the main wine producing region of the Czech Republic), exceeding the national average by about 54%. In this same NUTS II region two districts are problematic: Znojmo and Breclav, characterised by high unemployment.

The **Moravia-Silesia region** exhibits many particularities. In terms of social, environmental and economic profile this territory can be split in two. On one hand it possesses agricultural pockets with production having a nation-wide character. On the other hand, mainly in and around Ostrava, there are major industrial sites undergoing restructuring, which translates into high unemployment. There are also pockets of very high pollution such as in Karvina.

Finally, the **Northwest region** is still a problematic territory in spite of some recent signs of change. It remains saddled with chronic ecological problems and unsustainable industrialisation (despite restructuring). The National Development Plan quotes this region as the Czech Republic's most negatively affected region. Nonetheless pockets of growing business activities exist, especially in Usti nad Labem and to a lower extent in Cheb and Karlovy Vary (that is also home to some of the most renowned spas in the Czech Republic). Cross-border trade with Germany and the presence of universities are the two most important factors explaining this positive trend.

To sum up, each NUTS II region has its own economic, social and environmental profile, but it appears that they share similar difficulties such as the coexistence of lagging districts with more dynamic territories and an insufficient number of activity centres or dynamic local hubs. Reducing unemployment, redressing regional inequalities by supporting the emergence of new attractive activity centres and correcting environmental damages are the key challenges currently facing the eight NUTS II regions in the Czech Republic.

National trends and regional performances: overall assessment

The Czech Republic presents many aspects of most transition countries in Central and Eastern Europe: lower inflation from year to year, productivity gains, significant average growth rate of GDP, ongoing privatisation, emergence of a dynamic service sector and banking sector undergoing major restructuring but an unemployment rate recently increasing again. If the early 1990s were mainly times of economic recession, the trend at the beginning of the new millennium expresses sign of economic recovery with continued threats on employment and budget deficits. Moreover transport infrastructure remains largely obsolete, thus compromising future development potential. The Czech Republic, often considered as one of the most successful transition countries, experienced in 2002 a growth rate below the regional average (see Chapter 2).

At the regional level, due to different initial endowments and industrial structures, economic performances greatly differ from one region to another. The city/region of Prague exhibits impressive improvement and sustained economic growth, with a large influx of foreign direct investment (FDI) and a low unemployment rate, but the environmental situation is getting worse because of increased automobile traffic, in spite of the reduction of other forms of pollution (industry, heating). Other regions converge in terms of GDP per capita, but regions hosting former heavy industry, chemical plants or military bases are facing increasing unemployment (many long-term unemployed) and major environmental problems.

At the district level differences in socio-economic situations are even more striking. First of all, cities are in most cases growth poles concentrating economic activity, FDI, services and human capital. Nonetheless, pockets of urban stagnation exist (Karvina in Moravia-Silesia and most of the districts in the Usti region), defined by high pollution levels, high unemployment and low social capital. On the converse most NUTS II regions have their own growth pole, usually relating to districts including a main city where universities and/or major educational institutions are present (Brno, Zlin, Plzen, Pardubice, Hradec Kralove, Olomouc, Ceske Budejovice). Accessibility often makes the difference: only Brno and Olomouc are directly linked to the highway network, and Ostrava, third city in the country, boasting a high level of educational institutions, is slowed down in its development efforts by difficult access.

1.3. Under-used potentials

A privileged geographical position in the heart of Europe

The Czech Republic is the only accession country sharing borders exclusively with EU members (Germany and Austria) and other candidate states (Poland and Slovakia). This simple fact underlines that the major

Table 1.5. **Driving distances and times between Prague and selected European cities (kilometres)**

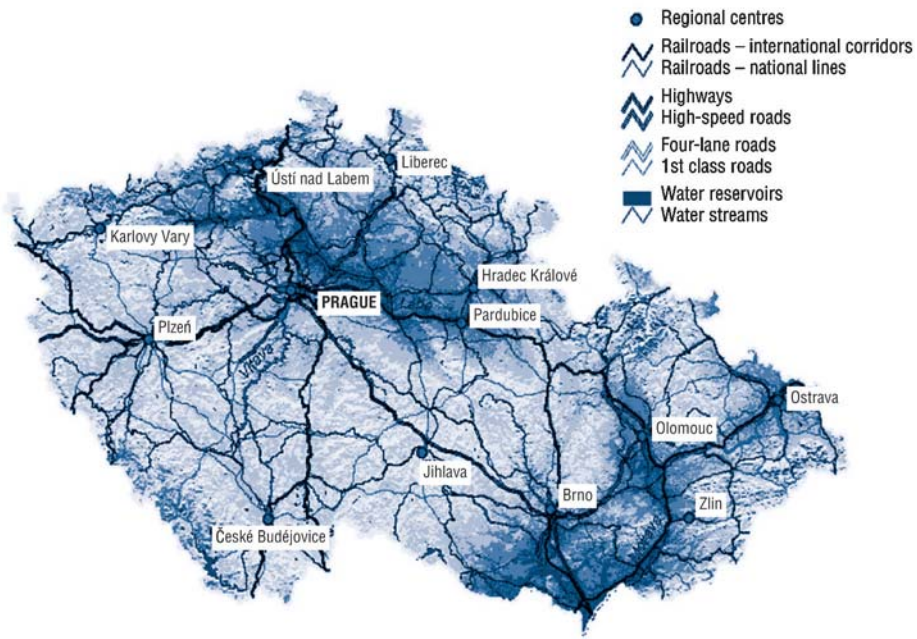
City	Distance (km)	Driving times (hours)
Berlin	341	4.4
Bratislava	326	3.3
Budapest	518	5.4
Munich	375	4.4
Vienna	294	3.5
Warsaw	608	8.4

Source: CzechInvest Fact Sheets (2002) and Ministry for Regional Development (2003).

geo-political shift in Europe induced by transition, democracy and the emergence of new market economies will be reinforced, from the perspective of the Czech Republic, by the accession process. The Czech Republic will be positioned strategically at the crossroads of the present EU-15 and new member countries, enjoying proximity to both. The Czech Republic can thus play a major role on a North-South as well as an East-West axis, representing a unique transportation and logistics hub in the new Europe, to its own benefit and that of neighbouring countries, while remaining a country of choice for foreign direct investment and regional headquarters of major international firms. This unique asset, if exploited with a strategic vision of the positioning of the Czech Republic in the EU-25 based on adequate transportation links, could be the foundation for a fully globalised economy, in the forefront of international trade in Europe, while enjoying an increase of tourism flows to all parts of the country (see further).

This undeniable geographical asset, placing the Czech Republic and its capital city within easy reach of other countries and major foreign agglomerations brings forward the essential role that the Czech Republic can play in the creation and strengthening of Trans-European Transport Corridors (road and rail), now being defined and implemented. This would be fully compliant with the logic and recommendations of the European Spatial Development Policy (ESDP, 1999). In order to valuate such a potential, transportation infrastructure in the Czech Republic is already one of the most dense in the region but it also needs to attain a good quality level to properly service all parts of the country, including remote or predominantly rural areas, while comprising high speed links between major cities and with neighbouring countries. As has been indicated previously, this is far from being the case today, even if important improvements have been made over the past decade. The financial resources invested in transportation infrastructure stay on a long-term basis behind the average costs of development recommended by the EU (1.5% to 2% of GDP). Rates during the

Figure 1.3. **Transport infrastructure in the Czech Republic**



Source: Ministry for Regional Development (2001a).

last ten years have been the following: between 0.7 and 0.8% for 1992-1994, growing from 1% to close to 1.5% between 1995 and 1997 and dropping again in 1999 to 1.3% (Ministry for Regional Development, 2001a).

Major examples of this situation are to be seen in the area of road transport with slightly more than 500 kilometres of motorways in operation out of a total road network of 55 432 kilometres (Ministry of Transport and Communications, 2001), important cities such as Ostrava are not yet linked to the motorway network, the poor state of maintenance of many secondary roads and border crossings (National Development Plan). Concerning rail transportation, track speed of the railways is deeply behind the European standard, with only 1% of the tracks permitting a speed of 160 km/h and 6% authorising speeds in the range of 120-160 km/h, out of a total network of 9 444 kilometres. In the field of air transport, although the country boasts some 60 small domestic airports and 11 with international capacity, a city like Brno, the second in the Czech Republic, has no regular scheduled air service to Prague. Concerning inland waterways, there are only 664 kilometres that are navigable and the share of freight transported has considerably decreased during the last ten years (Ministry of Transport and Communications). The main waterway is the Labe (Elbe) river, East of Prague, linking Central Bohemia

to the German border (and onwards to Hamburg) from Chvaletice (west of Pardubice), but plans to render it navigable from the latter city have been delayed. A major project, the Oder-Danube canal, which would open up international navigation to Ostrava, is still on the drawing boards. Major plans to overcome some of these handicaps by 2011 are the following:

Box 1.1. **Major road and rail infrastructure projects in the Czech Republic**

Completion of the D5 motorway (Prague Plzen Rozvadov) with the Plzen bypass.

Completion of the D8 motorway (Dresden Prague) connecting towards Berlin.

Construction of the D47 motorway connecting Ostrava to Olomouc and the rest of the motorway network.

Construction of the R47 expressway from Cesky Tesin to Belotin (Moravia Silesia).

Completion of the R1 ring road around Prague.

Completion of the modernisation of railway transit corridor I: Decin Prague Brno Breclav.

Modernisation of railway transit corridor II: Ostrava Prerov Breclav, with a Prerov Ceska Trebova branch.

Modernisation of rolling stock.

Source: Ministry of Transport and Communications (1998).

It is obvious that major efforts need to be made so that the Czech Republic can fully draw profit from its central position in Europe, by paying proper attention to its international ground transport links but also to its domestic network. Without a radical modification of the present day situation, the country will not only be losing international transit traffic, but regional disparities, often linked to difficulties in accessing territories, will be more difficult to overcome. Regions with low rates of FDI and high unemployment such as Moravia-Silesia are often lacking adequate transport infrastructure and connections. Also, if proper emphasis on a better territorial distribution of tourism across regions other than Prague is to be considered (see below), improved domestic and international accessibility by different transport modes of other cultural and natural amenities is required. A striking illustration of existing imbalances resides in the fact that Prague Ruzyne airport accounts for more than 95% of overall passenger air traffic and about 85% of freight traffic.

Linking growth, housing and labour force mobility

The Czech Republic is in a paradoxical situation concerning housing: the overall stock of dwellings seems sufficient, even if completion of new housing has considerably dropped in the first half of the last decade (from 44 594 in 1990 to 12 622 in 1995). Despite the growing amount of completions since 1996 (24 759 in 2001), the average age of the housing stock remains relatively high: in 1991, dwellings were already 42.4 years old on average and that of family homes was of 60.3 years. Prefabricated panel buildings account for close to one-third of the housing stock, and contrary to other transition economies like former Eastern Germany, no massive rehabilitation programmes have been undertaken (Ministry for Regional Development, 2001b). On the other hand, transfer of ownership from the State and public enterprises has been swiftly accomplished, with municipalities taking up a large share of the stock, and restitution carried out. The available housing stock of 4 304 084 units in 2001 (4 039 738 in 1991). About 95% of this stock is inhabited and distributed as follows:

Table 1.6. **Structure of the housing stock according to tenure in 2001**

Sectors	Share (%)
Owner occupied housing	47
Rental housing	29*
Co-operative rental housing	17
Other	7
Total	100

* Available data for 1999 show that occupied rental housing represented 31% of inhabited dwellings (24% municipal, 7% private).

Source: Ministry for Regional Development.

In spite of these changes, important distortions remain on the housing market, because of rent regulation that concerns not only municipal rental housing but also private restituted rental housing. Even if average regulated rents have increased considerably between 1990 and 2001 (from CZK 134 to CZK 1 291 per month), the present level is not sufficient to cover most maintenance costs and to permit the creation of a transparent rental market. On-going, but slow privatisation of the municipal housing stock (and to a lesser degree that of co-operatives), can be explained by the high costs of acquisition for many potential homeowners, the same being true for new construction, not compensated by sufficiently attractive and developed loan schemes, and also because of high interest rates in the banking sector until the end of the 1990s. Efforts are made by the government to create a true housing market by continuing the increase of regulated rents as a prelude to

full liberalisation, on the basis of a Constitutional Court decision taken at the end of 2002, invalidating a rent regulation provision. As long as the present situation remains unchanged, social and territorial distortions will tend to create barriers to mobility of the workforce, thus contributing to maintaining or even increasing regional disparities in levels of unemployment and economic development.

One of the most striking illustrations of the "housing paradox" lies in the fact that regulated rent does not even fulfil its main purpose: providing cost-affordable housing only to those in real need of it, permitting most people in that category to benefit from social housing. "Regulated rents are not targeted with respect to household income but are linked to tenancy agreements prevailing before transition. There are no significant average income differences between households living in municipal, private rental, co-operative or ownership housing. In other words, the share of rich and poor households is comparable in different types of housing" (Lux, 2000). If there is an incentive for wealthier households to spend less on rent by benefiting from provisions originally designed in a context corresponding to rather limited income disparities, there is also an incentive for poorer households to hold on to regulated rental housing in their area, even if the local job market offers limited possibilities. This also applies to younger households who inherit the rights held by their parents. Conversely, moving to another region or a bigger city might entail significant difficulties in obtaining a dwelling at an affordable price and, in such a case, long delays are the rule.

Considering average rents on a monthly basis in the Czech Republic, at the end of 2001 (Ministry for Regional Development, 2001b) for a standard dwelling in the private or co-operative sector (68 m^2, 30 years old), Prague appears at the top of the scale (CZK 9 391), followed by regional centres such as Hradec Kralove, (capital of the NUTS III region of the same name), Jihlava (Vysocina Region), Brno (South Moravia), all topping CZK 6 000, closely tailed by Zlin and Karlovy Vary, at more than CZK 5 000, with Plzen and Pardubice under CZK 5 000 and Olomouc at slightly more than CZK 4 000.[12] Inside regions there are very significant disparities, which means that moving to the regional centre to find a job can be very costly or even unaffordable for many, as compared to regulated rent in their locality, which is often at a level comparable to that of social benefits or financial support for those having lost their job.

Concerning Prague, the situation is somewhat different, because rental rates around the capital, in Central Bohemia, in what is known as the Prague Central Bohemia Conurbation, are around half of those prevailing in the city, unaffordable to most employees. This price differential has contributed to massive congestion and pollution problems due to commuting (120 000 daily commuters), in spite of an improving public transport infrastructure, and to

the continued role played by "dormitory cities", created on the outskirts of the capital during the socialist era, with the ensuing complexities of tax issues and cost sharing for infrastructure between the municipality of Prague and the Central Bohemian region.

The structurally affected regions to the north, mostly Usti in the northwest and Moravia-Silesia in the northeast are those that account for the lowest rental levels (with massive construction during the previous era to house workers in heavy industry), correlated with high levels of unemployment. Many private dwellings remain vacant in spite of their cheap rental price because regulated rental dwellings are even more affordable. Locally, certain price differentials also exist: the average rental rate in Ostrava is generally lower than that of surrounding smaller cities, probably because of the more pleasant environment offered by these than the old industrial centre of the city.

This overview amply shows that lack of a transparent and liberalised housing market has artificially created enormous price differentials even within the same localities for the same categories of housing (regulated rental housing *versus* new construction and old private rental housing released from rent regulation because of the non-transfer of tenancy agreements to new occupants), affordable to the happy few only), as well as creating negative externalities within regions and between regions. Such a situation is a major obstacle to workforce mobility that can only contribute to fostering greater regional disparities and maintaining pockets of unemployment within regions. Progressively opening up the rental market would facilitate a more balanced development between Prague and its hinterland and, within each region, between the regional capital and other settlements. It would also provide workers with more job opportunities entailing a move, if such a decision does not automatically lead to trading off existing advantages for a leap into the unknown. Growth centres such as Brno and Zlin could thus benefit more to their whole region while structurally affected regions such as Moravia-Silesia could solve some of its unemployment problems by facilitated migration to other areas.

The question of housing raises serious problems relating to economic and social development. Concerning the construction sector, generalised rent control is probably an important factor in the sharp decline in new housing production since ten years, albeit with some recent recovery. In this context, the share of luxury housing, mostly single family dwellings in peripheral areas, has increased substantially, leaving new social housing at a low level. This has also contributed to urban sprawl, rather than encouraging inner city residential construction/regeneration at cost-affordable prices or rents. Socially, the widespread system of shadow subsidies resulting from generalised rent control is an obvious problem. Rent control in itself can be

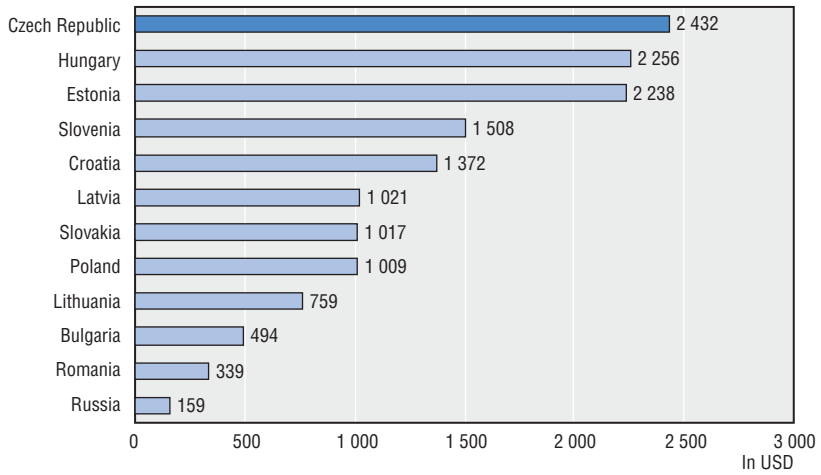
legitimate when correctly targeted but the unchanged and common practice, including in expensive areas of main cities, has introduced major distortions. Prague is on top of the list, and a specific adjustment process should be initiated there. This does not mean that rent should become free immediately and without restrictions. It would be unacceptable on social grounds and inefficient since it would imply a drastic movement of relocation of households, incoherent with economic growth. The adjustment should be progressive and targeted according to incomes. Recent Constitutional Court decisions concluded clearly that rents should be freed, but legislative or regulatory measures are yet to come.

FDI versus *SMEs: a dual economy?*

The Czech Republic hosts more than 1 200 subsidiaries of foreign firms. It has been one of the most successful transition economies in the field of foreign direct investment (FDI). By the end of 2001, this country had attracted more FDI per inhabitant than any other in Central and Eastern Europe, according to the Vienna Institute for Comparative Economic Studies. Since 1993, USD 36.787 billion in FDI has been registered.[13] A record level was attained in 1999 (USD 6 324 billion), with average figures for 2000 and 2001 of USD 4 900 billion. These remarkable achievements rest on the relatively high level of skills of the Czech workforce, low wages and specific manufacturing experience in different fields (electronics and automotive industries, which represent together around two-thirds of total investment, are good examples). An ambitious promotion, incentive and Industrial Zone programme (see Chapter 2), led by CzechInvest, a public agency, has undoubtedly spurred these developments. The share of FDI in the Czech economy has now attained important levels from several view points. 65 to 70% of all manufactured exports are produced by the more than 1 200 foreign backed firms,[14] which employ directly around 300 000 people (25% of the manufacturing workforce in firms with more than 100 employees). Ten thousand Czech suppliers in the manufacturing and service sectors are sub-contractors to these firms, representing a minimum of 600 000 jobs (approximately 12% of the total employed Czech labour force) (CzechInvest).

FDI is relatively concentrated in certain regions.[15] The main beneficiary is Central Bohemia, host to many greenfield developments and where the Skoda motor works, belonging to the Volkswagen group, are located (Mlada Boleslav). This region, benefiting from the proximity of Prague and its transport infrastructure, accounts for 35% in value of finished FDI projects between 1992 and 2002. It is followed by Usti, a hard-hit unemployment region undergoing restructuring, with 15%, and Olomouc, with 14%. All other regions represent less than 10% each. Prague itself, which is not eligible for investment aids, accounted only for 1%. In terms of job creation, Central Bohemia reaped 20%

Figure 1.4. **FDI stock per capita in Central and Eastern Europe, 1993-2001**



Source: The Vienna Institute for Comparative Economic Studies, cited in CzechInvest Fact Sheets (2002).

of jobs created by FDI, followed by South Moravia (mostly Brno) with 13%, Usti, with 11%, and Olomouc with 10%. All other regions are below the level of 10% (8% for Hradec Kralove and Pardubice). Not surprisingly, Moravia-Silesia, which encounters the same type of industrial reconversion problems as Usti, but is still not properly connected to the transportation network, only succeeded in obtaining 5% of the new jobs created by FDI (for a share of 4% of the total foreign investment).

Manufacturing firms in the Czech Republic employ 1 381 626 people at the end of 2002, divided as follows in relation to number of employees:

Table 1.7. **Employment by firm size, 2002**

Firm size	Employees
0-9	218 967
10-49	203 697
50-249	336 055
250-999	322 740
More than 1 000	292 201

Source: Reply to OECD questionnaire by the Ministry of Industry and Trade (2002).

The biggest firms represent the highest share in revenues from sale of own products and services of the manufacturing industry (34.6%), with added value in production amounting to 31.3% for 21.3% of the workforce. Their value added per capita was also the highest, at CZK 488 000. Conversely, the

lowest added value per capita (CZK 142 000) is that of the smallest firms (less than nine employees). Medium-size enterprises (50 to 249 employees), had a decisive share in overall added value, exceeding their share in manufacturing employment (24.4%). Whereas the number of employees is decreasing in the firms situated in the 250 to 999 segment, the number of employees is growing in small- and medium-sized enterprises (SMEs), which already represent more than half of total manufacturing employment. This trend is expected to continue even if their share is different from sector to sector. The health of this category of firms, that represents about one-third of Czech exports, is essential to maintaining employment.[16] These constitute the supply base for major companies and they should be dynamic, flexible and innovative. However their access to credit, for lack of sufficient collateral, is difficult, their market knowledge is often more limited, whether for domestic or foreign sales and acquisition of EU rules and procedures is slower, not to mention more limited language skills than in bigger firms. The same is true concerning the level of managerial skills and use of ICT (cost and training issue for the latter).

The Czech government is perfectly aware of the strategic value of SMEs to nurture a growing economy and has taken different steps to support that category of enterprises, in particular by the creation of Business Innovation Centres, advice and counselling to new firms and more advantageous loans under the terms of different programs (see Chapter 2). Encouragement of industrial clustering is part of the same strategy. It is too early to evaluate results, but a forward looking policy is essential to keep existing enterprises competitive while helping new ones to develop. Such an approach is necessary to overcome the gap between a buoyant FDI sector and a large number of poorly performing enterprises suffering from weak corporate governance, long kept alive by soft loans from state dominated banks. "The future performance of the economy will importantly depend on overcoming the emerging dualism in the business sector and the quality and pace of interaction and productivity diffusion between international and domestic firms" (OECD, 2002a).

It is clear that management techniques and technology diffusion occur most where there is a sufficient concentration of FDI. As has been analysed above, the regions of the Czech Republic are not in the same position from that point of view, as a few attract most of FDI, with positive "trickle down effects", leaving others in a weaker position to prop up their domestic firms. A more balanced spread of FDI over the territory would enhance the opportunities of other regions, particularly those undergoing industrial restructuring such as Moravia-Silesia. Accessibility plays an essential role in this case, as a positive correlation can be established between the amount of FDI and proper linkages to transportation networks, as in the case of Central Bohemia, Usti, South Moravia or Olomouc.

Education and training: strengths and weaknesses

The Czech Republic possesses a relatively high level of educational attainment and has traditionally been endowed with a specific strength in the technical and scientific fields. In 1999, the proportion of the adult population that had completed secondary school (86% of the Czech population aged 24-64 against an OECD average of 62%) was the highest in Europe. Also, the percentage of scientific and technical graduates is at a very high level, second only to Germany in 1999, with slightly less than 35% (OECD, 2001a). Findings from the PISA studies (OECD, 2001b) conducted in OECD and non-OECD countries to measure the literacy of 15-year-olds in different fields also underline the good position of Czech youth in science. The best scores are registered by Japan and Korea. Other countries situated significantly above the OECD average are Australia, Austria, Canada, the Czech Republic, Finland, Ireland, New Zealand, Sweden and the United Kingdom. The technical universities and faculties in Prague, Brno and Ostrava, to mention only those with the highest enrolment, enjoy an international reputation.

To maintain these high standards, use of Information and Communication Technologies in teaching as well as acquisition of ICT skills by students are essential. From this point of view the Czech Republic could better exploit its potential. The average number of PCs per 100 students in 2001, at slightly less than five, ranks higher than the performance of other countries in the region (Hungary: 3.75; Poland: 2.5), but this is still below the OECD average which stands at 12.5 (OECD, 2002b). Also, the percentage of school computers connected to the World Wide Web is increasing. In 2002, 94% of secondary schools in the Czech Republic are connected to the Web (Ministry of Education, Youth and Sports). These percentages should be put in the context of very high Internet access costs for these countries, with Hungary and the Czech Republic leading by far in terms of prices amongst OECD members (OECD, 2002b). This is of course an obstacle to Internet diffusion and use not only in the school system but also in small businesses and households.

Foreign language skills in the Czech Republic are also well developed, measured in percentage of people fluent in one or more foreign languages and attain levels that are often double that of neighbouring countries [FESSEL-Gfk Austria, 1998, Institute for Information on Education (UIV), 2000]. A survey carried out at the end of 2002 at the request of CzechInvest (by Universitas Consortium for Applied Sociology), concerning the level of language skills among the adult population showed that 14% of the population enjoys at least a basic knowledge of one foreign language, 28% of two foreign languages and 21% of three. English is now close to being the dominant foreign language, spoken by 35.3% of the population, an increase of 6.3% since 1998. German remains spoken by 35.9% of Czechs. The younger generation leans more

towards English (52% in the 18-39 age bracket) versus 42% for German in the same age segment. The same survey established a positive correlation between language knowledge and computer literacy. Sixty-eight per cent of the 2 953 respondents in the survey are able to work with a computer and 47% use the Internet. Eighty-nine per cent of those working with a PC have a command of a foreign language, compared to 46% of others. Among Internet users, the percentage of language skills rises to 95%.

In spite of these remarkable achievements, important shortcomings remain that either introduce certain territorial disparities, or highlight the present difficulties of the educational system at a time when regions are being transferred certain responsibilities in that field,[17] with mismatches between the educational output and labour market needs still remaining. The PISA studies reveal that pupils' attainments in the combined reading literacy scale are highly influenced by their school's mean economic, social and cultural status much more than by that of their family. Amongst OECD countries, differences between schools from that point of view are more important only in Germany, Austria and Belgium [in Germany this factor accounts for slightly more than 65% (only 8% for family status)]. In the Czech Republic, school status accounts for slightly over 50% (family status for 10%). Also, differences in levels of achievement are also markedly higher when measured between schools (51.9%) than when measured within the same establishment (45.3%). This simply means that some schools are better than others and chances are that quality of education is best in bigger cities or in certain neighbourhoods than in rural or remote areas. Acknowledging this, the Ministry of Education launched a four year programme in 2003 which aims to eliminate regional disparities in the educational offering, particularly in the field of vocational training.

The White Paper on Education (Ministry of Education, Youth and Sport, 2001) puts a strong emphasis on improving the status, salary, training and career perspectives of teachers, which will be one of the focus points of different measures to be translated into law while increasing the share of the national budget devoted to education. Standing at 4.6% of GDP in 2000 it is below EU averages: the proclaimed goal is to increase this percentage to 6% by 2005. Levelling off of differences between performances of schools can also be facilitated by increased use of ICT in the classroom, which implies continued efforts to equip schools and train teachers for that purpose. Also, endowment of a good part of the Czech student population with good technical and scientific skills has not yet resolved the mismatch between the production of the educational system and the labour market.

This is recognised by the Operational Programme for Human Resources Development (Ministry of Labour and Social Affairs, 2002), in stating the following: "Especially in secondary education, the concept of a wider general

basis for vocational training and an orientation towards key skills (such as team work, working with information, using computing technology, creative problem solving) is only beginning to develop. Its development must be supported as ignorance of these key skills leads to employment problems among graduates." One of the missing links is the absence of true implication of employers in curricula definition (Ministry of Education, Youth and Sport, 2001), another resides in the fact that there exists no mechanism for ensuring the involvement of employers in financing vocational training (Ministry of Labour and Social Affairs, 2002). There are also true capacity constraints: the current intake to tertiary education, universities and higher specialised education represents 40% of the relevant age group, with a demand for enrolment double the supply (Ministry of Labour and Social Affairs, 2002).

Concerning adult education, quantitative indicators have started to decrease. "Only about one-quarter of Czech companies consider education as a priority of their personnel policy or human resources as part of a strategy of their development. In the majority of sectors there are no coherent systems of employee education. On average, the expenditure of Czech companies and institutions intended for employee education is not even half of what is invested in Western European countries. Only every 20th job seeker takes part in retraining schemes." (Ministry of Education, Youth and Sport, 2001).

A unique and well distributed cultural and natural heritage

The Czech Republic possesses strong tourism assets. Besides Prague, which presents one of the most remarkable syntheses of the architectural styles characterising Europe from the Middle Ages up to the Art Nouveau period, the country, with 11 other UNESCO World Heritage sites in 2003 in many different regions, has the highest number of these major cultural attractions in Eastern Europe (UNESCO, 2003). Forty-three "Urban Heritage Reserves" and 211 "National Heritage Zones" also benefit from special protection. The natural environment is generally well preserved,[18] with 80% of the territory available for leisure activities, four national parks, numerous natural parks and protected natural heritage, as well as a dense network of hiking trails and cycling paths enhancing these endowments. In spite of this diversified potential, the Czech Republic receives fewer foreign visitors than Hungary and Poland, which are among the world's top 15 tourism destinations (ranking respectively 12 and 13 in 2000 and 2001). Hungary attracted 15.3 million visitors from abroad in 2001 and Poland 15 million, whereas the Czech Republic received 6.9 million foreign tourists the same year. On the other hand, average annual growth over the 1995-1999 period has been remarkable in the Czech Republic (13.5%), with Hungary and Poland losing

ground (minus 7.4 and 1.7% respectively). Nonetheless, in terms of growth of receipts, Hungary, over the same period, increased its average annual earnings by 6.5% and the Czech Republic by only 1.4%, which tends to prove that the average expense per tourist in the former is growing and higher than in the latter (World Tourism Organization).

Table 1.8. **World's top 15 tourism destinations**

		International tourist arrivals (million)		Change (%)	Market share (%)
		2000	2001*	2001*/2000	2001*
1	France	75.6	76.5	1.2	11.0
2	Spain	47.9	49.5	3.4	7.1
3	United States	50.9	45.5	–10.6	6.6
4	Italy	41.2	39.0	–5.3	5.6
5	China	31.2	33.2	6.2	4.8
6	United Kingdom	25.2	23.4	–7.4	3.4
7	Russian Federation	21.2	–	–	–
8	Mexico	20.6	19.8	–4.0	2.9
9	Canada	19.7	19.7	–0.1	2.8
10	Austria	18.0	18.2	1.1	2.6
11	Germany	19.0	17.9	–5.9	2.6
12	Hungary	15.6	15.3	–1.5	2.2
13	Poland	17.4	15.0	–13.8	2.2
14	Hong Kong (China)	13.1	13.7	5.1	2.0
15	Greece	13.1	–	–	–

* Data as collected by WTO (June 2002).

Source: World Tourism Organization (WTO) (2002).

These improving performances are mostly benefiting Prague, which attracted 47.6% of foreign guests in 2001, *versus* 39.4% in 2000. Other regions trail far behind, with Karlovy Vary (world famous spas west of the capital) following at 7% in 2001, preceding Southern Moravia (Brno, second only to Prague in terms of urban historical heritage, major wine-producing region of the country) with 6.3% and Central Bohemia (castles) at 5.5%. Seven regions do not even attain the 4% mark (Czech Statistical Office, 2002). Tourism is now a major contributor to GDP (6.8% in 1998 versus 1.3% in 1989) and employment, both directly and indirectly (9 to 10% of the active workforce, which corresponds to around 500 000 people) (Ministry for Regional Development, 1999a). Its impact on economic development is strong in the capital and to a lesser extent in a few other regions, which means that there is still a largely untapped potential in other parts of the country, including rural tourism. In terms of domestic tourism, there is also room for expansion, as expenses by Czech citizens for travel amount only to about 3-5% of their total

expenditures, as compared to 13% for Western Europeans (Ministry for Regional Development, 1999a). The lower overall performances of the country, in comparison with its neighbours and the very uneven distribution of visitors over the territory can be explained by several converging factors.

One of the major obstacles to tourism development is the lack of sufficient and adequate hotel infrastructure in most parts of the country, with the exception of Prague, Brno and major spa areas, in spite of the fact that the number of establishments increased almost fourfold between 1989 and 1998, with accommodation capacity nearly doubling over the same period (Ministry for Regional Development, 1999a). Efforts by entrepreneurs and investors in this field often meet with the stiff conditions of the banking sector, high interest rates and in the case of SMEs (most hotels are family businesses), lack of collateral. Quality often leaves room for improvement as there is no official hotel classification, the outmoded one of the socialist era having been simply abolished, but not replaced by a new system of standards. Poor service in the hotel and catering industry, recognised by the Czech Tourist Authority itself (2003) is another explanation, with the specific skills required in this sector often lacking, including language abilities, except in major cities or spas. Accessibility is another issue, as only Prague Ruzyne airport possesses an extensive network of international connections while regular domestic service is very limited. Road and rail accessibility and quality, as has been indicated previously, are not up to European standards yet, thus limiting incoming tourism from neighbouring countries. Promotion constitutes the last bottleneck, with sums devoted to international marketing and regional development by the Czech Tourist Authority through government subsidies remaining relatively modest,[19] in comparison with efforts made by other tourism destinations.

Notes

1. The Czech National Accounts have been extensively revised; figures provided in this chapter came from various sources: IMF International Financial Statistics, World Bank World Development Indicators and the Czech Statistical Office (national and regional offices). It is likely that macroeconomic indicators may differ from other studies. Unless specified, data used in this chapter come from the Czech National Statistical Office or the Czech National Bank.
2. Each series has been seasonally adjusted using the X-11 procedure (monthly data from January 1993 to October 2002 of unemployed people), then the seasonally adjusted series have been decomposed into trend and cyclical components using the Hodrick Prescott algorithm.
3. Although these have ceased to exist since the beginning of 2003, they remain basic statistical units for which time series exist.

4. The cluster analysis is a convenient method to identify similarities between regions but it is quite sensitive to the choice of variables. This should be borne in mind when interpreting the typology proposed in this study.
5. A remark on interpreting the results. Belonging to one cluster means that the district has a specific profile, its main characteristics. This does not exclude the possibility, to a lower extent, that it could share some of the characteristics of other districts in another cluster, but less significantly.
6. This district hosts the Skoda automobile factory and suppliers.
7. Exception made of the town itself, with the prosperous spa industry.
8. Even if the situation has significantly improved over the past ten years.
9. There are, however, some "development corridors" crossing these areas, along the axis of the highway linking Plzen, Prague and Brno, in the proximity of the capital.
10. In percentage of the EU average for the year 2000, the GDP per capita of the Czech Republic, in Purchasing Power Parities is of 56.2 versus 121 for Prague.
11. Central Bohemia, with Prague and Moravia-Silesia is the only region that is situated both at the NUTS II and III levels.
12. When name of region is not indicated, it carries the name of the main city.
13. Sum includes USD 9.305 billion of investment registered in 2002, on the basis of preliminary data, which would constitute an absolute record (Czech National Bank, 2003).
14. Over the past ten-year period, Germany has been the leading foreign direct investor (24%) followed by Japan (21%). Czech investors, which benefit from the same support schemes as foreign firms, represent 16% of this investment. These figures take into account only major investments meeting conditions making them eligible for aid (see Chapter 2).
15. The following data, supplied by Czechinvest, concern only FDI having benefited from investment incentives, so the true stock of FDI is probably higher (example: there is no investment incentive for Prague and some investments do not meet the required conditions of level or job creation).
16. See previous endnote.
17. Regions are responsible for the building and maintenance of secondary schools but they can also create non-university higher education institutions. Municipalities are responsible for primary schools and kindergartens.
18. The only exceptions are certain parts of northwest Bohemia and of Moravia-Silesia, where mining and heavy industry were concentrated until the beginning of the 1990s, but major efforts undertaken since to remedy the situation are beginning to produce visible results.
19. 2001 budget: CZK 140 052 000 (CZK 180 000 000 in 2000); 58 employees; 12 offices abroad. Only 10% of this budget is devoted to regional development.

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Chapter 2

Strategies and policies

Introduction

Economic development strategies and policies implemented by the Czech Republic since the beginning of the 1990s have followed phases characteristic of all transition economies, with the fundamental changes brought about by the return to a market economy. Initial focus was put on regulatory and macroeconomic issues, to create the framework for private enterprise creation while selling publicly owned companies. The progressive installation of district Labour Offices and the introduction of Active Labour Market Policies aimed to fight unemployment. Focus was also rapidly put on support to old industrial regions where restructuring created a dramatic downturn of activity in traditional sectors like steel making and coal mining. Sectoral policies than sought to address environmental issues like brownfields or the creation of proper infrastructure, particularly in the area of roads and transportation. Only more recently have direct investment aid and innovation programmes as well as incentives for job creation with territorial modulation been introduced, as SME support programmes were completed with measures aiming at encouraging entrepreneurship and new activities. EU pre-accession instruments supported these efforts, while the adhesion process itself led to the creation of new NUTS II and III regions as well as a National Development Plan integrating sector and regional approaches into a single document. One of the main challenges of future policies in the post-accession period will precisely be to fight growing territorial disparities, particularly between the capital and other regions but also between certain lagging regions and others starting to exploit their assets with positive results.

2.1. Economic development strategies in transition

At the beginning of the 20th century, the Czech lands were the most industrially developed part of the Austro-Hungarian Monarchy, competing technologically and commercially with the most advanced countries in Europe. Created in 1918, Czechoslovakia, ranked by the 1930s among the ten major European industrial countries. The new nation enjoyed a strong tradition of craftsmen, skilled at producing machinery and other manufactures and businessmen adept at exporting these goods. Incomes were high, and the well-developed economy succeeded in forging close financial and industrial links with the rest of Europe (Bohata and Mladek, 1999). The break up and loss of independence of the country in 1938,

following the Munich agreements, the war and than the 1948 communist coup dealt severe blows to entrepreneurship and the economy of the country. The 1989 "Velvet Revolution" thus had a heavy agenda to recreate a market economy, what with close to 97% of its GDP originating from the socialised sector, dominated by heavy industry (Bohata and Mladek, 1999), while dealing with the 1993 break up with Slovakia.

Initial measures

The entrepreneurial law of April 1990 legalised the establishment of private companies. Privatisation of big companies, restitution of many smaller ones and "small privatisation" (more than 22 000 units sold in public auctions) were the main features of initial policy destined to re-establish the foundations of a market economy, alongside the creation of an adequate financial environment (low inflation, stable exchange rates). In spite of these efforts, that have helped to partly overcome some of the initial burdens (restructuring in heavy industry, repair of environmental damage, retraining of the workforce), the Czech economy is still facing important challenges. The estimates of the potential growth rate of the economy – currently clustering between 2.5 and 3% – show a clear lag relative to other countries in the region. While these estimates are based on a variety of different methodologies, they all associate low potential with ineffective utilisation of inputs. This peculiarity, which has sustained high labour force participation and employment rates, reflects the rapid pace of ineffective industrial investment in the first decade of transition under government-sponsored banking and weak corporate governance, and low subsequent exit of unprofitable firms. Consequently, a large segment of the labour force is employed in enterprises and activities that are not sufficiently productive to meet domestic and international competition. This problem will intensify with an expansion of the highly productive FDI sector (see below), which contributes to further real wage growth and currency appreciation. The size of the "vulnerable component" of the industrial sector is estimated at between 5 and 10% of dependent employment, with recent signs of an increase due to the worsening competitiveness (OECD, 2003).

Although emphasis was first put on the hardest-hit regions (North West Bohemia and Moravia-Silesia), these measures were taken in the absence of a true regional policy, that only began to emerge in recent years, in the context of EU accession. In the first half of the 1990s, regional policy did not play a significant role in the Czech Republic, as the government concentrated on addressing transition issues at the national level, with an essentially macroeconomic vision of the required reforms. Besides, regional disparities in the Czech Republic were still rather reduced and only began to appear progressively. They translated into growing differences between the capital area in terms of GDP per capita and employment and the rest of the country,

with certain parts afflicted by much higher rates of unemployment than the national average (mostly the districts of North West Bohemia and Moravia-Silesia but also some smaller rural regions struck by the abrupt decline in agricultural employment), as the following table shows.

Table 2.1. **Unemployment rates since 1995, calculated from number of unemployed registered at labour offices**

NUTS III regions	1995	1996	1997	1998	1999	2000	2001	2002
Central Bohemia	2.6	3.0	4.6	6.1	7.5	6.8	6.8	7.2
Hradec Kralove	2.0	2.6	4.0	6.1	7.5	5.9	6.3	7.3
Karlovy Vary	2.1	2.7	4.6	6.9	9.0	8.0	8.7	10.1
Liberec	2.5	3.0	5.2	7.0	7.8	6.4	7.4	8.7
Moravia-Silesia	5.1	5.7	7.9	11.5	14.9	15.1	15.1	15.9
Olomouc	4.3	5.3	7.6	10.2	12.4	11.9	11.8	12.2
Pardubice	2.7	3.4	4.7	6.6	9.0	7.9	7.9	8.7
Plzen	2.2	2.6	4.2	6.1	7.4	6.5	6.5	7.1
Prague	0.3	0.4	0.9	2.3	3.5	3.4	3.4	3.7
South Bohemia	2.0	2.5	4.0	5.8	6.7	5.8	6.0	6.6
South Moravia	2.9	3.4	5.4	7.9	9.9	9.4	9.7	11.2
Usti	5.8	7.1	10.0	13.2	15.9	16.2	15.8	17.1
Vysocina	3.4	4.0	5.7	7.5	9.2	7.5	7.0	8.3
Zlin	2.4	3.2	4.7	7.0	8.7	8.1	8.5	10.2
Czech Republic	2.9	3.5	5.2	7.5	9.4	8.8	8.9	9.8

Notes: **Methodology**: 1995: % of registered unemployed of the number of all working persons in districts with only one or main job, according to labour force survey + number of registered unemployed. Since 1997: % of registered unemployed of the labour force.

Source: Ministry of Labour and Social Affairs (2003).

Unemployment rates and job creation

The different measures taken to fight unemployment produced mixed results, as the number of new jobs created each year often remained below the level of jobs suppressed. In spite of active labour market policies (ALMPs) aimed at job creation and retraining, a growing mismatch between labour market needs and skills progressively appeared. ALMPs concentrated in particular on public works type of jobs, mostly in regions with high unemployment, more than on active counselling for the search of new jobs or retraining linked to perspectives of new activities, as in the expanding service sector.[1] As the next table shows, the number of jobs created yearly was more than 20 000 in 1995 (similar figures in 1996 and 1997), with significant increases as of 1999 (more than double), the maximum level (close to 60 000) being attained in the year 2000, and a downward slide ever since (less than 40 000 in 2002), also reflecting the worldwide slowdown in economic activity. One-third of jobs created were in the Regions of Usti and Moravia-Silesia but

Table 2.2. **Job creation since 1995**

NUTS III regions	Newly created jobs (sums for respective years)					Jobs created in 2002 (% by selected types) *definitions in notes below*			Unemployed entering retraiing
	1995	1999	2000	2001	2002	1	2	3	2000
Central Bohemia	1 658	3 113	4 336	3 850	2 935	46.1	33.0	19.5	2 105
Hradec Kralove	948	1 594	2 279	1 750	1 040	46.1	28.8	21.2	1 656
Karlovy Vary	341	757	1 679	1 170	728	40.5	32.1	27.2	498
Liberec	660	1 480	1 800	1 743	1 343	47.5	23.6	16.5	1 044
Moravia-Silesia	5 217	7 643	11 361	9 332	6 323	32.4	39.7	26.5	8 566
Olomouc	2 230	3 903	5 848	4 804	3 364	31.7	45.2	21.4	4 125
Pardubice	1 096	2 278	3 104	2 838	1 836	41.9	33.1	23.9	1 131
Plzen	383	1 215	1 902	1 649	1 171	38.3	39.8	18.4	963
Prague	113	243	661	309	302	47.7	27.2	9.9	368
South Bohemia	721	2 326	2 863	2 412	2 157	46.3	30.3	19.8	1 406
South Moravia	3 000	4 235	5 704	5 313	4 026	31.8	43.5	22.4	2 980
Usti	3 456	8 140	11 145	10 333	8 993	59.3	21.9	16.1	5 023
Vysocina	2 233	3 368	4 377	3 583	2 929	38.6	40.9	20.3	1 037
Zlin	1 585	2 140	2 807	2 178	1 862	24.5	47.4	25.2	2 429
Czech Republic	23 641	42 435	59 866	51 264	39 009	42.2	34.5	20.8	33 331

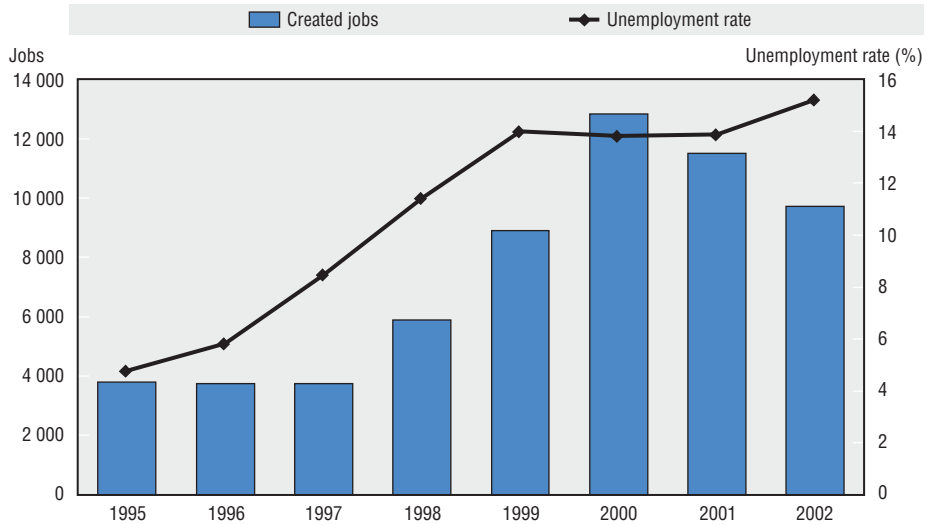
1. Public Works jobs.
2. Jobs for marginalised groups and future self-employed.
3. Work places for graduates and trainees.

Source: Ministry of Labour and Social Affairs (2003).

this did not prevent registered unemployment rates in these regions from tripling between 1995 and 2002, as shown previously, attaining much higher levels than in other parts of the country.

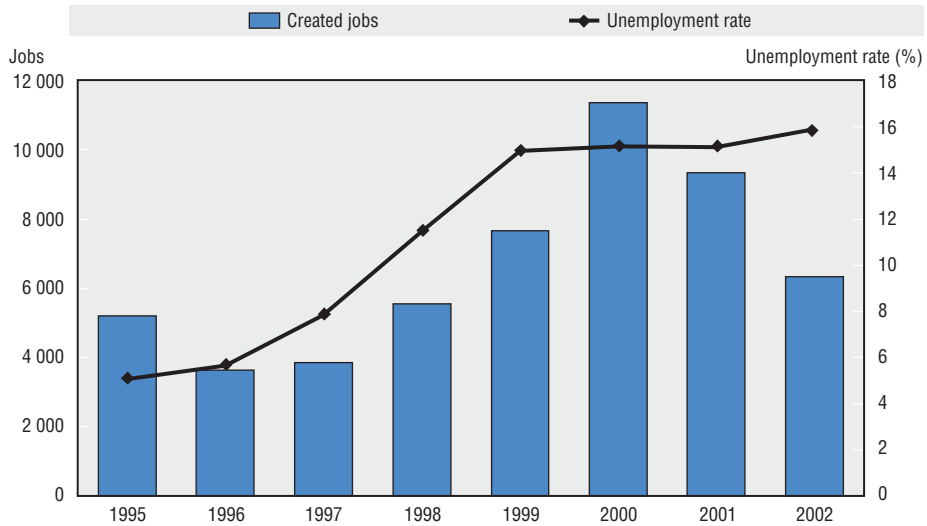
Rigidities of the Czech labour market contribute to explain that efforts to create jobs have been hampered, more acutely in regions already suffering from high unemployment. The main obstacles are: the high cost of hiring and firing employees, high taxes on wages, extension by decree to other sectors of wage increase agreements, the disincentive of high social benefits, contributing to the high percentage of long-term unemployed. Besides, many public works jobs seldom lead to permanent re-qualification and hiring. The mismatch between labour market needs and educational output are also often cited. Obstacles to mobility of the labour force (lack of an open housing market and insufficient transport infrastructure) contribute to maintaining high levels of unemployment in certain areas. Lastly, "The value of retraining without mobility appears to be questionable: in the chronically high unemployment regions with extremely low vacancies, it is unclear what kind of skills ought to be provided by training." (See the above-mentioned OECD Economic Survey of the Czech Republic for a detailed analysis.)

Figure 2.1. **Number of created jobs and unemployment rate in years 1995-2002 in NUTS II North West Region**



Source: Ministry of Labour and Social Affairs (2003).

Figure 2.2. **Number of created jobs and unemployment rate in years 1995-2002 in NUTS II Moravia-Silesia Region**



Source: Ministry of Labour and Social Affairs (2003).

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Targeted state aid for regions with highest unemployment

On the basis of the new Strategy of Regional Development of the Czech Republic, Regional Development Programmes were designed for the regions suffering from the highest unemployment rates. The objectives of these programmes are mainly to diversify production capacities and create new job positions in existing or new firms including SMEs. These programmes are the following:

- Regional Programme for the Support of the NUTS II North West Region (May 1999).
- Regional Programme for Support of the Moravia-Silesia NUTS II Region (June 1999).
- Programme for Support of Regions afflicted by low economic performance and structural changes concerning four border districts (Germany and Austria) in the NUTS II South West Region (Tachov, Klatovy, Prachatice, Cesky Krumlov), four (three of which are on the Austrian border) in the NUTS II South East Region (Trebic, Znojmo, Breclav and Hodonin, added in May 2000), two in Central Moravia (Jesenik, bordering Poland, and Prerov) and one in Central Bohemia (Kladno, Northwest of Prague).
- Programme for Transformation of Former (Soviet) Military Bases of Ralsko and Mlada, in parts of Central Bohemia (Nymburk, Mlada Boleslav) and the North East (Ceska Lipa).

Out of the CZK 378 million decided for these programmes in the 2002 national budget, CZK 78 million were allocated for clean up and recovery after the August 2002 floods, CZK 100 million were spent for development in the North West and CZK 160 million in Moravia-Silesia. The remaining CZK 40 million were divided between regions with low economic performances and the military zone programmes.

In the case of the first two programmes, investment subsidies of up to 50% were granted to firms, (ceiling of CZK 10 million per firm), on condition of creation of a certain number of jobs. Thirty-three businesses in Moravia-Silesia and 15 in the North West were granted such subsidies in 2000. In 2001, 32 businesses in the former region and 21 in the latter were beneficiaries, thus creating 1 249 new job positions in Moravia-Silesia and 676 in the North West (Ministry for Regional Development; information supplied to OECD in May, 2003). In 2002, 15 companies in Moravia-Silesia and six in the North West received subsidies for a total amount of CZK 139.8 million (planned creation of 312 new positions in the first region and 196 in the second). The final outcome, as monitored, was lower though: 156 jobs in Moravia-Silesia and 57 in the North West, with extensions granted to comply with job creation obligations by the end of 2003. It is to be noted that the monitoring process,

conducted under the supervision of consulting firms, can lead to interruption of subsidy, allocated with milestones, if obligations are not met.

Other programmes implemented concern specific aid to SMEs in these regions in conjunction with the Czech-Moravian Guarantee and Development Bank (see below), as well as programmes devised within the "Guidelines" drawn up in 2000 by the Ministry for Regional Development (MRD) for support to the North West and to Moravia-Silesia. These aim at developing business infrastructure for SMEs (industrial zones, revitalisation of unused industrial facilities) and promoting tourism, with grants going to individual municipalities. 17 projects were selected in 2001 for Moravia-Silesia for a total subsidy amount of CZK 92 million (roughly two-thirds of the sum in the first category). In 2002, these same projects were allocated funds totalling CZK 67 249 000 (two-thirds in category two). In the North West, ten projects were selected in 2001 (CZK 10 176 000 in category one and CZK 27 302 000 in category two).

In regions afflicted by low economic performance, aid granted to municipalities for business infrastructure and promotion of tourism amounted to CZK 30 million in 2001 (41 projects) and roughly the same sum in 2002 (23 projects). The smallest subsidy amounted to CZK 102 000 and the most important one to CZK 1 081 000 (50 and exceptionally 70% of total investment cost for localities in the Sumava area which houses a National Park). In response to the August 2002 floods, an additional allocation of CZK 78 278 000 was decided, supporting 64 repair projects. The military zone programme only received CZK 10 million, due to budgetary re-allocations, financing four projects concerning business infrastructure, developed by municipalities.

Specific support for SMEs in these regions, managed by the MRD until the end of 2002, concerned 301 projects (majority of very small businesses), granted a total of CZK 302.9 million. This contributed to the creation of 902 new job positions in 2002. More than half of the total amounts granted went to the most afflicted districts of the North West and Moravia-Silesia. On the other hand the proportion of jobs created in these areas was lower: 181 jobs in Moravia-Silesia and 117 in the Usti NUTS III Region (North West).

Overall assessment of job creation for these programmes between 2000 and 2002 is as follows:

- 3 985 new job positions in the North West and Moravia-Silesia;
- 350 new job positions through the business infrastructure programme for municipalities in selected districts (economically weak areas);
- 902 new job positions in SMES in areas benefiting from specific support.

It is difficult to evaluate the effectiveness of such recent measures but it is possible bring forward several questions and issues. Of these job creations, how many will reveal to be truly sustainable? Considering the important sums allocated to the two most hard-hit regions in terms of unemployment (North West and Moravia-Silesia), the number of jobs created does not seem to be in proportion, as the preceding charts show. Probably better linkages with educational output, training programmes and improved access to information on support programmes would help. Also, the road accessibility problems afflicting Moravia-Silesia (see below), constitute a serious obstacle to attracting further domestic and foreign investment to the region and developing the process of a value chain that public money could otherwise contribute to initiate.

2.2. Sectoral policies

The purpose of a territorial review is not only to examine different sectoral policies and their impact on territorial disparities but also to identify areas where better policy co-ordination would create the proper conditions for economic development, while preventing negative externalities and ensuring best use of public funds, whether at national, regional or local level. Since it is not possible to analyse all sectoral policies and their effects on territorial development, two policy areas with certain linkages have been selected to identify issues and problems concerning infrastructure and the environment. Difficulties in establishing co-ordinated priorities, that would ensure more efficient spending and sustainable development have been identified concerning brownfield eradication and reuse on one hand and construction of major road infrastructure on the other.

The brownfield issue

The environmental legacy of communism is a heavy one in all post-socialist countries. Disregard for the environment (practically no integration of the environmental cost of industry and heavy industry in particular nor of massive mining activities) and concentration of these activities in certain areas (in the Czech Republic, mostly Moravia-Silesia and North West Bohemia) led to very high levels of pollution at the beginning of the 1990s that the new democracies had to cope with, in parallel to industrial restructuring entailing high unemployment. Reconversion to new activities implied not only retraining but also site clean up. Public health considerations required in all cases and in many parts of the country a reduction in the level of industrial pollution (air, water, solid waste disposal, nature conservation). All transition economies have made remarkable progress in this field and the Czech Republic is no exception (see OECD, 1999). "Notwithstanding these successes, much of the accumulated contamination of the past is still in place

and current emissions and discharges remain high compared to OECD average levels. The road towards environmental convergence with other European OECD countries will be a long one."[2] One of the areas where this convergence is the least advanced concerns brownfields, as the Ministry of the Environment (2003) itself recognises, in spite of proclaimed goals in this area.

Thus, the *Up-dated State Environmental Policy* (Ministry of the Environment, 2001), concerning the urban environment, explicitly states: "In revitalisation of the urban landscape, emphasise directing investment plans towards the original industrial and abandoned zones of cities. Prevent the creation of new commercial zones in suburban areas. Consistently support the use of these areas for free-time activities, tourism and sports". This has not prevented urban sprawl and the creation of shopping centres around most major cities, particularly Prague, and extensive greenfield developments, rather than reuse of brownfields, as in the case of FDI, although the Investment Incentives Programme is applicable to both types of investment. The reasons of this situation are numerous, but one of the major ones appears to be the lack of a true brownfield strategy, with the intervention of several administrations in this field, without sufficient co-ordination. It is to be noted that the implementation of environmental policies, under the guidance of the Ministry of the Environment, is one of the areas of competence devolved to the newly created NUTS III regions. Will the new regions dispose of the required financial resources and well-trained staff to deal with these complex and sensitive matters? The implementation of a greenfield project is a quicker answer to local unemployment problems but often at a longer term higher cost (new infrastructure for greenfield development added to the economic and social cost of urban decay).

A seminar on the search for brownfield leadership in Central European Cities, organised in April 2001 by the Institute for Transportation and Development Policy (ITDP), and held in partnership with the City of Prague in April 2001, presented a comprehensive overview of brownfield issues in transition economies as well as some guidelines for future action (Jackson and Garb, 2001). The following developments concerning the Czech Republic are largely inspired by the results of this conference as well as by OECD team discussions and site visits in Ostrava and Zlin.[3] Extensive brownfields are definitely a post-socialist legacy as the predominant industrial model developed called for extensive urban land use (lack of a real estate market), often in city centres (this is quite typical of Ostrava for instance), with residential areas (prefabricated slab housing complexes) circling the zone of activity up to the fringes of the city. The Prague seminar notes that Central European cities (even those that are not heavily industrial) have two to three times the amount of space devoted to current or past industrial uses than their western counterparts.

In this context, restitution issues, cost and delay of clean up (even with state aid) as well as division of property resulting from the first wave of privatisation (divestiture of least valuable assets, including former industrial sites), led to preference for greenfield developments at the expense of brownfield decontamination and reuse. The City of Prague even excluded for that reason 11 brownfield sites from the land use plan approved in 1999. Low property tax rates also constitute a disincentive for owners to sell to potential investors. The latter, if willing to go ahead in spite of the obstacles, often have to tackle with a lengthy and complex process (a minimum of 2.5 years) to clear property and land use issues (public and municipal consultation) and comply with strict environmental safeguards, even before beginning of construction (see further). With the exception of choice central city sites such as Smichov in Prague,[4] redeveloped into a thriving shopping area, most brownfields do not attract private investors (industrial or commercial), who prefer to locate in more suburban areas such as Letnany (Prague North East) where huge shopping malls have sprouted up. Similar patterns have emerged in other cities, with FDI taking the lead. The Brownfield Programme managed by the public agency CzechInvest has only been used by a handfull of investors (less than five out of the 1 200 foreign investors in the country) and the Industrial Zone Programme (62 sites built since 1999) concerns mostly greenfield development.

Greenfield "short-cuts" towards economic development and job creation are taken all the more easily by investors that there is no clear "brownfield leadership" in the Czech Republic, with many different administrations intervening in the rehabilitation process, with a lack of co-ordination and even conflicting objectives. These are: the National Property Fund (NPF), the Ministry of the Environment, the Ministry for Regional Development, the Ministry of Industry and Trade, CzechInvest (under the supervision of the latter) and the Ministry of Finance.

- The National Property Fund instituted an "Environmental Clearance Contract" (ECC) at the beginning of the second wave of privatisation (mid-1990s), assuring purchasers that any prior environmental clean-up costs would be covered by the NPF. The scope of these guarantees was expanded in 2001 to companies first privatised, restituants with contaminated land restored to them and receivers of bankrupt companies holding contaminated land. Notwithstanding a big barrier to application remains: the detailed initial site study and the risk analysis are at the applicant's expense. This and FNM cash flow problems are slowing down the environmental clearance programme.
- The Ministry of the Environment holds a national registry of damaged sites[5] (SESEZ), with around 2 000 items but it is incomplete, as there is no mandatory registration process.[6] Besides, for potential investors there is no

classification by potential economic or amenity value. The Ministry of the Environment oversees the strict application of environmental standards, without necessarily taking into consideration the economic context of urban land recycling. Clean up can bring a site to a level higher than needed for its ultimate use, which is costly for the tax payer and time consuming for the investor: parking areas or new industrial activities are submitted to the same obligations as leisure areas.

- The Ministry for Regional Development has focused its attention on smaller brownfield areas (less than 10 ha.), while CzechInvest's programme concerns former industrial sites of more than 10 ha. The MRD does not have direct means of intervention (incentives or funding) but took the initiative of surveying brownfields owned by municipalities. Return on the questionnaire was however disappointing, as indicated during the above-mentioned seminar (few answers, few complete ones). Considering that environmental matters are now devolved to regions and that this Ministry is in close touch with local authorities, it would be useful to have the MRD conduct a new survey, co-ordinating with the NUTS III regions so as to insure total responsiveness, basis for a complete inventory of brownfields under public ownership in the country, first step towards the definition of an eradication strategy based on criteria and priorities to be selected and using future structural funds. Adequate staffing of the Ministry for that purpose would be necessary (see following chapter).
- The Ministry of Industry and Trade (MIT) has a long tradition (dating from the 1950s) of intervention to compensate for mining pollution. A portion of proceeds from these industries (EUR 0.5 for each ton of coal extracted) has been going to a fund for site rehabilitation once extraction ends (in the form of reforestation and creation of lakes and recreational areas). It is under this programme that the MIT is supervising the regeneration of 15 000 hectares of open pit mining areas in North West Bohemia. Land is returned to agricultural uses (now 30%) within five years and reforestation takes 12-15 years.
- CzechInvest developed its brownfield initiative to respond to potential investors, provided that besides the incentives awarded for greenfields, depending on level of investment and number of jobs created (see further), support be provided to clear hurdles linked to property rights and observance of environmental standards, as well as financing of demolition costs. The limitation to this programme is that eligible sites (more than 10 ha.) are seldom found in city centres and their new destination must of course remain industrial. The agency was awarded in 2001 with EU technical assistance grants (covering 100% of costs) for a total of EUR 3 million for pilot regeneration projects that could serve as models for future rehabilitation policy. The Ostrava Vitkovice site, located in the city centre, is the first one

to benefit from this scheme. Contrary to rules normally applied by CzechInvest, the Vitkovice project is not planned exclusively for new industrial activities.

- The Ministry of Finance already plays an important role in brownfield regeneration as main purveyor of funds and incentives used by other entities for that purpose. In the future, revision of unused brownfield property taxation could spur new developments for site re-use (sale for new activities or investment by the property owner himself). Other options to be considered are designation of special development areas (as those used in areas of high unemployment) to revitalise abandoned city centres by entitlement to tax breaks or specific aid.

Box 2.1. **Brownfield regeneration in Ostrava**

The third city in the country, that used to be known as the "Czech Manchester" in the 19th century, has the most extensive urban brownfields in the country, right into the city centre. Sixty per cent were employed in industry before 1989, now only 38.5%. Average unemployment rate is 16%. Brownfield regeneration started in 1993 on the Karolina site (60 ha), within "Project Silesia", (Ministry of the Environment), financed by the United States (support from the Brownfield Centre of Carnegie Mellon University). The Ostrava municipality played a leading role in initiating, managing and co-ordinating the project in co-operation with other cities (Kosice, Slovakia; Katowice, Poland; Miskolc, Hungary). Other sites under regeneration are Hrusov (45 ha), close to former chemical production plant (Slab housing demolition/reconstruction to regenerate "social brownfield") and Vitkovice lower area (more than 100 ha). This is a pilot regeneration project in co operation with CzechInvest to return publicly owned land and premises to multiple uses: commercial, recreational (parks) and industrial heritage (restoration of mine and coking plant, application for UNESCO heritage site status).

Source: The City of Ostrava (2001).

The above-mentioned State Environmental Policy of January 2001 explicitly calls for a National Brownfield Strategy, without specifying the body in charge of conceiving and applying such a policy. The issue being by definition a cross-sector one, it would be logical to give this responsibility to an entity whose vision is not limited to certain aspects of this complex problem, if this department is properly staffed and that strong and efficient co-ordination mechanisms are devised and applied. Under these conditions, this could be the responsibility of the Ministry for Regional Development, also properly co-operating with the new regions[7] in this area and ensuring, in

liaison with the Ministry of the Interior, proper training of local officials in these matters (see chapter on governance). More generally, this last requirement is strongly underlined for all environmental questions by the EU *Regular Report on the Czech Republic's Progress towards Accession* (2002).

Road infrastructure projects

Infrastructure needs and priorities

Basic transport infrastructure in the Czech Republic, both road and rail, has been long neglected, as in many other former socialist countries. The National Development Plan (NDP) published in June 2001 by the Ministry for Regional Development (see further), underlines that "the transport infrastructure is comparable from the point of view of density with EU states; however its low quality, neglected technical condition and limited linkage to European transport routes are incomparable". The NDP also notes that financial resources allocated to transport infrastructure remained on a long term basis behind the recommended average spending (1.5 to 2% of GDP) for all of the 1990s, approaching 1.5% only in 1997. In 1999, investment represented 1.3% of GDP, with the state budget contributing only 0.8%, the remaining part coming from long-term loans. The threats stemming from this situation are clearly stated in the NDP: "development of infrastructure behind needs, which may contribute to a lower interest of investors in the Czech Republic", noting also the "insufficient co-ordination of infrastructure development with foreign countries".

The NDP comprises six priority axes, with development of basic infrastructure ranking second (after strengthening of industry competitiveness and entrepreneurial services). The second priority itself is broken down in to: modernisation and development of transport infrastructure, development of transport services and the regional infrastructure, decrease of the negative impact of transport on the environment and development of the technical infrastructure of municipalities, towns and regions.

Point number one falls under the responsibility of the Ministry of Transport and Communications (linking with the MRD, the Ministry of the Environment and regional authorities), whereas priority number two (transport services and regional infrastructure) is the responsibility of the MRD, linking with the Ministry of Transport and Communications, the Ministry of the Interior and regional authorities.[8] This first point is divided into four measures: railway corridors, highways and speedways, air transport, river navigation. Accordingly, railroads (the Czech portion of European railway corridors such as Berlin-Prague-Vienna-Budapest, renewal of track and old rolling stock) receive the lion's share of planned funding: CZK 12.2 billion in the year 2000, followed by roads (CZK 9.85 billion). From 2001 to 2006, the EU

recommends attaining the 1.5 to 2% of GDP devoted to transport infrastructure, with some amount of funding provided by ISPA (see below) and structural funds. For the overall period and the four measures, investments of close to CZK 223 billion are needed, the main source of financing being the State Transport Infrastructure Fund.

Road infrastructure issues and obstacles

The present section is devoted to the problems and issues concerning the implementation of a modern highway network, essential to the balanced development of all regions, on the basis of the above-mentioned priorities. The following are the most important road infrastructure projects planned for the period in question, or which have already begun but are not yet fully operational.

- Completion of the D5 motorway (Prague-Plzen-Rozvadov) with the Plzen bypass.
- D8 motorway (Dresden-Prague), connecting to Berlin.
- The R1 ring-road around Prague.
- The D47 motorway connecting Ostrava to the motorway network.
- The R48 expressway from Cesky Tesín to Belotin in Moravia-Silesia.

Amongst these projects, a certain number have been delayed for various reasons. The lack of proper highway accessibility to Ostrava is a major handicap as well as the absence of a by-pass around Plzen. Both situations have become emblematic of the difficulties facing major road infrastructure implementation in the Czech Republic. While not as publicised, the fact that cities like Zlin, Pardubice or Hradec Kralove, located at close distance from existing highways without benefiting from direct access, somewhat stymies the development efforts of these otherwise dynamic regional hubs. Delays in road construction, aside from purely financial factors, can be explained in many cases by land use problems and the lack of appropriate legislation concerning expropriation in the public interest, whereas NGOs are particularly active in the environmental field.

The case of the D47 motorway to Ostrava, which would link the third city in the country to the main highway network, is a simple one: the Prague-Brno highway, which is the main road transportation artery in the country, extends to Olomouc and Lipnik further north, with the link to Ostrava still being only a poorly maintained two lane road (80 km). Ostrava itself is only 10 kilometres from the Polish border and the completed D47 should connect to the Polish motorway AI to Katowice, Czsetochowa, Lodz, Torun and Gdansk. Towards the South, the D47, once completed, would offer an adequate highway link, through Brno, to Bratislava and Vienna, Györ and Budapest. This missing link

prevents Ostrava from benefiting from a central and strategic position at the border with Poland and Slovakia on a north-south axis of increasing importance in an enlarged Europe. Also, the city and region of Moravia-Silesia suffer from a high unemployment rate due to the scope of restructuring required in this old mining and industrial area, which explains that the highest levels of investment incentives are available there. In spite of this, few foreign investors (see further) are attracted to such a poorly connected region.

Construction of the motorway has suffered setbacks, which explain the present day situation, without certainty that completion will be achieved by 2008 as now indicated. A first contract for the construction of the highway segment was awarded in 2001 under dubious conditions (loopholes in the call for tender process, high cost and delays, lack of experience in road construction) to a foreign consortium, with completion planned by 2009. This contract was cancelled by the government elected in June 2002 and announcements were made concerning completion by 2008 for a lower price by a yet to be chosen new contractor. It is not necessary within the context of this territorial review to examine the reasons behind this situation but only to underline the fact that such a strategic investment was decided so late.

As has been analysed before, Moravia-Silesia (like North West Bohemia), has received priority attention from the national government at least since the mid-1990s, with considerable amounts of money spent to help the region operate its industrial restructuring and create new activities and jobs. Without proper access, the impact of the different measures taken has necessarily been stifled, as the limited amount of jobs created or FDI attracted to Moravia-Silesia shows. Conversely, the high levels of activity and innovation in and around Prague as well as in Brno can be explained, at least in part, by proper domestic and international road connections.

The Plzen bypass is another "cause célèbre" in the Czech Republic because of the fact that this highly industrialised city located to the West of Prague, not far from the border with Germany, constitutes the only missing highway link between the major border crossing in the Czech Republic and Prague and than on to Brno. The absence of a bypass considerably slows down traffic (freight and many foreign tourists) and creates a major source of noise and carbon monoxide for inhabitants. The reason of this lack of highway continuity around the city lays in the absence of proper legislation to speedily expropriate land in the public interest (with due compensation). Private property rights, in a reaction to the previous political era, are highly protected and environmental activists are at no difficulty in exploiting the loopholes, even at the expense of the environmental quality of the city itself.

Given an adequate transportation network (road and rail), the Czech Republic can play an important role as an industrial and logistics hub in

the centre of Europe: this potential asset must receive all the attention it deserves if the country is to respond to the call. The EU Regular Report on the Czech Republic's Progress towards Accession of October 2002 similarly concludes, in the area of Trans European Transport Networks that "little progress has been achieved in transport infrastructure construction, although work is on-going to prepare and adopt relevant projects". It takes note in particular of the understaffing of the State Transport Infrastructure Fund, established in 2000 (30 people instead of the 43 planned), as compared to the increased number of infrastructure projects, in the area of Trans-European Transport Networks, for which it is responsible.

Public interest, expropriation and evaluation of private property

Acquiring land in the public interest, in order to build transport and communication infrastructure, raises a series of problems, rooted in the legal system, concerning the definition of public interest, valuation of property as well as the significance of landownership for people at large. The present legal system results from the addition of the 1976 Building Act, coherent with communist ideology, with a general prerogative for public authorities to seize land, and a recent system of compensation without reference to a "market price". The old legal framework, not yet abolished, has thus only been modified in some aspects. A comprehensive legal framework has yet to be established. Draft legislation is now being prepared, but it is resisted in several ways by various lobbies. The inadequacy of the legal system to permit rapid development of infrastructure networks while offering fair compensation constitutes an important brake in the implementation of national and regional policies in these fields.

Due to these legal drawbacks, expropriations are pronounced following certain practices that highlight the key points to be reformed. Firstly, a decree of 1998 (132/1998 Coll.) taken by the Ministry for Regional Development concerning the application of the Building Act of 1976 includes several elements relating to expropriation, stating in particular the basic principles according to which the expropriation procedure can be used for projects that correspond to the "general interest". Here there is a legal void since there is no legal definition of what the "general interest" is, or of the procedure and criteria to observe and the competent court or judge is not designated. This means that the only way to expropriate is to agree with landowners beforehand, since litigation could completely block the project, in the absence of clear definitions or procedures.

Today, the practical process to implement expropriation is not at all straightforward: in a first step, the administration of the cadaster is supposed to provide the information about landownership, but it is the expropriating body, for instance the body responsible for building highways, which gets in

touch with the landowners to try and reach a direct agreement. In case of failure or if landowners do not accept to negotiate with the expropriating body, the latter then seizes the municipality requesting it to negotiate a solution. In the new institutional framework (see Chapter 3), municipalities with so called "delegated powers" have received the responsibility for expropriation, which they are supposed to implement in close co-operation with the expropriating body, but the legal loopholes remain. In the present draft legislation, "public interest" or "general interest" is narrowly defined by the nature of the project (rail tracks, pipelines…), instead of receiving a wider scope as in most countries, thus avoiding unnecessary legal terminology squabbles.

Deciding the level of compensation for expropriated property, a key stage of the expropriation process, must be based on firm principles, such as reference to market price, and along a well defined and strictly implemented procedure. At present, the law does not indicate precisely which should be the reference and there is no systematic statistical observation of market prices. The first step of the process is the determination by a specialised service of the Ministry of Finance of a "normative price", or officially set price, but the principles along which this price is calculated are not specifically mentioned, and practically this normative price does not have a firm relationship with economic reality.

For this reason, the expropriating body than determines a proxy to the market price that is offered to the landowner, in order to reach an informal agreement. In certain cities, notably Prague, some private companies have established price maps. The methodology is not always completely defined but the result is usually much closer to economic reality than normative prices determined by the government. At this stage, the landowner can accept the price or decide to go to court with his own evaluator. Entering in to litigation is a complicated and lengthy process, with a possible much higher price resulting at the end. This explains that the expropriating body is usually inclined to quickly reach an agreement. Speculation by "insiders" having "private" information about future public projects, for instance the expected path for a highway, often distorts the process. Land bought by anticipation offers the perspective to be expropriated later at a much higher price.

In order to understand the difficulty to improve the legal and economic process of expropriation, the recent history of the country must be taken into account, and specifically the way property has been "seized", without due process or "fair compensation". The attitude towards ownership shows a very strong attachment to the very notion of private property, and the use of expropriation, necessary as it is, requires a carefully designed process to determine what the "public interest" is and how compensation should be calculated. The privatisation of so called "people's property" is very recent and still ongoing. Expropriation of a piece of property which has just very recently

been privatised or restituted can be psychologically painful for the owner and politically damaging for the public authority. Private property is still considered "untouchable" by many: there is a long way to go to make people admit expropriation and have it applied through a straightforward and accepted process. Transfer to the regional level of the responsibility of valuation, as recently decided by law, could thus create certain difficulties for local authorities. The very word of "expropriation" still has a very strong negative connotation. Reluctance is so deep that new draft legislation avoids using it, preferring the concept of "permanent lease".

2.3. Direct investment aid, incentives, innovation and SMEs

The Czech Republic now disposes of a wide array of programmes to attract investment and support job creation, with incentives linked mainly to the level of unemployment (regular up-dating of area classifications), to develop economic activities in less favoured areas but also to facilitate innovation, the creation of technology centres and strategic services (such as ICTs) in different parts of the country. SME creation and support measures, initially geared mostly towards financial tools, now also integrate entrepreneurship schemes with management and IT training, through a network of information and advisory centres.

Investment aid, incentives and territorial modulation

Programmes available

The first investment incentive measures for the manufacturing industry, adopted in April 1998, were designed as a scheme that applies both to domestic and foreign investors, with territorial modulations in favour of (former) districts with the highest unemployment rates. A new Act on Investment Incentives, effective since May 2000, amended in January 2002 (Framework Programme for Support of Strategic Services Projects and Framework Programme for Support of the Establishment and Expansion of Technology Centres), simplifies the original scheme's procedures and follows European guidelines on State aid. The main components are: tax incentives, job creation and retraining grants, provision of low cost building land and/or infrastructure (industrial zones).

Tax incentives are higher for companies formed for the purpose of the investment project (corporate tax relief of up to ten years) than for existing Czech legal entities planning expansion or modernisation (partial tax relief for up to five years). Tax relief (starting before the end of the third year of investment) is terminated when the maximum total level of eligible state aid, in compliance with EU regulations, is attained. This corresponds to a maximum of 25% of the costs for buildings, machinery and equipment,

including expenditure into intangible assets. Just as tax incentives, conditions for job creation and training grants are more favourable in areas with high unemployment. Conversely, site support (Industrial Zones Programme), is nationally available and subject to the existence of suitable sites, with the application considered once the investor has selected a location. The incentive is granted to the municipality and/or the private developer under the form of subsidies for development of site infrastructure and the eventual transfer of land from state ownership at an advantageous price.

The main eligibility criteria are the following: at least 50% of machinery from a government approved list of high tech equipment, at least 40% of the investment made into machinery, compliance with Czech environmental standards, investment (and equity share) subject to a minimal amount (reduced in areas with higher than average unemployment), investment and newly created jobs to be sustained for at least five years. Territorial modulation favours (former) districts with highest unemployment. Whereas the minimal investment level is normally CZK 350 million (approximately EUR 10 million), in areas with chronic unemployment, this sum is reduced to CZK 100 million (around EUR 3 million). Likewise, investor's equity of CZK 145 million (EUR 4.5 million) is reduced to CZK 50 million (EUR 1.5 million) in the same areas.

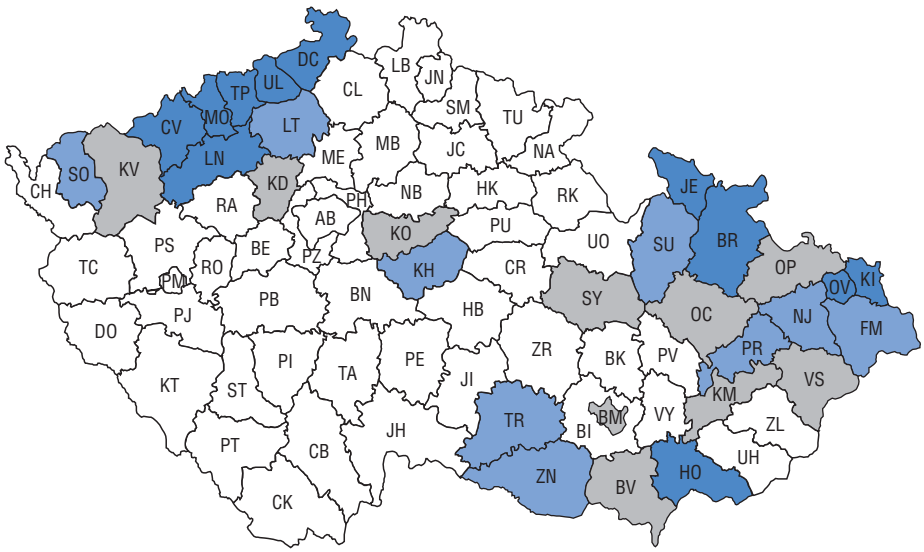
Table 2.3. **Job creation grants and retraining grants**

District group	Unemployment rate	Grant per employee	Retraining (%)
A (example BR)	Over 50% above average	CZK 200 000	35
B (example TR)	25%-50% above average	CZK 120 000	30
C (example SY)	Up to 25% above average	CZK 80 000	25
D (example PZ)	Below the national average	None	0

Source: CzechInvest.

The maximum level of State aid within the eight NUTS II regions, as agreed with the EU, for the period 2002-2006, also varies, reflecting regional differences in economic performance, GDP and past average unemployment, but with limited differences between seven regions on one hand (from 50 to 46%)[9] and Prague on the other (20%). The instruction of investment incentives applications follows a rigorous procedure and timeframe to ensure conformity with the different rules and conditions. Applications are received by CzechInvest (30 days for evaluation before transmission to the Ministry of Industry and Trade or MIT). The latter solicits the comments of the Ministries of Finance, Labour and Social Affairs, Environment and the Office for the Protection of Economic Competition, which are given a two-week delay to deliver their response. The MIT, on the basis of these comments, prepares a definite offer to grant incentives, specifying types and amounts of aid.

Figure 2.3. **Job creation grant levels by regions (1 July to 31 December 2003)**



Source: CzechInvest.

CzechInvest, also manages the Supplier Development Programme, designed to improve links between Czech suppliers of components and services and foreign manufacturers or joint ventures operating in the Czech Republic. Co-funded by the EU PHARE programme in the pilot stage, it consists of three activities:

- Collection and distribution of information about Czech component suppliers (selection of over 1 000 suppliers with profiles available on the agency's website).
- Organisation of specific meetings between foreign direct investors and Czech suppliers.
- Upgrading potential pre-selected Czech suppliers, initially in the fields of electrical engineering and electronics: detailed consultancy and training support concerning new technologies, management techniques, financial management and quality control. Since 2003 the programme includes process engineering, automotive and aircraft components, pharmaceutical and biotechnology industries.

Impact of programmes and incentives

The FDI incentive programme has been extremely successful, as the Czech Republic is the regional leader for FDI (see Chapter 1) but with an unequal geographical spread as the following table shows.

Table 2.4. **Regional distribution of supported investment in the Czech Republic (1993-2002)**

Investment by regions (NUTS III)	FDI (USD millions)	Jobs created	Share of investment* (%)	Jobs created by projects (%)
Central Bohemia	2 266.1	12 301	33	20
Hradec Kralove	314.9	4 260	5	7
Karlovy Vary	71.1	690	1	1
Liberec	208.9	2 002	3	3
Moravia-Silesia	291.1	3 362	4	5
Olomouc	940.1	5 913	14	9
Pardubice	296.9	5 554	4	9
Plzen	235.7	3 470	3	5
Prague	124.8	2 305	2	3
South Bohemia	171.4	1 911	3	3
South Moravia	217.5	8 412	3	14
Ustl	1 016.1	6 976	15	11
Vysocina	465.4	3 662	7	6
Zlin	181.1	2 766	3	4
TOTAL	6 801.0	63 584	100	100

Source: CzechInvest (2003), for 219 completed projects.

Concerning industrial zone development, achievements since inception in 1998 are the following:

- 71 industrial zones created, totalising 2 124 ha (CZK 2 465.2 million from state budget) but only one brownfield,[10] registered in 2002 (state budget contribution of. CZK 1.3 million);
- 25 applications (CZK 5 063 million from state budget) to improve existing zones.

Innovation, Strategic Services and Technology Centres

In order to strengthen the Czech Republic's position as an ICT hub in Central Europe, a new system of investment incentives was introduced mid-2002 to support new projects in the services (and also manufacturing processes) sector. The Framework Programme for Support of Strategic Services Projects and the Framework Programme for Support of the Establishment and Expansion of Technology Centres (Decree 573, 5 June 2002) offer the following incentives:

- a subsidy for business activity covering up to 50% of eligible business expenses (wage costs during the first two years, capital expenditure into buildings, machinery and equipment, including intangible assets for up to 25% of the costs for the former);

- a subsidy for training and retraining per employee covering up to 35% of special training costs (knowledge and skills focused on the project) and up to 60% of general training costs (transferable skills, such as management techniques or organisational capacities).

Strategic services are selected activities of companies characterised by a high proportion of added value, qualified labour, intense use of ICTs and an international focus. This applies to: customer services, outsourcing, software development, expert solutions, hi-tech maintenance and regional headquarters of multinational firms. Technology Centres are centres of innovative activities closely related to manufacturing, with the expectation that the results of the new process would be applied in regular production within a three-year period. Innovation can concern changes to products, production lines, manufacturing processes or services. All sectors, except defence industries, are eligible.

The development of Science and Technology Parks is already supported by the central government through the PARK programme,[11] but ought to be spurred by the new measures indicated above. The Association of Science and Technology Parks of the Czech Republic, founded in 1990, counting

Box 2.2. **Eligibility criteria for investment support in the area of Strategic Services and Technology Centres**

Strategic Services

Investment of a minimum of CZK 50 million (approximately EUR 1.5 million) into the strategic services sector. Limit reduced to CZK 25 million (EUR 750 000) in areas undergoing economic restructuring and for projects focused on software development or expert solution centres for ICTs.

Creation of at least 50 new jobs; 25% covered by investors' own equity. Minimum of 50% of revenues generated by aided project to come from export. Use of new machinery and equipment. Meeting all Czech environmental standards.

Technology Centres

Minimum investment of CZK 15 million (EUR 450 000), creation of at least 15 new jobs and at least 25% of investment covered by investor's own equity. At least 50% of results of technology centre's activity to be exported or used to enhance products and services which will be exported.

Maximum share of outsourced specialists involved in the activity of 40%. Compliance with Czech environmental standards. Results in serialised production after three years and investment to be sustained for five years.

Source: CzechInvest (2002).

20 accredited parks across the country (another five in the process of accreditation), constitutes a network permitting members to better access central government and financial institutions. The association also provides consultancy, technical, educational and training services to its members, diverse both in size, status and aims as the two following examples, from Brno and Ostrava show. Their single point in common is their location within a high quality technical and economic university environment, which characterises the second and third largest Czech cities, thus providing foreign and Czech firms in the area with a highly skilled workforce and facilitating the creation of start-ups, supported by business incubator processes.

The Czech Technology Park (CTP) in Brno (South Moravia), created in 1993 (90 ha. of land now used, potential expansion of up to 120 ha), is a joint venture between the City of Brno and the Peninsular and Oriental Steam Navigation Company (P&O), a multinational shipping, transport and property development firm, in co-operation with the BUT, the City's Technical University. The greenfield site is conveniently located 3 km from the City centre, with excellent connections to the Prague-Brno highway and the international motorway network (Austria, Hungary, and Slovakia). Most of the land has been provided by the city or under lease from the university and the buildings put up by P&O, which owns them. Both office space and production facilities are offered to the tenants in various hi-tech sectors, with a noticeable concentration of IT companies. IBM in particular has chosen the CTP for its Eastern Europe Global Services Centre. Siemens, SGI, Lexmark, Philips and Invensys are some of the other multinational tenants. Six hundred and fifty people, many having been directly recruited from the University, now work on the premises. The business incubator, to be housed in the BUT end of 2003, will facilitate the creation of university spin-offs and hi-tech start-ups in the Park. The strategy adopted for the development of this Park follows a private logic: attract major foreign investors (with the support of CzechInvest), to create a critical mass, before turning to more R&D oriented activities. P&O indicates it has now attained the breakeven point for this facility that constitutes an undeniable asset for the City of Brno in attracting investment and creating new jobs. The Park has been dubbed the "Czech Silicon Hill".

The Science and Technology Park (STP) in Ostrava (Moravia-Silesia), now nearing completion, took a different approach. It is jointly funded by the European Union, the Ministry for Regional Development and the City of Ostrava (main stakeholder because of land and infrastructure provided, besides participation in the construction effort: EUR 4.9 million out of EUR 7.6 million). It is constituted as a joint stock company associating the City, the Technical University of Ostrava, the Silesian University in Opava and the Regional Development Agency. Most construction work of this 10 ha facility is due to be finalised by the end of 2003. No manufacturing is planned on this

greenfield site situated on the city outskirts,[12] devoted mainly to R&D and business incubation. Six companies are already located in the Science and Technology Park, the first one being a spin-off from the University. Plans are to accommodate ten private investors in buildings they would own and 30 to 40 tenants in three or four buildings owned by the City. Due to the high level of human capital in Ostrava (11 000 students in the Technical University, which enjoys an excellent reputation), the creation of the STP is a logical step towards facilitating and supporting new endogenous activities and enterprises.

SME creation and support measures

"Unlike Hungary, Poland or East Germany, where the SME sector survived under the Communist regime, the Czech SME sector was almost completely wiped out. Since 1989, the growth and development of SMEs has been remarkable. The SME sector grew through new start-ups, restitutions, small-scale privatisations and the division of big state enterprises into smaller units. Restructuring and liberalisation of monopolised sectors also created the potential for SME expansion" (OECD, 2001c). There were 657 130 SMEs in 1997, out of which 568 855 were physical persons. This represented 99.8% of the number of enterprises in the Czech Republic and 59.8% of employment. In 2001 the corresponding figures had increased to 746 127, out of which 634 829 were physical persons (99.8% of the number of enterprises and 59.7% of employment).[13] Around 60% of Czech employees working in firms are thus in the SME sector, meaning that the maintenance of a healthy and competitive SME sector is essential for good economic performance.

Nonetheless, some worrisome trends have been witnessed in the recent years. SME share in total industrial outputs was at 52.9% in 1997 and added value represented 57.4% of industrial production. The corresponding figures for 2001 were: 51.4% of total outputs and only 51.3% of added value. The SME export share has also dropped from 36.4% in value in 1997 to 34.2% in 2002 (Ministry of Industry and Trade, 2003). This means that the productivity gap between SMEs and larger firms is increasing. Comparisons of output and added value per employee illustrate these differences: for the year 2000, average output per employee in SMEs was at CZK 1 162 972, as compared to CZK 1 601 491 for enterprises of 250 employees and more. Added-value per employee in SMEs was at CZK 372 889, whereas for bigger firms this figure stood at CZK 505 311. Considering the situation, what are the impediments to SME creation and sustainability? Financing and the need to provide sufficient collateral when applying for bank loans seem to be major obstacles to SME development (OECD, 2002c). This appears clearly from a survey of 100 SMEs conducted in Prague and Central Moravia, published in 1999 (Bohata and Mladek, 1999). It indicates that personal savings or loans from families and

friends account for 64.5% of starting capital resources, bank loans representing only one-tenth of starting capital. Retained profits are the main source of working capital. To finance investment, retained profits represent 39.3% and bank loans (plus leasing), 37.9%. Collateral is a major hurdle for small companies, followed by the cost of loans.

Improving productivity by acquiring new equipment or expanding production requires investment and working capital that SMEs often have difficulty in accessing. For this reason, the government, as early back as 1993, created the Czech-Moravian Guarantee and Development Bank (CZMRB), to address the needs of SMEs. This public bank also manages some of the SME support programmes devised by the Ministry of Industry and Trade. Providing information on government programmes, as well as training and advisory services for the preparation and assessment of investments and projects is the role of the Business Development Agency, also founded in 1993. This semi-governmental institution animates a network of 35 Regional Advisory and Information Centres (RAICs) and five Business Innovation Centres (BICs). It also acts as Programme Management Unit (PMU) for the PHARE pre-accession fund SME sub-programmes.

RAICs provide information and advisory services for entrepreneurs, organise training sessions, assist in making business plans, facilitate the establishment of companies and act as mediators for bank credits. BICs focus especially on support to innovative businesses, technology transfer, implementation of R&D results and business incubation. In 2001, 132 companies were located in the four main business incubators (Prague, Brno, Ostrava and Plzen), with 55 receiving specific financial support for that purpose (Business Development Agency). The Business Development Agency asserts that as a result of subsidised consultation, revenues of SMEs in regions have increased in average by 4-5%. Also, the average risk rate of commercial loans represents 26 to 29% throughout the Czech Republic, but in the case of SMEs monitored by RAICs, this rate decreases to 16%. According to the Ministry of Labour and Social Affairs statistical data, 80% of the unemployed do not return to Labour Offices after having used subsidised advisory services and start working as entrepreneurs.[14] The following table illustrates the breakdown of activities of the Business Development Agency network in 2001.

The Czech government is well aware of the strategic importance of the SME sector for employment and the well-being of the whole economy. Policies are devised by the MIT with other administrations but also with social partners through a "National Discussion Group" which integrates Chambers of Commerce, business and employers associations and representatives of entrepreneurs. The *Policy on Support to Small and Medium-Sized Enterprises for 2001-2004* (Ministry of Industry and Trade, 2003a), underlines the existing shortcomings that still need to be overcome, such as "difficult access to

Table 2.5. **Summary of subsidies provided through RAIC/BIC network within SME support programmes in 2001**

Programme	State Budget 2001		PHARE 9902		Total	
Types of services	Number	Subsidy CZK	Number	Subsidy CZK	Number	Subsidy CZK
Introductory consultations	1 818	1 987 640	4 814	5 202 000	6 632	7 189 640
Special advisory services for SMES	537	4 127 334	1 758	7 939 308	2 295	12 066 642
Special advisory services for regional authorities	–	–	105	2 000 539	104	2 000 539
Special seminars and trainings for SMES	63	–	164	3 076 817	227	5 504 052
Innovative companies support in BIC incubators	58	2 427 235	147	2 654 419	205	3 074 104
Subsidy to centres improvement	–	428 685	–	6 402 478	–	6 402 478
TOTAL		8 970 894		27 266 561		36 237 455

Source: Business Development Agency (2002).

capital, limited access to professional education and the necessary information and consulting services". Amongst policy objectives the support of co-operation between innovative SMEs and university research centres is indicated. Policy focus is also on ICT (business information portal, training programmes for commercial use of the Internet),[15] active co-operation between the central government and regions, with a "focused decentralisation of decision making powers in respect of aid provided for individual projects".

Box 2.3. **The Ostrava Business Innovation Centre**

First BIC in the Czech Republic, founded in 1994 by the city of Ostrava, the Regional Development Agency, Vitkovice steelworks, the Regional Business Fund Ltd. and the Business Development Institute Ltd. EUREKA contact point. It is the biggest such facility, with 9 500 m^2, housed in parts of the premises of the steelworks, in the city centre.

Selection process for incubation assesses the level of innovation, the quality of the business plan, research, development and production. Funding for supported businesses is from PHARE and the MIT. Length of presence in incubator is normally three years, exceptionally five. Over 90 firms have passed through the incubator and are still operating in the region. In 2003, there are 43 firms with more than 350 employees in the incubator.

Source: Ostrava BIC and OECD Secretariat.

SME policy, covering the years 2001-2004 is an integrated policy, with a shift away from the traditional direct subsidy approach: to gain access to capital, "starting entrepreneurs will have to demonstrate prior education in the field necessary for the management of their business". Partnerships are to be encouraged (support for business associations and chambers of commerce with focus on apprenticeship and improvement of qualifications of workers). Amongst the measures adopted, there are many narrowly focused financial instruments (around ten) either granting low price guarantees, favourable interest rates, guarantees for venture capital, specific interest rate subsidies for projects in economically challenged regions, small communities, and border areas. Most of these programmes, that many SMEs are not always aware of, are administered by CMZRB. The following table gives the level of support for 2002.

Table 2.6. **Financial support measures of the CMZRB in favour of SMEs for the year 2002**

Use of financial tools by the CMZRB	Number of projects	Total aid (CZK millions)
Promoted guarantees for bank credits	487[1]	578.8
Regional guarantees	11[2]	36.7
Guarantees for participation in public tenders	211[3]	
Grants towards interest repayment	485	453.5
In framework of "market" programme	238	278.7
In framework of regional programmes	247	174.8
Credits in framework of programmes	571	618.2
KREDIT (more favourable interest rates)	151	347.1
PREFERENCE (<25 employees, in disadvantaged regions)	37	86.7
START (first-time entrepreneurs)	377	179.7
OPERATION (inventory procurement)	6	4.7
Grants for jobs in SPECIAL (disadvantaged groups)	37	29.5
Grants	1 060	228.5
Market programme	1 021	127.0
CO-OPERATION (support to SME associations)	39	101.5
Increased cost for restructuring of measures/sorting out applications from 2001		*12.3*
CMZRB Implementation costs of credit		*22.7*
TOTAL	2 862	1 980.2

1. Total guaranteed amount: CZK 2 231.9 million.
2. Total guaranteed amount: CZK 71.1 million.
3. Guaranteed amount: CZK 230.9 million.

Source: Czech-Moravian Guarantee and Development Bank (CM2RB).

The SME priority continues to be well reflected in the Operational Programme for Industry and Enterprise covering the period 2004-2006. Priority one is "business development and production sector competitiveness improvement" and measure one within this priority is "development of SMEs".[16]

Key words are encouragement of new activities as well as stabilisation of the existing SME base. The territorial dimension is fully retained. ("Projects of entrepreneurs in less developed and structurally affected regions shall be promoted.") Strengthening ability to compete, by creating production-trade and services chains and generating added value at higher level will be sought, with new measures to facilitate sub-contracting for large manufacturers. This means an improvement in production quality (accreditation systems, international standards), to better satisfy supply needs and face international competition more efficiently. Increased use of ICTs in internal processes and production management is highlighted. Another key area is improving the availability of information for business decision making. This is a recognition that the existing business information network can be improved. Business information (national and European policies and programmes), is at difficulty in trickling down to SMEs in remote or rural areas where there is often high unemployment, because of the wide and complex array of regulations and forms of support (OECD, 2002c).

The effective use of these instruments and policy tools, as well as the proper dissemination of information on the new measures adopted for the period 2001-2004 are essential to improve the competitiveness of Czech SMEs, representing close to 60% of employment, lest a "dual economy" develop with performing bigger firms, in many cases Czech subsidiaries of foreign firms, leaving behind a lesser performing domestic[17] and SME sector. This trend, in terms of territorial economy, can be particularly damaging in many rural or remote areas, where local employment is heavily dependent on small firms that cannot benefit from the positive spill-over effects of FDI or firm clustering.

2.4. EU accession and policy reshaping

The Czech Republic applied for EU membership in 1996 and the accession partnership was concluded in 1998. As for others, progressive compliance with the EU Acquis (rules, regulations and standards) through legislative measures and reforms in many areas (competition policies, privatisation, civil service reform, regionalisation, etc.) and sectors (industry, agriculture, environment, transportation, etc.), was regularly monitored by the EU Commission and published in a yearly "Regular Report on the Czech Republic's Progress towards Accession". One of the main instruments of the accession process was the elaboration of a "National Development Plan", so as to obtain assistance from structural funds under Objective 1.[18] Regional reform (see Chapter 3) is of course the basis of the NDP, which concerns the new eight NUTS II or cohesion regions.[19] The Czech Republic acquired, as other accession countries, experience in the field of pre-accession instruments through the PHARE programme.

The National Development Plan

The Ministry for Regional Development (MRD), created in 1996, was entrusted with co-ordination of NDP preparations, started in January 1999. The NDP comprises six priority axes or Sector Operational Programmes (SOPs): strengthening of industry competitiveness and entrepreneurial services, development of basic infrastructure, human resources development, protection and improvement of the environment, rural development and multifunctional agriculture, development of tourism and the spa sector.

The NDP consists of four parts: main part (international context, national economic development analysis, overview of regional development strategies and policies, overall implementation and financing), sectoral part (presentation and analysis of the six priority sectors), regional part (regional strengths and weaknesses at the NUTS II level, priority development areas) plus statistical and methodological appendices (assessment, monitoring indicators). The preparation of this document, first submitted to the EU in January 2000, was based on the principles of co-ordination and partnership: all other ministries were associated in the process (with the Ministry of Finance, directly responsible for the preparation of the financial framework, retaining essential prerogatives in the implementation/control process) as well as regional bodies, local government and NGOs. Regions played an important role in preparing their Regional Operational Programmes (ROPs), in consultation with the MRD and other ministries.

The final version of the document, incorporating European Commission comments, was published in June 2001 (Ministry for Regional Development, 2001a). It contains a detailed financial framework, with adherence to the principle of additionality and indicative allocation of funds to the respective SOPs and ROPs (Regional Policy and Preparation for Structural Funds, Ministry for Regional Development, Prague, February 2002). The NDP rests on the logic of a matrix approach, each ROP containing elements adapted to the regional context of the SOPs. To ensure overall cohesion under the responsibility of the MRD, the final output was a so-called "Joint Regional Operational Programme" (JROP), bringing together the seven ROPs and the Single Programming Document (SPD) for Prague (Objectives 2 and 3). This means that the central government retains an essential role in the implementation process and in financing, in spite of a partnership approach and decentralisation. Initial experience in the field of pre-accession assistance programmes in the Czech Republic is mostly at the national level but also within certain municipalities and the first Regional Development Agencies created, (see next chapter), since regional reform has been a parallel process to the elaboration of the NDP.

Pre-accession assistance programmes

The first pre-accession assistance programme, devised before application for membership by the accession countries, was PHARE, in the early 1990s, completed in 2000 by ISPA and SAPARD. Within this overall framework, the amount allocated to the Czech Republic corresponds to EUR 158 million at minimum and EUR 183 million at maximum.[20] After EU accession, the Czech Republic can obtain from the different structural and cohesion funds contributions that could amount to 4% of GDP per year, which might represent as much as CZK 90 billion in 2006 (Ministry of Education, Youth and Sport, 2001). This is more than a fifteen fold increase in volume as compared to pre-accession instruments. Proper experience with the latter, in terms of preparation, selection, management, monitoring and evaluation is a condition for readiness towards full use of structural and cohesion funds ("absorption capacity"). This is not only related to provision of matching funds, but also to the availability of adequate human resources for conception of projects in the private sector and in local government as well as in the public sector to manage and monitor these in a sustainable fashion.

Table 2.7. **Pre-accession funds: annual amounts starting in the year 2000 for candidate countries (EUR millions at 1999 price level)**

Candidate countries	PHARE programmes	ISPA minimum	ISPA maximum	SAPARD programmes	Country totals	
Bulgaria	100.0	83.2	124.8	52.1	[235.3/	276.9]
Czech Republic	79.0	57.2	83.2	22.1	[158.3/	184.3]
Estonia	24.0	20.8	36.4	12.1	[56.9/	72.5]
Hungary	96.0	72.8	104.0	38.1	[206.9/	238.1]
Latvia	30.0	36.4	57.2	21.8	[88.2/	109.0]
Lithuania	42.0	41.6	62.4	29.8	[113.4/	134.2]
Poland	398.0	312.0	384.8	168.7	[878.7/	951.5]
Romania	242.0	208.0	270.4	150.6	[600.6/	663.0]
Slovak Republic	49.0	36.4	57.2	18.3	[103.7/	124.5]
Slovenia	25.0	10.4	20.8	6.3	[41.7/	52.1]
TOTAL	1 085.0	878.8	1 201.2	519.9	[2 483.7/	2 806.1]

Note: For the period 2000-2004, pre accession funds of EUR 57 million for Cyprus and EUR 38 million for Malta have been allocated.

Source: EU Commission.

PHARE

The PHARE programme, created originally in 1989 for Poland and Hungary, was soon extended to other transition economies. It concentrates on institution building and investment support. The first aspect relates to the conception and implementation of administrative structures necessary for the adoption and use of EU legal regulations. Assistance can be in the form of

"Twinning" (long-term stays of EU experts in administrative bodies) or training of civil servants. Investment support is geared towards adoption of EU legal norms and standards covering areas such as regional development, SME support, transport infrastructure and environmental protection. Maximum level of EU financing is 75% of project costs.

Table 2.8. **PHARE Programmes in the Czech Republic 1995-1999 by area (EUR millions)**

	1995	1996	1997	1998	1999	Total
Institutional integration/strengthening institutional/ administrative capacity for implementation of Acquis	5.0	0.0	13.0	3.0	5.8	26.8
Development of civil society – support for Civil Society Development Foundation /strengthening of the democratic system – protection of human rights and minorities	0.0	0.0	3.0	2.0	0.5	5.5
Economic and social cohesion						
Development of human resources					0.0	
Regional development/preparation for SF	2.0	0.0	2.0		2.4	
Business/investment support	0.0	7.0	2.0		3.4	
Labour market development/employment	1.0	0.5	3.0		2.0	
Large investment projects	0.0	0.0	2.0	7.0	16.2	50.5
Agriculture	0.0	0.0	1.0	3.0	1.0	5.0
Environment	0.0	5.0	2.0	2.2	1.0	10.2
Justice and the interior – pillar III	0.0	0.0	0.0	4.8	4.2	9.0
Infrastructure integration/TransEuropean networks	60.0	0.0	0.0	0.0	0.0	60.0
Other	3.0	0.0	0.5	0.5	0.2	4.2
Tempus	8.0	7.5	3.0	1.0	1.0	20.5
EC programmes	0.0	0.0	3.5	3.6	4.0	11.1
Cross-border co-operation programmes	33.0	36.3	25.0	19.0	45.0	158.3
Road modernisation	2.6	1.8	2.2	0.0	0.0	6.6
TOTAL	114.6	58.1	62.2	46.0	86.6	367.5

Source: Ministry of Finance (2000).

One of the first pilot programmes was introduced simultaneously in 1998 in the three micro regions of Hana, Jeseniky and Most, situated respectively in the following NUTS II regions: Central Moravia, Moravia Silesia and the North West. Hana was chosen as a growth pole (small area beginning to properly exploit its assets but in need of expertise and financial means), Jeseniky as a rural area in difficulty and Most as an area suffering from restructuring. The objective was to finance small projects (aid of EUR 10 000 to EUR 50 000 per project) capable of regenerating the local area (SME creation and support, information centres for entrepreneurs, village renewal, ecological farming). No quantitative or qualitative goals were established: the pilot projects,

evaluated on their capacity to create jobs and become sustainable, gave the opportunity to local actors such as the Regional Development Agencies (see next chapter) to familiarise themselves with EU standards and methods for project design and implementation. The overall evaluation conducted by the EU was positive from that point of view.[21]

Since 2000, PHARE programmes have been enlarged to wider areas, while focusing on set priorities. The chosen NUTS II regions were those (see above) suffering from the effects of severe restructuring (mainly high unemployment with correlated mismatch between labour market needs and skills supply): the North West Region and Moravia Silesia. The selected priorities were:

- enhancement of the level of productivity of a given sector (diversification, support to business activities, modernisation of production methods and facilities);
- enhancement of human resources capacity: retraining, improvement of managerial skills, innovation capabilities;
- infrastructure improvement, particularly in terms of transport accessibility.

Selection of projects is linked with the implementation of the corresponding Regional and Sector Operational Programmes. EU funding amounts to EUR 8 million for each region with equivalent sums from the state budget. One of these projects is the Ostrava Science and Technology Park presented above, with other projects relating to business support in both regions (competitiveness in SMEs, tourism infrastructure) as well as human resources development (improved flexibility of professional education and training). An additional sum of EUR 8.1 million was released by the Commission in July 2000, to be used for four major industrial projects (two in each region): industrial parks, logistics centres and industrial zones. In 2001, the Central Moravia NUTS II Region (high unemployment in the northern part) was included, with an allocation of EUR 9 million for business infrastructure development support (PHARE contribution between EUR 0.6 to 2 million per project).

Within the framework of PHARE, cross-border co-operation has been implemented since 1994. Projects are mainly in the areas of transportation infrastructure, telecommunications, tourism, the environment and trade. Between 2000 and 2002, EUR 19 million are provided annually (10 million with Germany, 5 million with Poland, 4 million with Austria). PHARE CBC programmes, supplemented by INTERREG III covering the period 2000-2006, include co-operation with Slovakia.

ISPA

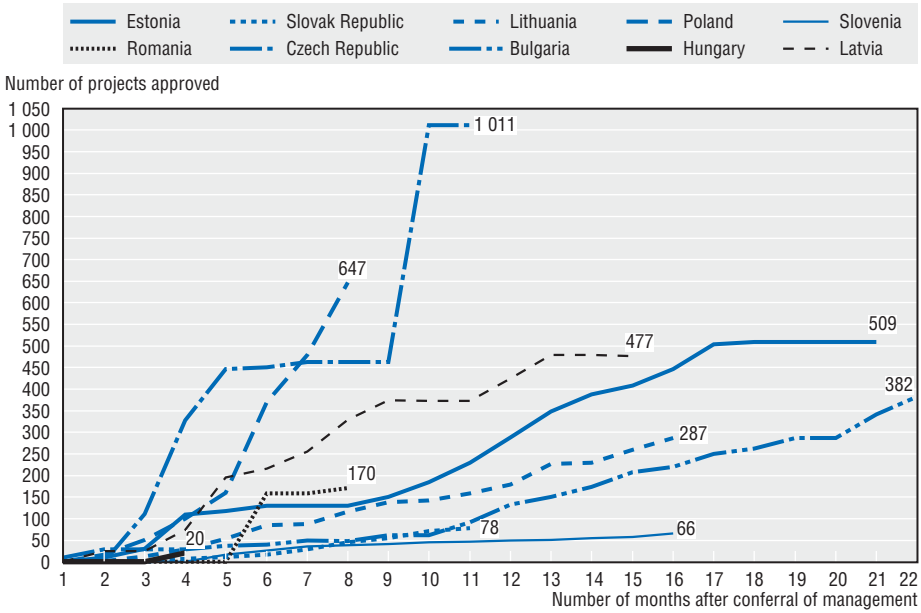
The ISPA pre-accession programme aims for economic and social cohesion in the fields of the environment and transportation. The Czech Republic will receive between EUR 57 million and EUR 83 million per year. Concerning the environment, projects aim to enable the country to be able to comply with the Acquis in this area. In the field of transportation infrastructure, the main objectives are to support sustainable mobility, better interconnect internal networks and their links with Trans-European Networks (road and rail). Projects must attain a critical mass so that impact is tangible and measurable (project cost not lower than EUR 5 million). Level of assistance attains 75% of public expenditures. Exceptionally, the Commission can increase the amount to 85%, if necessary, for strategic projects. Preliminary studies and technical support measures are also eligible (up to 100%). Nine environmental projects and five transportation projects have been approved under the aegis of ISPA (Ministry for Regional Development).

SAPARD

The goal of SAPARD is to support the sustainable development of rural areas through the modernisation of agriculture (processing, quality control), the diversification of farming (multi-functionality) and rural renewal (SME support, creation of new activities, heritage preservation, community and multi-purpose facilities) as well as tourism and environmental improvement.[22] Integration of and harmonisation with the Common Agricultural Policy is part of the framework. The Czech Republic receives EUR 22.1 million per year for this purpose. The EU contribution can amount to 75% of the total planned public expenditure. When an investment is to bear yields, public funding is limited to 50% (of which EU contribution can represent 75%). Technical assistance and studies can be financed up to 100%.

The pre-condition for funding is the preparation of a plan for agriculture and sustainable development of rural areas for a minimum of seven years. The Czech plan, including a financial agreement, was approved at the end of the year 2000. It is implemented by the SAPARD agency (Ministry of Agriculture), jointly with the MRD, for Rural Development. The agency is present in all cohesion regions (average staffing of seven from the Ministry of Agriculture and three from MRD). The Czech Republic has shown in this area a remarkable capacity to conceive and implement projects (many concerning micro-regions), leading accession countries in number of projects approved and in level of financial commitment agreed by the EU.

Figure 2.4. **Cumulative number of projects approved by the candidate countries under the SAPARD instrument since inception (31.03.2003)**



Source: EU Commission, DG AGRI, SAPARD Unit (2003).

2.5. Recommendations

Targeted aid to regions undergoing restructuring

Policies applied in regions like the North West (Bohemia) and in Moravia-Silesia, that have received massive state aid, have shown their limits: unemployment has grown faster than job creation, often boosted by public works programmes more than by development of new sustainable activities. Many administrations and agencies intervene in this area and it is not clear whether the regional representation of the MRD was really able to co-ordinate different objectives, in the absence of a clearly defined strategy. Now that regional authorities are in place at the NUTS III level as well as the NUTS II cohesion regions, proper co-ordination with these bodies is essential to ensure delivery of the Joint Regional Operational Programme (JROP), with an overall vision of priorities and linkages shared by the government and regions. Particularly in these structurally affected regions, parallel action needs to be taken for infrastructure (see below for roads) and "softer" measures such as education, training and overall improvement of the business environment.

Sectoral policies

Brownfields: little progress has been registered in terms of brownfield eradication since the 1990s. An overall strategy needs to be defined as well as a leader for implementation and co-ordination, whatever the destination of the cleaned-up brownfield site. This requires stronger regulatory links between the final planned use of regenerated land and the applicable environmental rules. Obviously these need not be so stringent for the construction of an office complex as for that of a school, playground or park. The prior conditions are a sufficiently precise knowledge of the different types of pollution prevalent in each area and a systematic inventory of brownfield sites classified by category with indication of possible use for the information of potential investors. More incentives and support need to be developed so that these sites rather than greenfields are chosen for future investment (for instance special development areas in city centres).

Transportation infrastructure: the Czech Republic, due to an outdated transportation network (road and rail) and missing links (particularly highways) is not able to capitalise on the strong asset of its location in the heart of Europe. All regional development plans and strategies need to fully integrate the transport dimension in terms of accessibility, as the case of Moravia-Silesia amply shows. Precise financial priorities and calendars and close collaboration between the Ministry of Transport and Communications and the Ministry of the Environment, combined with urgent reform of expropriation procedures in the public interest, should be clearly established and co-operation with neighbouring countries systematically sought, to ensure proper connection of the domestic network with international routes (trans-European transport corridors). Concerning legal aspects, it is suggested to determine clearly the legal process leading to the "notice of public interest", prior to expropriation. Following the practice of many other OECD countries, this definition should be enlarged so as to cover all types of public works legitimately recognised as being of "general interest". A sound and firm valuation process should also be established. The political sensitivity of expropriation makes it practically impossible to devolve this responsibility to the local level, and for technical reasons, at least in a first step, the valuation process should remain centralised or at least be carried on jointly by the national and regional levels.

Investment aid, incentives, innovation and SMEs

There is a growing dualism between a dynamic FDI sector and a lagging SME sector, in spite of the existence of successful Czech SMEs in areas like electronics and automobile components. To overcome this, a more systematic strategy for information dissemination towards SMEs (EU regulations, support

and training programmes, access to credit) is necessary, by reinforcement of the Business Development Agency network (opening up of more RAIC offices, increased staffing). Also, widespread consultation of information on the Internet (business portal) will develop only if Internet access costs are significantly reduced. To better integrate quality standards, new production processes and modern management techniques, the Supplier Development Programme of CzechInvest could be stepped up. Support to innovation through Science and Technology Parks and Technology Centres should also aim at dynamic SMEs and not only bigger firms.

EU accession

Two essential requisites need to be systematically pursued so that the Czech Republic can draw full benefit from structural funds and these are linked to recommendations presented above: adequate information dissemination and capacity building in local government and civil society for the conception and implementation of development projects (see next chapter).

Notes

1. From analysis of ALMP policies at the local level in an area with above-average unemployment in OECD, 2002c.
2. From Conclusions and Recommendations for 32 countries of Environmental Performance Reviews, 1993-2000, OECD Working Party on Environmental Performance: the Czech Republic. The same document notes that environmental protection spending amounted to 3% of GDP for the period 1990-1996, (with the private sector financing most of the amount) which is sizeable compared to other OECD countries.
3. Zlin is home to the world-known Bata shoe works, renamed Svit under the socialist regime. Loss of export markets up to 1990 and outdated production methods led to an important reduction of activity. The main factory facilities in Zlin have been partly occupied by a power company (Cinergy) but 6 ha, mostly owned by the City and the bankrupt company are seeking a new investor. The Bata name remains through the University and a foundation.
4. Many other choice locations along the Vlatva, that were contemplated for residential or commercial use, are too exposed to flooding, as the August 2002 floods demonstrated, thus rendering this type of development risky, in the absence of precise land-use guidelines.
5. The OECD was not able to obtain a national map of these sites.
6. The Inspectorate of the Environment holds a separate database of sites representing a serious health hazard (700), in particular to groundwater and for which a specific clean-up programme has been devised, jointly funded with the Ministry of Finance.
7. There are on average only ten persons working on environmental issues in each of the NUTS III regions (EU, 2002a).

8. The new NUTS III regions are responsible for secondary road maintenance.
9. Highest rates at 50% in Central Bohemia and Moravia-Silesia, lowest at 46% in the Southwestern Region.
10. The Zatec Industrial Zone Triangle in North West Bohemia, on the location of a former Soviet military airport (360 ha.), in the Usti Nad Labem NUTS III region, afflicted by particularly high unemployment. CzechInvest also initiated another important brownfield regeneration project in a structurally affected region (Moravia-Silesia): the Vitkovice site in Ostrava, but with EU financing.
11. The PARK 2 programme, launched in 2001, as compared to its predecessor, adds the following conditions: creation of a business incubator, co-operation with a university or research centre and technology transfer. Up to 65% of investment costs can be covered.
12. The centre of the city contains many brownfield sites, only some of which such as Karolina and Vitkovice are being regenerated progressively.
13. Sector definition is that of the OECD and the EU: Medium Sized Enterprise, less than 250 employees; Small Enterprise, less than 50 employees; Micro-Enterprise, less than 10 employees (Ministry of Industry and Trade).
14. Evaluation of the impact of these services is from the Business Development Agency website.
15. Internet access costs in the Czech Republic are amongst the highest in OECD member countries, surpassed only by Hungary, (OECD, 2002b)
16. Operational Programme, Industry and Enterprise, Ministry of Industry and Trade, Prague, April 2003.
17. The OECD Economic Survey of the Czech Republic, issued in April 2003, underlines, in the discrepancies between the burgeoning FDI sector and lagging domestic firms, the negative role of "a large number of poorly performing enterprises, suffering from weak corporate governance, which had been kept alive by soft loans from state dominated banks".
18. Criteria for eligibility is that a NUTS II region not exceed 75% of the average EU GDP. Prague is beyond this limit but qualifies for support under Objectives 2 and 3.
19. There are 14 NUTS III regions, the only ones to have elected bodies.
20. Explanation: of the three programmes, ISPA allocations are the only ones indicating a minimum and a maximum, so as to ensure greater flexibility in the sharing of resources and permit to finance more projects if the corresponding country has the capacity to do so.
21. For a detailed presentation of these pilot projects, see Ministry for Regional Development, 1999b.
22. The Rural Renewal Programme, managed by the Ministry for Regional Development, pursues similar goals with higher levels of grants accorded to associations of municipalities than to individual ones.

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Chapter 3

Territorial governance in flux

Introduction

Some key challenges that the Czech Republic must face and which require to improve governance are: the evolution of a recently transformed market economy, globalisation and its local consequences as well as European integration. Compliance with EU standards is therefore a central driver for change in public administration, although this domain is not directly part of the *Acquis Communautaire*. Decentralisation has been perceived as a key movement to address theses challenges. For this reason it has played a central role in public administration modernisation and reform. Amongst the expected positive impacts of decentralisation in the Czech Republic, two have been highlighted. Decentralisation of tasks may help to upgrade the quality of services, thus improving the degree of trust of citizens, while helping to establish a framework to support European integration. In the context of public administration reform, the Czech Republic has transferred a wide range of responsibilities to municipalities and regions, which had been originally exercised by the national government, with a special view to equip them with sufficient capacity for enforcement of community rules and regulations.

The main features of the reform include a clear definition of responsibilities between the national, regional and municipal) levels, the distinction between state delegated tasks and own decentralised powers and finally the creation of a new environment for all civil servants (national and sub-national levels). Decentralisation is characterised by the transfer of personnel and of properties, with complex mechanisms having been put in place to avoid over or understaffing, regarding the targeted assignment of responsibilities across levels of government. Staffing within NUTS III regions (for state, regional and municipal tasks), following the dissolution of district offices, is monitored by the Ministry of the Interior, which provides funding, but it is the responsibility of regional and local entities. In this context, within central administrations and agencies the perception sometimes exists that the regional level has received a large degree of autonomy, whereas in regional bodies, the feeling is often that the central government is not giving sufficient leeway. Understanding the proper balance and aims of decentralisation from the perspective of different government levels will require new working methods and vertical partnerships. At such an early stage, there is no clear-cut assumption as the process is progressive and open to evolution, with many

important features still to be defined on a long-term basis (allocation of financial resources to regions, fiscal powers).

3.1. Institutional background: towards decentralisation and delegation

Local and regional governance in the Czech Republic is a moving field, where most achievements towards building an effective system of local and regional governance are still to be met. Some entities have been suppressed.[1] New entities have emerged, creating sources of potential opportunities such as the development of more local democracy, but at the same time this evolution has brought forward specific challenges, in particular to create conditions and capacity for good governance across levels of government. Multi-level governance patterns of the Czech Republic are of a rather complex nature, considering the size of the country.

Regional administration is situated at the NUTS III level (14 regions with elected bodies), the eight Cohesion regions, created to comply with EU accession requirements (critical mass for management of structural funds), comprising only indirectly elected Assemblies. As indicated in Chapter 2, three NUTS III regions (Prague, Central Bohemia and Moravia-Silesia) have a sufficiently important population (around 1 million inhabitants)[2] so as to simultaneously retain NUTS II status without addition of other regions. On the other hand, recent reform has addressed the issue of municipal fragmentation through encouragement of micro-regions and delegation of certain state powers to selected municipalities.

Municipal reform and co-operation for improved governance

A major feature of municipal administration in the Czech Republic is fragmentation**.** Following the Velvet Revolution, many municipalities reacted to forced amalgamation under the socialist regime and the number of municipalities jumped rapidly from 4 000 to more than 6 000. With over 6 200 municipalities for a population of less than 11 million, 90% of municipalities with less than 2 000 inhabitants and 17.2% of inhabitants living in municipalities of less than 1 000 inhabitants (January 2002), this constitutes an important obstacle to efficient application of national policies.[3]

Due to municipal fragmentation, voluntary groupings of municipalities known as micro-regions (more than 200), that first appeared in the mid-1990s to share development aims and projects, have been encouraged by the government. Concerning former state powers exercised by the now defunct district offices, these have been divided between regions and 205 municipalities (19 of which have less than 15 000 inhabitants within their administrative area), with delegated administrative powers, relating mostly to citizen's services. To

Table 3.1. **Size groups of municipalities with number of inhabitants in 1999**

Region	Up to 199	200-499	500-999	1 000-1 999	2 000-4 999	5 000-9 999	10 000-19 999	20 000-49 999	50 000-99 999	100 000+
Central Bohemia	318	423	232	97	45	13	14	4	1	0
Hradec Kralove	128	164	84	29	21	13	6	2	1	0
Karlovy Vary	22	40	28	16	12	6	4	2	1	0
Liberec	45	57	58	26	15	10	2	2	1	0
Moravia-Silesia	14	62	76	77	39	16	4	7	4	1
Olomouc	58	123	95	73	30	4	4	4	0	1
Pardubice	125	168	91	38	14	8	7	1	1	0
Plzen	200	147	75	42	27	8	4	1	0	1
Prague										1
Prague districts	1	4	6	12	10	6	2	6	6	4
South Bohemia	255	199	75	44	31	12	2	4	1	0
South Moravia	115	191	167	94	55	14	3	5	0	1
Usti	76	119	74	35	23	10	8	4	5	0
Vysocina	364	209	90	36	14	9	4	3	1	0
Zlin	18	82	100	48	31	11	4	4	1	0
Czech Republic	1 738	1 984	1 245	655	357	134	66	43	17	5

Source: Czech Statistical Office (2000).

understand the supplementary state powers delegated to bigger municipalities with a mandate covering a wider area than the town itself, it is necessary to know the powers exercised by all municipalities, regardless of their size. These mandatory responsibilities are indicated in Box 3.1.

Concerning delegated state powers, the rationale for allocating competencies between municipal and regional levels was subsidiarity,

Box 3.1. **Main mandatory responsibilities of municipalities**

Education: kindergarten and primary schools.

Health: primary health and secondary hospitals.

Security: local police.

Welfare: public housing, nursing homes for the elderly.

Public utilities: water supply and treatment, natural gas supply, heating.

Infrastructure: city planning, maintenance of local roads, transportation.

Environment: sewerage and treatment, street cleaning, garbage collection and treatment of solid waste.

Culture and recreation: local libraries, sports parks.

Source: Ministry of the Interior and OECD Secretariat.

granting municipalities with "the most frequently executed powers" and regions with "less frequently executed powers". Specific attention has been paid to the following criteria:

- accessibility for citizens;
- effectiveness;
- quality and economy of public administration performance at the respective levels;
- number of first-instance decisions issued in particular fields of state administration;
- qualification demand of transferred powers from the point of view of human resources;
- restriction of transfer of first-instance-decision processes to the regional level because of an undesirable growing extension of appellate processes in central administrative offices;
- effort to transfer more frequently executed powers with direct relation to citizens at the lowest possible level.

On the basis of these criteria, the following competencies are exercised by the 205 municipalities with delegated state powers.

Box 3.2. **Major delegated state responsibilities to 205 selected municipalities**

Population register, issue of IDs and travel documents.

Issue of driving licences and motor vehicles license plates.

Water management, waste management and register.

Environmental protection and management of forestry, fishing and hunting.

Local transportation, in co ordination with region.

Protection of childhood and disadvantaged citizens.

Social benefits, social care services, care for the elderly and disabled.

Source: Ministry of the Interior and OECD Secretariat.

Voluntary groupings of municipalities, founded on a bottom-up approach, rest on a very open legislative framework (the 1992 municipal law simply authorised co-operation between municipalities without specifying aims or conditions), with the degree and nature of co-operation between communes left pretty much to their initiative.[4] The new Act on

Municipalities (128/2000), effective since November 2000, laid down some basic rules obliging certain groupings to modify their acts of association. Articles 49 to 53, entirely devoted to municipal associations, define these as legal entities, with only municipalities as members. Before, rules were similar to those concerning associations of private persons and membership was not limited to communes. The law defines provisions concerning resources and expenses, including sharing of profits and losses. It also specifies that citizens are entitled to attend meetings of the bodies of the association and to inspect the minutes. They can also submit written proposals. The possible areas of co-operation are now specified in particular as the following (Article 50):

- "work in the sphere of education, social care, health, culture, fire protection, public order, environmental protection, tourism and care of fauna;
- ensuring the cleanliness of the municipality, management of greenery and lighting in public places, collection, removal and safe treatment, use or disposal of domestic refuse, water supply and sewage disposal and treatment;
- installation, expansion and improvement of main networks and public passenger transport systems to provide transport services in the area in question;
- work concerning air quality protection and arranging the conversion of heating and hot water systems from solid fuels to more ecologically appropriate sources of energy in housing and in other buildings owned by the municipalities;
- the operation of quarries and installations for the purposes of mining and treatment of mineral raw materials;
- administration of municipal property, especially local roads, woods, the housing stock, sports and cultural facilities and other facilities administered by the municipalities."

These micro-regional associations appear more and more as natural partners for the new NUTS III regions, generally organised around one or two small or medium sized town centres. Micro-regions are expected to foster economic development, but the lack of a more precise framework (development charter, definition of consultative processes, critical size as a small "functional region", and existing possibility of membership in several micro-regions, proper financing)[5] may be a limit to their growth.[6]

Sharing of responsibilities between NUTS II and III regions

The new NUTS III regions were only established in 2000, the first elections being held in November. In January 2001, the newly elected regional Assemblies assumed their functions and shortly thereafter the regional councils at the NUTS II level were elected by the former.[7] In addition to

democratisation of decision making, decentralisation is a key element in EU accession requirements that include the possession of a regionalised administrative capacity, partner to the Commission and national governments in the management of EU structural programmes, while carrying out certain state delegated and devolved tasks. The NUTS III regions have inherited own competencies in certain sectors of the main following areas: education, culture, transportation, former district hospitals, the environment, agriculture, fishing and water management. NUTS II regions are responsible for preparation and follow-up of development strategies (ROPs), in co-operation with the NUTS III regions but also national authorities.

State devolved tasks and state delegated tasks in NUTS III regions

In the field of education, regions are responsible for secondary professional and vocational schools and some specialised primary schools (with healthcare facilities, art schools) and institutions (childcare homes). Regions provide for their operations and financing but teacher's salaries and learning aids continue to be covered by the State with school inspection, opening and closing being state delegated tasks. In the area of culture, the region manages historical monuments while performing the functions of the State Heritage Authority. In the field of transportation, the region is the owner of second and third category roads, which it maintains. Delegated powers concern the transportation of heavy goods, supervision of crews of long-haul vehicles and international road freight. In the area of health, regions have been transferred the 61 former district hospitals, which represent the vast majority of available bed capacity and wage-earning physicians and nurses in the country.[8] A five-year adjustment period will permit regions to formulate their own policies, to render a public service in a cost efficient way (privatisation is not excluded), but hospital capital investments continue at this stage to be funded by the central budget. There are however financial incidences of this transfer (debts) that could be considered as unfunded mandates (see further). In the area of the environment, regions have significant powers concerning waste management, with the ability to formulate a regional waste management policy. It is also their responsibility to promote education of the public concerning environmental protection. Protection of agricultural land resources, nature and air quality are exercised as state delegated duties, just as the monitoring of hazardous substances.

Regional Assemblies, funded for the time being on the basis of annual national grant schemes (see Chapter 3), dispose of permanent staff, often recruited from the dissolved District Offices. The majority is devoted to the execution of State devolved tasks. Only small teams are assigned to regional development matters. In the case of Southern Moravia, for example, the Regional Assembly oversees a staff of 520 people, of which only 24 work in the

Department of Regional Development. On the other hand, the pre-existing Regional Development Agency (RDA),[9] staffed by 12 people, brings additional support and expertise in this area on a contractual basis. Possible contradictions and overlapping in this area but also obvious complementarities are examined further.

NUTS II and III regions and development policies

Regional Councils of the NUTS II Cohesion regions manage the production and implementation of programmes co-financed by pre-accession and structural funds. They decide on the use of such financing for individual measures and activities and are responsible for the efficient use of these funds, monitoring their management as well as project implementation. In NUTS II regions comprising at least two NUTS III regions, the elected Assemblies of the latter may authorise the Council to discuss and decide on other tasks on which they agree within their co-operation framework. The Regional Councils of the Cohesion Regions dispose of no permanent staff and meet alternately in different locations, as there is no regional capital.[10] On the other hand, on the basis of the Act on Support for Regional Development, the Regional Councils have set up Regional Development Committees,[11] associating the public and private sectors and civil society, with the purpose of monitoring the application of the Regional Operational Programmes (ROPs).

Regional Assemblies are the basic element in regional development policy at the level of NUTS III regions. In this area they co-ordinate the development of their regions and arrange the production, implementation and monitoring of the regions' development programmes. They also evaluate intra-regional disparities and participate in the process of allocation of public funding to support regional development. They provide support and loans to municipalities and other legal entities such as micro-regions and co-ordinate their development objectives. They can set up or rely on organisations to support regional development such as Regional Development Agencies (RDAs). They contribute to the preparation, and arrange the implementation and monitoring of regional support programmes (pre-accession and structural funds).

Box 3.3. **Milestones in Czech regional reform**

Creation of the Ministry for Regional Development in 1996, as a cross-sector administration* playing a co ordinating role in terms of the preparation of the regionalisation process, alongside the Ministry of the Interior, as well as managing directly, with the Ministry of Finance, the pre accession funds allocated to the Czech Republic.

Vote by Parliament of Act 347 in 1997, creating 14 new NUTS III regions ("higher autonomous territorial units") that entered into effect on 1 January 2000.

Vote of a set of laws in May 2000 defining and organising the NUTS III region's devolved sector competencies (mainly secondary education, environmental matters within the national policy framework, public hospital infrastructure, maintenance of secondary roads, see Chapter 3).

Adoption by the government of the Regional Development Strategy of the Czech Republic, on 12 July 2000 This document is connected with the Development programmes of the NUTS III regions, which subsequently lead into operational programmes (ROPs) at the NUTS II level.

Vote by Parliament of Act 248 on Support to Regional Development, defining the basic types of regions to be supported (regions with structural problems, economically weak regions, rural areas, other regions such as former military bases or border areas).

Elections to the new regional councils in November 2000, with these bodies functioning as of January 2001.

Publication of the National Development Plan (NDP) by the Ministry for Regional Development in June 2001.

Suppression of the 73 District Offices (State representations) since 31 December 2002, but the district remains *de facto* an important unit of reference for many administrations (collection of statistical data, Labour and Ministry of Agriculture Offices).

* It also holds its own competencies in the fields of Housing and Tourism (Czech Tourist Authority placed under its direct responsibility).

Source: OECD Secretariat.

3.2. Control, co-ordination, coherence and unclear mandates

In this context, effective control mechanisms as well as proper co-ordination and checking coherence of policy implementation by a cross-sector approach that the Ministry for Regional Development can bring are essential. This is particularly the case because of some unclear mandates and possible

overlapping in certain areas, as illustrated by the lack of a precise framework and status concerning the pre-existing Regional Development Agencies that appears necessary since the creation of the NUTS III regions.

Existing control mechanisms and the challenge of autonomy

Strategic choices concerning how state supervision over sub-national government should be exercised and how institutional co-ordination and collaboration across levels of government should be organised will have a key impact on the quality of territorial governance, given the fragmentation of state competencies across levels of government and the need to establish an effective system of self-government. The Czech Republic has no tradition of a specific body to represent the central government at the sub-national level, if one excepts the Party Committees of the former socialist regime. In the system in place before the Velvet Revolution state supervision was exercised by District Offices. In the ten years since the creation of the Czech Republic, municipalities remained under the supervision of District Offices both for advisory services and control. The supervision over the legality of the new region's activities is under the responsibility of the Ministry of Interior. These supervisory institutions have identified cases of illegality in municipal and regional activities and helped voluntary corrections of imperfections. However, upon the supervisory institutions' initiative only, can General Courts (eventually the Constitutional Court in Brno) have the right to cancel illegal norms of municipalities and regions.

From 2003 on, supervision follows similar principles, with the necessity to ensure the succession of District Offices in their supervising functions over municipalities. An amendment to the Act on Municipalities delegated this task to the Ministry of the Interior in co-operation with other central state authorities and partly on the regions, which execute limited supervision powers, as recipients of transferred state administration powers. This means principally that supervision can be provided both by regions and the Ministry of the Interior from January 2003 but only the Ministry of the Interior can apply repressive action (suspending force of execution of incorrect acts of territorial self-government, and proposal to the Constitutional Court for cancellation).

The new system is expected to make repression an exception rather than the rule. Continuous supervision is expected to present a methodological and advisory character and should play a preventive role. In the past, municipalities asked supervisory District Offices for advice, law interpretation, and assistance. The Ministry of the Interior will ensure supervision over municipalities from territorial offices. This provision is expected to guarantee the continuity of accessible advisory services for municipalities. Conversely, supervision over regional self-government will be performed from Prague by the Ministry of the Interior. It is too early to evaluate the impact of this system of supervision on the emerging system of self-government in place in the Czech Republic. Only practice

Box 3.4. **Czech tradition of territorial administration: self government and delegated powers**

Within the self-governmental bodies in the Czech Republic, there is a difference between own powers connected with execution of own self-government activities and delegated powers with execution of state administration.

To execute their own powers, self-governing bodies follow law but internal directives of ministries and other central administration bodies are not compulsory. State institutions are only allowed to check compliance of their performance with the law. To execute delegated powers, self-governing bodies are obliged to follow laws and other regulations, directives of ministries and central state administration bodies. These directives cannot however charge self-governmental bodies with tasks going beyond the law.

Source: OECD Secretariat.

can indicate whether this evolution will reinforce local autonomy or will in fact limit initiative from the regions. However it could be stressed, on the basis of other OECD countries experience, that building capacities within local administration to manage their new freedom would be essential to avoid relying on advice from the centre.

Co-ordination and coherence: the role of the Ministry for Regional Development

The Competence Law of 1996 (Act 272),[12] specifies in paragraph 14 the following:

> "The Ministry for Regional Development (MRD) is the central state administrative authority in matters of regional policy, including regional business support, housing policy and housing development, in matters of rental housing and non-residential premises, town and area planning and construction rules, investment policy, tourism and urban and rural development. The MRD shall manage financial resources intended for the State's housing and regional policies; co-ordinate the activities of ministries and other state administrative authorities in arranging the state's housing and regional policies, including co-ordinating the financing of these activities, if it does not manage the financial resources concerned. The MRD shall provide assistance to self-governing regions, municipalities and associations of municipalities in terms of information and methodology. The MRD shall arrange activities associated with the process of integrating self-governing territorial units into European regional structures."

The Act on Support to Regional Development of 2000 (248) indicates in particular that the MRD:

- "Co-ordinates the activities of all relevant administrative authorities in the preparation and implementation of the regional development strategy and state regional development programmes, draws up analyses evaluating the development of individual self-governing regions; … for this purpose it is entitled to require the necessary information from the relevant administrative authorities and regions…"
- "Draws up the draft regional development strategy and draft state regional development programmes in co-operation with the relevant central administrative authorities and regions and submits them to the government for approval."
- "Arranges and monitors the implementation of state regional development programmes."
- "Arranges international co-operation in the field of regional development support and co-operation with the EU in the field of economic and social cohesion, including co-ordination of the actual implementation of aid instruments and the associated production of programming documents, implementation of programmes and evaluation of progress in their implementation."

These two Acts clearly assign strong direct and indirect competencies to the MRD in several areas concerning regional development, which imply robust co-operation mechanisms with other administrations and across levels of government. The MRD, staffed by around 400 people today, fully played its role in the phase of negotiation with the EU, led by the Ministry of Foreign Affairs,[13] as well as in the preparation of strategic documents such as the National Development Plan. It was than at the centre of an intensive consultation process that involved other ministries, regions and NGOs. It also played an essential role in the allocation and co-ordination of state support to structurally affected areas such as North West Bohemia and Moravia-Silesia, where it maintains a "Government Plenipotentiary Delegated to Regions". The distribution and monitoring of the implementation of projects co-financed by pre-accession funding instruments (CBC, PHARE), through its Centre for Regional Development (CRD), appears to have been well carried out, as is also the case for the preparation, jointly with the Ministry of Agriculture, of the use of SAPARD funds for agriculture and rural development. The CRD, staffed by 23 people at the end of 2003, all located in Prague,[14] is now the implementation and monitoring body for the J-ROP (Joint Regional Operational Programme). Other missions relate to the set-up of information systems with regions and co-operation with Regional Development Agencies.

However, in the evolving context of regional development, it appears that there is a slow but progressive erosion of its initial competencies, although the MRD is the guarantor of the use of pre-accession and Structural Funds, jointly with the Ministry of Finance. Certain recent transfers of responsibilities and the creation of numerous state agencies with regional offices illustrate this. The management of SME support programmes in regions (most of which are administered by the Czech Moravian Guarantee and Development Bank) is no longer under the responsibility of the MRD[15] but of the Ministry of Industry and Trade (MIT), which finances these. CzechIndustry, a new agency established in November 2000, is, amongst other responsibilities, in charge of implementation of pre-accession and Structural Funds in the industrial sector as well as development support to regional industry and services in selected regions threatened by economic decline, in particular restructuring of industrial enterprises in Ostrava. Likewise, CzechTrade, the official trade promotion agency, is building up its own international and national network to support Czech exports. The Business Development Agency (see Chapter 2) is another example of a body supervised by the MIT, enjoying a certain degree of autonomy.

Table 3.2. **Ministerial Employment in the Czech Republic**

Ministry	Headcount
Ministry of Interior	2 049
Ministry of Finance	1 217
Ministry of Defence	1 103
Ministry of Agriculture	1 092
Ministry of Transport and Telecommunications	796
Ministry of Foreign Affairs	773
Ministry of Industry and Trade	734
Ministry of Labour and Social Affairs	563
Ministry of Environment	561
Ministry of Education, Youth and Sport	415
Ministry of Justice	377
Ministry for Regional Development	359
Ministry of Health Care	291
Ministry of Culture	228
TOTAL	10 558

Note: Last year available: 1999.

Source: Ministry of the Interior for the OECD Public Management Service (2002).

In general terms, it is important to define the present role and functions of the MRD in the context of the new institutional framework. The multiplication of new specialised entities renders co-ordination tasks, which are at the core of MRD responsibilities, even more difficult. How to co-ordinate these different bodies

and with which kind of organisation and method? How can the ministry fully play its role, while at the same time giving more leeway to the expression of the regions? If it is to effectively be the "voice of the regions" in central government, is its staff sufficient, does it always have the adequate qualifications and is there a systematic territory-wide presence to efficiently ensure co-ordination while maintaining a continuous dialogue with regions in all sectors?[16]

Unclear mandates: the future of Regional Development Agencies

As a response to growing regional problems and as a recognition of the need for co-ordination of development activities within certain regions, Regional Development Agencies (RDAs) were established in the Czech Republic as early back as 1990. The first agency of this type was created in Ostrava that same year at the initiative of the State. As in North West Bohemia, the creation of this RDA was based on the necessity to address in an innovative way the problems facing old industrial areas under reconversion and suffering from increasingly high unemployment. In the following years, RDAs, often on the basis of private initiative (Chambers of Commerce) or that of certain towns and municipalities as well, were created in other parts of the country. This means that RDAs, diverse in their legal status as well as in their membership, were created before the new NUTS III regions appeared in the context of regional reform and EU accession. With the new regional assemblies taking more and more development matters into their own hands, as authorised by law, some degree of adjustment and pragmatic arrangements to rely on the expertise and experience of RDAs are necessary and have been implemented in many regions, but some ambiguities remain.

The general mission of a given RDA, usually staffed by not more than 20 people,[17] is to promote the particular region, lobby for regional interests and seek governmental and European financial support for different projects. RDAs are now performing many activities such as providing information and consulting services, elaborating municipal, local and regional development strategies as well as managing regional development projects. These agencies were also the main channels for obtaining EU pre-accession funds and implementing/monitoring projects.[18] Three of them host a Euro Info Centre (EIC).[19] Regional Development Agencies often represent CzechInvest, which has helped them set up Regional Information Centres since 2001. Training courses, focusing on marketing presentation skills and materials have been organised by the national agency. The information centres promote their regions in the field of FDI and provide information on CzechInvest missions, activities and programs such as industrial zone development. CzechInvest is already performing information services for the RDAs, as its website acts as a portal for access to the websites of each Regional Development Agency.

The main ambiguity facing RDAs today in the context of the new regions is their commercial status. Although they heavily rely on European, regional or municipal/micro-regional contracts, they are not subsidised and cannot be considered as the unique or privileged development and planning tool of regions and local government. Well versed, by definition, in European procedures and programmes, they play a precious role from that point of view but are no longer in charge of implementation of pre-accession instruments, which is now accomplished with the regions under government supervision (see in Chapter 2 the arrangement for SAPARD). They can be in competition with private consulting firms when it comes to implementation of specific projects co-funded by the EU. They also respond to calls for tender from regions and municipalities just as any other firm. Their future, besides ensuring the representation of certain national agencies like CzechInvest, thus remains uncertain and depends, on a case to case basis, on the willingness of regions to use their expertise, while respecting competition rules. This is of course linked to the degree of self implementation that regional administrations wish to foster by fully staffing their regional development departments, so as to rely as

Box 3.5. **The Regional Development Agency in Ostrava (Moravia-Silesia)**

A PHARE pilot project, founded as a public entity in 1993 to oversee reconversion projects in this old industrial region with a highly damaged environment and high unemployment.

Shareholders: Region of Moravia-Silesia for 70% and the Ministry for Regional Development for 30%.

Main customers: City of Ostrava and Region of Moravia-Silesia.

Euro Information Centre under contract with DG Enterprise.

A 12% stake in the Science and Technology Park of Ostrava.

Operational budget of approximately EUR 400 000 per year.

Staff: 12 people.

Main projects under way

Cross-border co operation projects with Poland and Slovakia (CBC PHARE): permanent secretariat.

Ownership transfer of Ostrava-Mosnov international airport to the city from the State.

Regional information System.

Source: Ostava RDA and OECD Secretariat.

little as possible on outside expertise, which can nonetheless be very helpful (technical know-how and experience, objectivity).

RDAs, in competition with consulting firms, represent a wealth of experience to be drawn upon. An interesting example of fruitful co-operation between a region, its capital city and its RDA, while drawing upon a private consultancy (DHV CR sro), is the establishment of the "Regional Innovation Strategy of South Moravia", co-funded by PHARE. On the basis of the document jointly prepared by the RDA and DHV CR, adopted by the City of Brno and the Region, a South Moravian Innovation Centre will be created in Brno to set up incubators in all of the region, encourage R&D and industrial clustering, develop networks between local firms and foreign investors as well as devising innovative financing for business start-ups. Construction work on the Innovation Centre is to start in 2003.

3.3. Adapting the public service

Public administration reform in the Czech Republic started with the reform of territorial administration, the Act creating the NUTS III level regions having been voted as early as 1997 (although certain provisions concerning in particular stable long-term financing, remain to be anchored) while civil service reform at the national level (creation of a professional and stable civil service, clear definition of the role of the national level, improved co-ordination between administrations) was only adopted in November 2002 and will come into force in January 2004 for most of its provisions. The implications of this situation, partly the result of accession negotiations, are considerable: the Czech Republic now faces the tremendous task of implementing regional reform while creating the conditions for a smooth and transparent functioning of the national civil service, itself conditioning an efficient dialogue with the new territorial entities, so as to ensure balanced growth of the different parts of the country. To complete these requirements, a territorial civil service is also being set-up to ensure the proper execution of state delegated tasks to certain municipalities and to regions, while building capacity for development projects.

National civil service in a time of change

The logic of the reform

Despite the fact that public administration is not part of the Acquis Communautaire, the EU has defined qualitative requirements for its functioning, in view of ensuring adequate implementation of EU rules and regulations and the necessary capacity for overseeing use of pre-accessions and structural funds, (with "absorption capacity" also resting on local ability to conceive and manage projects). These recommendations include the

adoption of a Civil Service Act and enhancement of horizontal co-ordination of administrative powers at all levels.[20] The following section deals only with issues linked to co-ordination at the national level.

The main rationale of the reform that has been under preparation for almost ten years is the emphasis on modernisation more than on reform, meaning a gradual and long-term process of evolution that does not change the core of the system but changes the way it functions. In view of this, the reform is focused on pillars that could be referred to as the "three Cs": Conceptual role, Co-ordination and Control (Ministry of the Interior, 2002). The accent is put more on the preparation of policy guidelines than on self-implementation, as many state administrative tasks are delegated to either regions or municipalities and decentralised decision-making power, in particular in terms of territorial development must fit into the national strategy (National Development Plan). To ensure this role efficiently, national administrations and public bodies must increase their efficiency and the quality of their outputs through proper co-ordination on the basis of an adequate organisation and smooth processes (inter-ministerial co-operation). Lastly, the supervisory and controlling activity *vis à vis* local government, requires effective monitoring and *ex post* evaluation of results (see above). The basic philosophy of this approach is that operative functions are more in the hands of local authorities than the direct responsibility of the national level.

The two civil service reforms, national and territorial (see below for the latter), are thus closely linked in time and in logic, with the success or difficulties of one necessarily impacting on the other. This entails careful and regular monitoring to ensure that the implementation of both reforms advances at an adequate and parallel rhythm. The success of the reform of the national civil service is just as important to regionalisation as the regional reform itself, by laying the foundations for effective and efficient multi-level governance.

The main features of the reform

The Civil Service Act (218/2002 Coll.), passed in November 2002, includes dispositions for internal restructuring of Central State Administration (partial standardisation of the organisational structure of ministries) and measures concerning the status, rights and duties of civil servants so as to ensure conditions of recruitment, career perspectives and training that constitute the basis of a politically neutral and efficient civil service. Internal restructuring aims to streamline organisations while defining clearly the scope of powers of individual departments and sections, deconcentrating the decision-making process as much as possible so as to avoid unnecessary cluttering at the top levels. The accent is put on supporting activities, in particular proper co-ordination with other ministerial departments through the creation of a State Secretary in each administration, holding the position of the highest ranking civil

servant within the ministry. Besides specific co-ordination tasks linked to the agenda, this official oversees proper information exchange with other entities and manages activities within the ministry (internal co-ordination and support).

The second and far-reaching measure of the Act on Civil Service reform concerns the framework necessary to offer civil servants the legal guarantees for recruitment and career advancement while providing for requirements in terms of education and training to deliver a top quality service to citizens. This may spell logic but it constitutes a radical change with the situation created at the beginning of the 1990s when the rights and obligations of the vast majority of civil servants were provided in the Labour Code. The act sets down the legal status of central state administration officials, their regular evaluation, training, remuneration and management. It also provides for a system of selection for positions in civil service and for appointments, including to senior posts. Civil service officials pledge their loyalty to the state and are not allowed to make their own business. The Institute of Public Administration, created in June 2001, is the single organisation responsible for the education and training of national civil service officials in the Czech Republic.[21] The implementation of this Act, under the direct responsibility of the Office of the Government in a five-year progressive process, definitely conforms with the guidelines contained in the OECD Report on Regulatory Reform in the Czech Republic (2001c), in particular, "to increase the capacity and responsibility of public administration by way of a more flexible and performance-oriented human resources management".

Reform of the territorial civil service

The new organisation of Czech territorial administration, with sharing of competencies between regions and municipalities, the former receiving mostly devolved competencies in certain areas and some of the latter delegated state administrative competencies, was completed by the Act No. 312/2002 Coll., on Territorial Self-Government Officials and on Change of Same Laws of 13 June 2002 Act, effective since January 2003. This act applies both to regional and municipal officials, many of which come from former district offices, and seeks mainly to introduce a greater degree of professionalism in the territorial civil service while providing officials with guarantees and obligations in accomplishment of their duties. Specific attention is duly given to education and training supervised by the newly created Local Government Institute, with accreditation given to training institutions throughout the country, whether public or private, by the Ministry of the Interior.

The new law concerns only officials of self-governing units, thus elected representatives and supporting staff are excluded, the former continuing to be covered by the Labour Code. It lays down conditions for access to the civil service and competence to perform legal acts (age, citizenship, permanent residence, clean criminal record). A senior official may only be a person with

prior experience in public administration or a senior manager in the private sector. There is an obligation to advertise vacancies and to announce an open competition for selected positions. A special professional examination is required for areas where the local government exercises delegated state administration powers. Special provisions aim to strengthen the impartiality of civil servants and highlight their duty to act in the public interest.

An important element of the law is the provision of the education of the officials concerned, considered as a duty and a right of each. This includes entry training (basic guidance, specific training linked to the agenda), on-going training for educational advancement and specialisation as well as training of senior officials. These different measures were prepared in a pragmatic fashion on the basis of the "System for Preparation of Officials for Public Administration", approved at the beginning of 2001, developing similar principles for recruitment, career advancement and training in the territorial civil service as in the national civil service. This "system" is itself the end-product of a PHARE project entitled "Human Resources Development in Czech Public Administration". By insuring better career perspectives for territorial officials, the new Act is expected to contribute also to a greater stabilisation of personnel of self-government units and to improve local administration delivery, even in the smallest municipalities.

Staffing of municipalities remains an area of concern, particularly in the smallest ones. Those with less than 100 inhabitants have few permanent employees. Their level of qualification is quite basic and not necessarily adapted to the social and economic challenges brought forward by efforts to administrate and regenerate a village or a small town. Training and capacity building provisions contained in the Act on Territorial Self-Government Officials should change this situation along with other measures already adopted. Thus, State authorities have taken fiscal measures to encourage amalgamation, albeit with limited success up to now. Other answers are *de facto* limitation of powers of the smallest municipal entities, both administrative (delegation of state powers to bigger municipalities) or economic (through membership in a micro-region association) (OECD, 2002c).

On the other hand, the situation in bigger towns and cities, is improving, as the example concerning the City of Brno clearly shows. The total number of municipal employees of the second city in the country (close to 374 000 inhabitants in 29 districts) is 1 159 (referring to local civil servants, excluding other categories of employees and workers which are not subject to local civil service employment rules). The profile of people working for the municipality has changed in the past ten years. The level of education of employees has raised, partly because of the change of nature of the work performed at the municipal level, maybe also because of the more positive attitude of the population towards municipal government with specific efforts to

develop recruitment of young professionals. A system has been put in place to encourage graduates to spend one year in the municipal administration (with the help of the Labour Office), which provides skilled employees and helps university graduates to gain experience. After one year these young professionals can apply for a job. About half of the young professionals who benefited from this programme eventually joined the municipality at the end of this experience.

Challenges for Czech public administration

As mentioned previously, reform and modernisation in the functioning of Czech civil service is being accomplished at all territorial levels simultaneously with the implementation of regional reform and delegation of certain state powers to local government. Thus, the two reforms are fully complimentary to one another and their near simultaneous application constitutes an opportunity to develop new methods of delivering public services across levels of government by horizontal and vertical co-operation, not to mention partnerships with the third sector (see further). On the other hand the process is necessarily a long one, with national administrations having a naturally ingrained tendency to retain power, heritage of both the Austro-Hungarian Empire and the Communist period, while regional and municipal administrations have to adjust to their new responsibilities, both in the exercise of delegated powers and in the development of new decentralised ones. Besides experiencing new mechanisms and processes to foster co-operation – and in this area the Ministry for Regional Development can play a pivotal role – the efficient implementation of the framework implies that proper resource allocation mechanisms be defined, which is not yet the case, and that trust be progressively consolidated.

Concerning resource allocation for state delegated tasks, sums ventilated from the state budget and corresponding to effective cost (minus possible fees recovered by local authorities) are redistributed to local government on the basis of criteria linked to operational costs (number of pupils or of retirees in homes for the elderly for instance). Concerning competencies devolved to the regions, specific financial mechanisms or supplementary fiscal powers have not yet been defined, which means that sums supposed to cover these expenses are voted in the state budget and shared by regions on an annual basis, as the result of the overall budget revenues and than (often with delay), allocated to the regions. This temporary arrangement is not satisfying for regions which need to have a longer term vision of expenditure, while the actual mode of "budgetary regionalisation" is criticised in the regions as it is unpredictable and has resulted up to now in allocations considered to be inferior to needs, particularly in certain sectors like public hospitals which imply debt repayment by regions (see next section). Another criticism voiced by regions is that strategic and urgent investment decisions in certain areas like infrastructure are still taken in Prague with little consultation of regional authorities.

A rapid clarification of the financial relationship between the national government and regions is essential to foster true decentralisation and facilitate the build-up of trust across levels of government and between civil servants working on common development goals. The strong ruling hand that existed in the past is expected to disappear as a consequence of the decentralisation process and this evolution is creating specific challenges. Indeed, modernising the system of state administration appears to be a much more complex task than the territorial reform itself, because it requires active involvement and leadership from national and sub-national employees. Finishing public administration reform is a key precondition for improvement of the socio-economic situation of the Czech Republic.

3.4. Financial and fiscal issues

Sub-national government's ability to perform their tasks is directly linked to adequate funding of their activities from their own revenues and grants. A basic feature of the Czech Republic's regional development is the current lack of sufficient financial capacities of the new NUTS III regions to cover all the costs incurred by the exercise of their responsibilities, both devolved and delegated. This situation is partly due to the fact that the reform of territorial administration is ongoing, with competencies transferred but provisions concerning allocation of resources (method and amount) still subject to debate. Annual amounts, considered insufficient by the regions, are for the time being voted in the State budget, which does not allow for long-term planning, particularly for investment expenditure. Regarding municipalities, the situation is somewhat different, as existing laws and successive fiscal reforms govern their resources and expenditures. The most recent measure concerns the 205 municipalities exercising delegated state powers that have received supplementary allocations from the State budget to cover the costs incurred by these new responsibilities.

The new distribution of tax revenues in place since 1 January 2002 exhibits relatively similar sources of revenue at the regional and local levels. The bulk of regional and local income (about 80%) comes from three main sources of revenue, designed and collected at the national level: VAT, physical persons' income tax, and corporate income tax. The reform introduced in 2002 did not modify the patterns of the financial allocation of responsibilities. It mostly changed the respective share of each of the resources with a substantial increase of the revenues coming from the state budget. This was achieved mainly to improve the financial capacity of sub-national governments to perform delegated tasks. On the short term, this evolution could help reduce the risk of "unfunded mandates" and contribute to improve the relationships between levels of government. However, on the

longer term, the combined dependence on contributions from the centre and the prevalence of state delegated tasks could harm local autonomy.

Under the new legislation, specific local sources of income from local fees represent a limited share of about 3-4% of the revenue of local and regional governments. The modest share of fees at the local level is a matter of vivid debate in the Czech Republic, as their limited importance does not fit actual needs. An illustration of the ambiguity of relations across levels of government is that taxes and revenues transferred from the national budget to sub-national governments are often presented as local government "Own revenues", although it is clear that the system of resource allocation remains centrally monitored. Due to the scarcity of resources and the need to maintain spending at reasonable levels, there is an urgent need for implementing financial reform on the revenue side of local public finance in order to increase the capacity of local government to carry their tasks of self administration while making progress on the "redistribution of tax wheels".

For the time being, the following table clearly show that regions receive a modest share of tax allocations as compared to amounts retained by the State budget or redistributed to municipalities:

Table 3.3. **Budgetary allocation of taxes between regions and municipalities in 2002**

	Regions by set %	Municipalities according to recounted number of citizens (%)	State budget (%)	Before redistribution (%)
Physical Persons Income Tax from dependent activity (National Revenue)	3.1	20.6 (+1.5% = municipalities according to number of employees)	74.8	
Physical Persons Income Tax collected by deduction	3.1	20.6	76.3	
VAT (National Revenue)	3.1	20.6	76.3	
Corporate Income Tax except taxes paid by municipalities	3.1	20.6	76.3	
Physical Persons Entrepreneurship Tax (PPET) before supplementary allocations	0.0	30.0	10.0	60.0
Physical Persons Entrepreneurship Tax (PPET) (allocation of 60%)*	3.1	20.6	76.3	
Corporate income tax paid by municipalities or regions				
100% regions (taxes paid by regions)		100% municipalities (taxes paid bymunicipalities)		
Property tax				
100% municipalities				

* Ten per cent of National Revenue from PPET is first distributed to the state budget. Thirty per cent of National Revenue from PPET is first allocated to municipalities.

Source: Ministry of the Interior (2002).

Main features and evolution of municipal finances

Revenues and expenditures of municipalities in the Czech Republic represent approximately 10% of GDP over the past years as the following table shows:

Table 3.4. **Structure of local government budgets Czech Republic, 1995-1999**
In % of GDP

Operation	Executed budgets						
	1993	1994	1995	1996	1997	1998	1999
Total revenue	9.2	9.5	9.4	10.4	8.7	8.7	10.2
Tax revenue	3.8	4.6	4.9	4.5	4.6	4.6	4.7
Shared tax revenues	2.8	4.1	4.6	4.1	4.1	4.2	4.3
"Own" taxes[1]	0.9	0.5	0.4	0.3	0.5	0.5	0.4
Transfers from State and State funds	2.8	2.6	2.5	3.9	2.1	2.1	2.3
Capital revenue	0.8	0.5	0.4	0.5	0.5	0.5	1.7
Privatisation incomes	0.6	0.5	0.3	0.5	0.3	0.4	0.3
Other non-tax revenues[2]	1.9	1.7	1.6	1.5	1.5	1.5	1.6
Total expenditure and net lending	8.9	9.5	9.6	10.9	9.0	8.7	9.2
Current expenditure	5.8	5.9	5.9	7.5	6.0	5.9	6.4
Capital expenditure	3.2	3.5	3.6	3.3	3.0	2.9	2.9
Balance including privatisation receipts	0.2	0.0	–0.2	–0.5	–0.3	0.1	1.0
Balance excluding privatisation revenue	–0.4	–0.4	–0.5	–0.9	–0.6	–0.3	0.7

1. Includes estate tax.
2. Includes entrepreneurial and income from property.

Source: Ministry of Finance, World Bank (2001).

Breakdown of these revenues and corresponding expenditures between 1994 and 1999 is the following:

Table 3.5. **Selected financial indicators of municipal governments (CZK billions)**

	1994	1995	1996	1997	1998	1999
Total revenues	92.8	106.8	114.6	123.9	137.9	169.4
Tax revenues	45.3	58.4	62.8	65.5	72.1	75.7
Total expenditures	95.5	110.8	123.5	129.2	136.3	150.0
Capital expenditures	32.1	39.1	43.1	42.1	41.3	45.5
Debt (loans, bonds, other)	14.3	20.3	28.3	34.4	39.0	40.0
Rate of inflation %	10.0	9.1	8.8	8.5	10.7	2.1

Note: Exchange rate of Czech crown (CZK) has been over the last ten years relatively stable. Currently: CZK 35 = EUR 1.

Source: Ministry of Finance, Kameníčková, Czech Statistical Office (2000).

Municipal revenues

The budget revenues of individual communes comprise: revenues from community property and rights, local fees, tax revenues, administrative revenues, (including from state administration tasks with which the commune is charged, such as fees for administrative acts, as well as fines or levies imposed by the commune), revenues from community business operations and from business activities of municipal corporations, subsidies (state budget and funds, region), repayable funds (loans, credits) and donations. The highest percentage of these revenues is from redistributed taxes (approximately 60%) and subsidies (around 23%). The rest consists of non-fiscal revenues.

Subsidies. An important source of income for municipal budgets consists in subsidies (19% in 1999). Municipalities receive subsidies from the state (previously through the district offices) and regional budgets (to a much lesser extent). These are contributions covering delegated state administration costs, departmental equalisation grants in various fields as well as territorial equalisation subsidies. These grants are divided into three categories of which only the first is non-discretionary (World Bank, 2001).

- Categorical Grants finance the full current cost of delegated government responsibilities. Generally, these are distributed on a "per head" basis and cover expenditures in social assistance and benefits, kindergarten and primary education, hospital and assistance institutions, fire brigades, and the execution of general government services, including registration and permits.
- Other current grants are awarded at the discretion of central government agencies and often require matching funds. These subsidies cover a variety of areas, including crime and drug addiction prevention, environmental issues, as well as employment and development policies.
- Capital grants are extended for a variety of purposes, including schools, hospitals, social care facilities, gas distribution, equipment of fire brigades, development of industrial zones, public transport, water and sewerage treatment plants. Municipalities also receive transfers from the State Environmental Fund. Capital grants are discretionary and almost all require matching funds.

Subsidies represent an important resource in municipal budgets but their share is diminishing, due to changes in the tax system and increase of other community revenues. Municipalities encounter certain problems in connection with state subsidies. Thus, there is no integrated set of suitable criteria for a more equitable allocation of discretionary grants. The allocation of discretionary grants, including the criteria for eligibility and award, is not

always transparent. Until recently, there was little visibility on how the system worked, with no publication of lists of recipients. This is now changed with details on amounts and beneficiaries of government subsidies available on the Ministry of Finance's website.

Furthermore, discretionary grants are an unstable source of revenue for local governments, which has damaged their ability to plan and budget expenditures in an efficient way. Besides, municipalities have insufficient information about the existence of the individual subsidy programs and ways of obtaining and using them. No unified system has been developed to ensure easy access to up-to-date information about subsidies, grants and contributions. Such information is supplied individually, in particular through the Internet, by each ministry or entity within whose competence a given subsidy or grant falls.

Loans. Loans serve mainly to build technical infrastructure, especially transport, transition to natural gas and environmental investments, such as wastewater treatment plants or dumps. Communes also use loans to reconstruct the housing stock or to build new apartments. Insufficient revenues lead some communes to take out bank loans and in some cases issue communal bonds. Sub-national governments enjoyed significant freedom in terms of borrowing until 1997. While in the first years of transition local governments recorded budget surpluses, in the middle of the 1990s municipal debt grew steeply.[22] In 1997, due to economic crisis, the government discouraged municipalities from taking new loans. This was decided by a resolution conditioning provision of state grants by "healthy" municipal financial management (maximum ratio of 15% for debt service). However, the recorded stabilisation of volume of municipal debt between 1998 and 1999 should be interpreted with caution, because of the one-off sales of energy company shares (see below). In 1999, debt represented 53% of municipal tax revenues, which corresponds to 2.2% of GDP and about 20% of the state debt.

Municipal expenditures

Czech local government expenditures since 1990 have been characterised by a high level of capital investment, particularly in the field of basic public infrastructure. Debt rose sharply until 1997 and seems to have slowed down since. The main development priority of many Czech municipalities is still investment into neglected or even non-existent infrastructure. On average, municipalities allocated nearly 40% of their budget to investment during the period 1993 to 1998. This figure represents about 3% of the Czech GDP and is quite high in comparison with other countries. Investment in infrastructure is a clear priority of local government in the Czech Republic.

Moreover, the high investment activity of Czech local governments has been encouraged by other factors (Blazek, 2000). The central government used to declare priorities in the sphere of local investment (*e.g.* wastewater treatment plants or houses for the elderly) and offered significant capital grants as an incentive for municipalities. Also, after a few years of economic turbulence at the beginning of transition, banks started considering local governments as stable, credible and low risk subjects. Some banks even developed special financial products (softer conditions for loans provision and more favourable interest rates). Finally, in the first half of the 1990s, municipalities got used to annual significant increases of their revenues in real terms (approximately 10% a year) which contributed to a pro-investment atmosphere.

Besides, in 1999, municipalities decided to sell their shares of regional energy companies because impending privatisation threatened to depreciate share value. The financial resources gained from this one-off sale were often earmarked for investment activities. At the beginning of transition towns and municipalities focused predominantly on construction and maintenance of infrastructure and were selling real estate. At the end of the 1990s, municipalities and towns started also to buy and develop property, especially new industrial zones. Over the last several years the sum of investments of local governments equals or even exceeds (depending on the years) the capital expenditures of central government. For example in 1999, capital expenditures of the central government (after exclusion of investment grants to local governments) amounted to CZK 42 billion, while capital expenditures of local government reached CZK 45 billion.

Fiscal reform

In 1993, a radical reform of local government financing was executed to increase the percentage of revenues that local governments generated themselves (following analyses from Blazek, 1999). The core of the reform was that revenues from personal income tax were allocated to local governments. This resulted in big disparities among districts and municipalities in per capita tax revenues due to differences in tax bases. The system was complex, with a strong equalisation mechanism among municipalities within districts on a per capita principle.

Another reform, decided in 1996, lasted until December 2000. The rationale for change was threefold. Firstly, the revenues allocated to local governments were growing more swiftly than the revenues going to the state budget. The share of the state in public budget revenues was shrinking although its responsibilities were not decreasing. Secondly, there were considerable disparities among districts (and larger disparities among municipalities) in per capita tax revenues according to local economies. These were contrary to the principle of guaranteeing a similar level of public services

throughout the state and were considered unjust because local authorities had no power to set the rate of income taxes. Thirdly, the government wished to stimulate municipalities to promote more actively employment and economic activities.

The main element of the reform was the replacement of 40% of revenues from the growing personal income tax by 20% of stagnating revenues from the business tax. The allocation criteria among municipalities were also changed. The impact of the system has been multifaceted. The strong equalisation mechanism operating among municipalities within districts was weakened, whereas stronger equalisation mechanisms appeared at the inter-district level. The main losers were the smallest municipalities, with limited employment opportunities, therefore not receiving the 10% share of personal income tax allocated according to plant location. These seldom benefited from the allocation of 100% of tax revenues from personal income tax of small entrepreneurs, according to residence.

Due to dissatisfaction with the previous model, another reform came into effect in January 2001. The main rationale of the new system is to eliminate sharp and unjustified disparities in per capita tax revenues, which the municipalities cannot influence. Consequently, the new system is fully adhering to the principle of solidarity and rests in equal sharing of revenues of selected taxes on a per capita principle. The list of shared taxes includes the value-added tax, personal income tax and business tax. The share of towns and municipalities has been set at 20.6% of total revenues of these taxes. The substance of the system is an equal sharing of both parts of the personal income tax (paid by employees and by small entrepreneurs) and of part of the business tax and of the value added tax, equally by all municipalities on a per capita basis. For this purpose, municipalities are divided into several categories according to their population, each being assigned a coefficient reflecting that larger municipalities and cities perform functions for outlying areas.

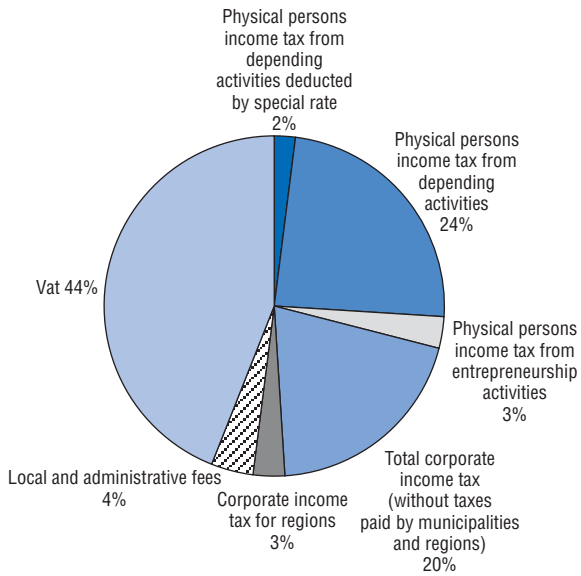
The new system also anticipates an increase in revenues from and discretion over property tax as well as larger discretion over local fees and their transformation into local taxes. Incentives for municipalities to encourage employment creation and business support on their territories remain limited. One of these authorises municipalities to keep 30% of taxes from personal income tax paid by entrepreneurs living on municipal territory. Thus, only 70% of revenues from this tax are transferred to the central fund from where the share allocated for local governments (20.6%) is redistributed. The reform aims to introduce greater equality between municipalities but discretion over taxes and fiscal autonomy remain modest.

A part of the annual Act on the State Budget is devoted to publishing the amount of contributions to municipalities and, since 2002, this is also applied to regions. It appears that the contribution is not sufficient to cover all costs of municipalities, who have to compensate the balance by levying administrative charges. Amounts transferred to sub-national governments differ according to the type of state administration delegated to these various municipalities. It is established on the basis of a multiple of a flat rate per each 100 permanent residents and one-hundredth of the population permanently resident in the territory.

Regional finances in transition and unfunded mandates

The new distribution of tax revenues in place since 1 January 2002 exhibits relatively similar sources of revenue at the regional and local levels, as has been seen above. The bulk of regional and local income (about 80%) comes from three main sources, designed and collected at the national level: VAT, physical persons' income tax, and corporate income tax. The newly established regions are temporarily financed by subsidies for the most important part. This system of grants is expected to last for a transition period, which will be necessary to strengthen regional own tax revenues.

Figure 3.1. **Regional tax revenues according to amendment of tax division as of 1 January 2002**



Source: Ministry of the Interior, Ministry of Finance.

In 2002, the rate of regional own tax revenues and fees was in practice only of about one-sixth of their total revenue.[23]

The basic consideration for determination of the volume of contribution to the regions towards their state administration duties is the running costs implied by regional staff dedicated to state administrative functions. The sum of the contribution from the state and the charges collected would, in ideal cases, cover all expenditures in connection with the delegated administrative function. In fact this is far from being the case and there is a risk of unfunded mandates for regions, as clearly demonstrated in the area of hospital infrastructure presented below.

At the regional level there are clear issues related to financial capacity, stemming from transfer of important responsibilities previously exercised by the State in the field of education (mostly secondary schools), culture (heritage preservation), the environment (environmental protection), infrastructure (second and third category roads) and healthcare (former district hospitals). To cover these expenses through grants provided by the State budget until a longer term financial and fiscal mechanism is devised, the permanent challenge for the government is to decide the amounts going to regions, according to the expected fulfilment of specific objectives and goals in the area of their devolved competencies. In this perspective, the Ministry of Finance is preparing a reform of public budgeting and a proposal on tax revenue assignment.

Amongst the responsibilities transferred to regions is the ownership of 61 former district hospitals, representing close to 80% of available bed capacity in the country,[24] many of which are debt-ridden. This has already led to the closure of certain hospitals (in the Plzen Region), but in other cases to a new division of work between establishments, so as to avoid costly duplications (in the former District of Svitavy in the Pardubice Region for instance). Although regions have a five-year period to adapt to the new situation and decide whether they wish to privatise establishments or run them as public commercial entities, the debt issue is of immediate concern for all regions, which tend to hold the State responsible for this situation because of increases in wages decided in 2000, whereas before that most hospitals seemed to break even or were even profitable, according to a survey of 71 establishments conducted at the beginning of 2003 (The Prague Post, 2003). Debts are estimated at between CZK 250 million to CZK 420 million (Prague Business Journal, 2003).

Some regions like Plzen are contemplating constitutional court action to transfer immediately the hospitals to new companies not having to adhere to state guidelines on wages, while this is normally not possible before the end of the transition period. Pharmaceutical suppliers are also considering

possible court action or even stopping certain deliveries. Due to this crisis, the logic of the grace period of five years, which was to permit gradual capacity and labour adjustments, cannot be applied. Policy decisions that were to be made at the end of this period by national and regional authorities, including subsidies by the national government or by the social insurance budget if certain hospitals proved not to be viable in spite of the introduction of new management methods or change in status, might have to be taken sooner, even if capital investment of hospitals remains a national government responsibility (OECD, 2003). This is a typical example of an unfunded mandate, with the risk that regions might have to carry a financial burden instead of devoting more resources to development projects in different areas. A satisfactory solution will have to be found by State authorities, if regions are to pick up their responsibilities in this area with a clean slate.

Box 3.6. **Specific problems as described by the authorities of the Region of Moravia-Silesia**

What the region is calling for: more responsibilities, reform of financing and of the taxation system so that more money goes to regions. For the moment only small projects are developed, usually subject to co-financing.

Perception in the region is that Prague does not really want to give up control because many important decisions are taken at the centre without enough consultation. Persisting modes of centralised decision-making processes makes things difficult for the regions and for entrepreneurs.

Problem of announcements not followed by rapid decisions: delays concerning the construction of the D47 highway are cited as an example.

Delays in allocation of grants, with amounts considered insufficient in comparison with new responsibilities.

EU accession: the ROP was elaborated in the region but is in fact now managed by the central government. Many preoccupations of regions disappeared from their projects. Government has not prepared yet the procedures and rules to transfer money to regional budgets. Unfortunately, in addition to the lack of vertical co-ordination there is also a certain lack of co-ordination between ministries that is felt in the regions, in spite of the action of the Ministry for Regional Development.

The paradox: the region deplores insufficient co-ordination by the MRD, but it is also perceived as one of the bodies of a central government that is not decentralising enough its decision-making processes.

Source: OECD Secretariat.

Fiscal discipline mechanisms

Mechanisms for fiscal discipline in local government have been put in place. Budgets are requested to be balanced. When there is a budget deficit, evidence must be provided on the source of the deficit. On the other hand, there are to date no specialised institutions or courts to check the financial activities of sub-national governments. Audits are carried as part of the yearly verification of accounts and are published. Although auditing is still performed by the Ministry of Finance (Auditor General), an independent agency should be set up in the future, which will have to conform to certain rules. Audits are expected to aim at controlling the nature of the activity undertaken, its suitability, its cost-efficiency, its performance and the success rate of the audited entities. Legal provisions are open to a system audit organised according to three basic "golden rules": the audit should be performed by a person with adequate qualifications, the audited entity does not chose the auditor, and the audited entity should not determine the auditor's fees (Ministry of the Interior, 2002).

3.5. Partnerships and the involvement of stakeholders

As in most transition economies, partnerships were slow to develop, although the number of NGOs, modest at the beginning of the 1990s, exploded thereafter (44 378 organisations with approximately 6 660 000 members in 1995) and 51 000 today (de Rynck, 2002; contains several case studies). Newfound freedom and a desire to engage in action at the local level, for instance in the field of the environment, but also to defend certain interests (Chambers of Commerce, Trade Unions) explains this trend. Emergence of partnerships, more recent in the Czech Republic, can be explained by the progressive understanding by different levels of government, particularly local, that consultative processes are essential to implement development projects of different kinds. On the side of the NGOs, engagement in public private partnerships (PPPs) meant overcoming fears that the process would be confiscated by the public sector but also increasing professionalism, in particular by setting up a system of self-regulation (code of ethics, separation of administration and governance of the NGO) (de Rynck, 2002). Building trust and capacity between partners through experience but also training has been instrumental in the development of these partnerships countrywide. Approximately 3% of overall employment in the Czech Republic is within the non-profit sector.

NGOs in the Czech Republic

Areas of activities

The range of activities of NGO organisations[25] in the Czech Republic is very broad. According to research carried out in 1998[26] the highest number of NGOs is in the area of education and research (37%), followed by free-time activities and sports (35%), culture and art (34%) and social services (31%). According to another research made in 2002 by the Centre for Social and Economic Strategies (CESES) the citizens of the Czech Republic are engaged mostly in sports and leisure activities (16% of respondents), the second largest group of people being members of very diverse traditional associations such as firemen, gardeners, bee keepers, fishermen, etc. (15%), followed by trade unions (10%) and lastly cultural organisations (7%). Many of these NGOs are "survivors" of the socialist era and are characterised by their hierarchical structure. The NGOs established after 1989, which are active mainly in the areas of health, social services, protection of nature and human rights, have a smaller number of members.

There is not yet an umbrella organisation representing the whole NGO sector in the Czech Republic but an initiative to create an Association for NGO organisations has recently been taken. For the time being NGOs are divided into sector associations according to their sphere of interest or the region they belong to. The main organisations concern: health and social services, the protection of the environment, human rights, community development, youth and leisure activities and finally NGO sector services.

Categories of NGOs

The NGO sector comprises, apart from non-governmental non-profit organisations, trade unions, political parties and movements, associations of corporate bodies, co-operative societies and non-business enterprises including, legal corporate bodies which are established by special Acts of law (Czech Academy of Science, Czech TV, Czech Radio, State universities).

The basic types of non-governmental, non-profit organisations in the Czech Republic are the following:

- civic organisations (established by Act of Law No. 83/1990 Coll.);
- Foundations and Foundation's funds (registered by Act of Law No. 227/1997 Coll.);
- Public Benefit Corporations (registered by Act of Law No. 248/1995 Coll.).

Civic associations apply to the Ministry of the Interior for registration, while foundations, foundation funds and public benefit organisations must apply to courts. Even though the laws relevant to registration of NGOs are basically adequate, in practice their implementation is too complicated and

time-consuming, requiring from six to 12 months in some cases. The reasons range from overly complex procedures to overloading of the judiciary. There were 3 789 civic organisations registered in the Czech Republic in the year 1990. At the end of the year 2002 the number had increased more then twelve fold and the current number is 47 100. In parallel, the number of Foundations rose from 1 551 in 1992 to 5 238 in 1997. That same year, a law instituted a new minimum of required capital for foundations and set down stricter rules for lending, which made the number of Foundations decrease: at the end of 2002 there were only 330 and 825 Foundations Funds. A new type of NGO was authorised also in 1997: Public Benefit Corporations (762 at the end of 2002).

State role

In 1992 the Czech government established the Council for Foundations, which was transformed into the Government Council for NGO organisations in 1998, the members of which come from both the State and the NGO sector. The aim of the Council is to inform government about the NGO sector and to co-operate on preparation of legislation concerning the NGO sector. The planned creation of a national information system should contribute to make information on government funding to NGOs more transparent.

In general Czech non-profit organisations are overly dependent on State support, increasing slowly each year, but still insufficient to cover needs, because of the low level of corporate and individual donations and the general weakness of Czech foundations. In 2000, the state granted CZK 3.1 billion to the non-profit sector. On average NGOs receive about 39% of their funding from the government. One-quarter of organisations receive half up to half of their funding from State sources (primarily in healthcare, social work, education and research) which makes them very dependent on public funding. This support is supplied on a year to year basis and for longer term programs it is necessary to keep re-applying without certainty of success. Also, the NGOs' range of financial resources is not diversified and they depend too often on the support of one or two primary donors, besides the State. The system of public funding remains basically non-transparent and does not allow for consideration of the efficiency of individual NGOs. On the other hand, a very useful innovation came into effect in January 2003 (Act of Law 198/2002) concerning voluntary service, indicating the conditions of State support to this sector.

Distribution of proceeds from the state privatisation fund[27] was completed in 2002 at the level of CZK 1.3 billion, benefiting 73 Czech Foundations. This improves the situation somewhat for these organisations, but is insufficient to fulfil the needs of the sector as a whole. Foundations may re-grant only the gains earned on their endowments,

which are limited by investment restrictions and low interest rates (currently between 1% and 2%). The disbursement of privatisation funds brought some positive effects as well: foundations have begun to observe greater financial discipline in order to make the best use of their endowments. Despite this, domestic foundations are unable to participate noticeably in financing the non-profit sector.

Main governance issues and tensions among actors

While countries with a long democratic experience are shifting progressively from "traditional" government to a more open system of governance, the Czech Republic is moving from its communist hierarchical heritage towards democratic government processes, but true legitimacy has yet to be established, with regionalisation and the civil service reform being important drivers for change. The low level of participation of voters in elections is an illustration of the necessity to build up more trust by sufficient transparency and open participatory processes. Thus, the regional elections held in November 2000 produced a voter turn-out of only 32.2%. Even the EU accession referendum of 13 and 14 June[28] 2003 did not really escape the rule: if 77.3% voted in favour of accession, only 55% of voters participated, which is nonetheless more than Hungary (46%) and Slovakia (52%). On the other hand, building trust may also require specific efforts to transform decision-making processes, in order to be more receptive to social partner's interests, while opening up more dialogue with specific groups such as environmentalists, so as to avoid situations of paralysis, as illustrated by the problem of the Plzen bypass (see Chapter 2).

To develop and manage public infrastructure, OECD countries often delegate this responsibility to the private sector in the form of contractual relationships. Alternatively, they may set up a mixed organisation with the private sector for the autonomous management of infrastructure or services. Both techniques are also known as public-private partnerships (PPPs). Czech legislation was rather restrictive as far as local PPPs are concerned. Thus, municipalities were able to perform profit-generating activities as a legal entity, not subject to business tax, and this possibility was widely used, putting a limit to partnerships, until different legislation was progressively enacted,[29] introducing more precise and restrictive guidelines and rules in this field, particularly since the year 2000. Delivery of certain services can now be accomplished by providers (companies, NGOs, associations) chosen by municipalities, following established procedures ensuring neutrality and best choice, with specified taxation and control mechanisms.

Towards partnerships

NGOs operate in all regions of the country, while the majority is located in Prague and the other large cities as well as in the Central Bohemian, Southern Moravian and Moravian-Silesian regions. A number of foundations operate on a regional level, while some of them also have a national scope. NGOs are evenly divided between those operating locally, regionally and nationally. There is thus an ample basis, well spread geographically, to develop PPPs, with a few examples given below.

Table 3.6. **Statistics of NGO organisations in regions in 2002**

Region	Civic/Civil organisation	Public benefit corporation	Foundations	Foundation funds	Total
Central Bohemia	6 540	48	17	29	6 634
Hradec Kralove	2 685	23	12	60	2 780
Karlovy Vary	1 339	13	9	14	1 375
Liberec	1 920	29	10	13	1 972
Moravia -Silesia	4 334	66	17	70	4 488
Olomouc	2 750	48	17	54	2 869
Pardubice	2 418	31	8	36	2 493
Plzen	2 393	29	12	20	2 454
Prague	7 808	195	140	223	8 366
South Bohemia	3 115	60	15	70	3 260
South Moravia	4 841	115	39	99	5 094
Usti	3 859	57	12	24	3 952
Vysocina	2 763	18	7	35	2 823
Zlin	2 343	30	15	78	2 466
TOTAL	49 108	762	330	825	51 025

Source: Czech Statistical Office (2002).

National level

In contrast with the insufficient involvement of NGOs in the decision-making system, two essential fields exist where these are made on a tripartite mode. This is the case of the Strategy for the Development of Human Resources on the basis of the Operational Programme for Human Resources Development, piloted by the Ministry of Labour and Social Affairs. The National Action Plan for Employment obeys to the same logic of consultation with Employer's Associations and Trade Unions. Some Employer's associations are also involved in regulatory processes. The tripartite model functions according to consultation within the policy review process, which usually organises a procedure for comments. Some ministries call on the expertise of employer's associations very early in the decision-making system. This is a positive aspect but there is a risk of capture by interest groups. The

role of Unions is relatively strong. About one-third of employees, on average, are unionised.

Local government level

An important multi-stakeholder project in each NUTS III region was the preparation of the Regional Strategy for Development, on the basis of an organised partnership at the national level under the impulse of the Ministry for Regional Development. Municipalities, private companies and NGOs were consulted but there appears to have been no evaluation of the process that was apparently limited to a small number of partners rather than offering the opportunity for an open public debate with publicised forums and media attention. At the municipal level, more and more cities and towns engage in consultative processes concerning economic development matters. The city of Zlin organises open workshops in the framework of strategic planning for the city. In Brno and in other parts of Southern Moravia, the definition of a Regional Innovation Strategy (see Chapter 2) gave way to a large consultation of Academia and the private sector.

3.6. Recommendations

Municipalities

Municipal fragmentation in the Czech Republic is a strong obstacle to better governance and efficient delivery of policies if "municipal freedom" is not accompanied by measures based on the principle of "functional areas" around one or two small towns. Service delivery of public administration is now organised around this concept, with 205 municipalities holding delegated state powers that they exercise for a wider area. In terms of economic development strategies, micro-regions are encouraged (delivery of certain grants based more and more on a "critical mass" of population) but the proper framework for their organisation, stronger resources and more active participation of citizens in the local decision-making process still does not exist. It is recommended that the proposals made by OECD in 2002 in the Territorial Review of Moravska Trebova-Jevicko, well received by the MRD, be debated with the micro-regions in view of their adoption and implementation (permanent own staffing, sustainable development charter, consultative body for civil society) along lines comparable to the EU LEADER type approach.

Regions

The main issue is financial. The new NUTS III regions need the proper resources to ensure accomplishment of State delegated tasks as well as that of devolved tasks. In the latter case, persistence of a temporary system of annual allocations from the state budget, unpredictable in their amounts and delayed

in their payment, is a serious hindrance for the implementation of the Regional Operational Programmes defined at the NUTS II level (which receives the EU funding for that purpose), while creating a potential problem for mobilisation of matching funds. Development strategies of the NUTS III regions need to be based on a long-term vision requiring stable multi-annual funding coming in part from their own resources. This means an increase in their own tax base, which is presently debated in parliament. Also, proper solutions to unfunded mandates should be sought, not only for purely financial reasons but to foster good governance across levels of government.

The unclear status and purpose of Regional Development Agencies, which have proved their usefulness and represent a capital of expertise, should be clarified, both to avoid duplication with staff in NUTS III regions and ensure their contribution to efficient use of EU pre-accession and structural funds. Their present commercial status could be a problem and a PPP approach, bringing together the major public and private actors in each region as main shareholders of a non-profit organisation acting in the public interest but without substituting itself to private sector consultancies, should be sought. This could be accomplished by a clear definition of mission (guarantor of the regional development strategy) that would enable it to prepare and launch public calls for tender to be answered by private sector consultancies. The RDAs would thus become full-fledged advisors to their regions.

Co-ordination across levels of government

The Ministry for Regional Development is a tool for dialogue on territorial development issues with other ministerial bodies and with regions. It is the co-ordinator at the national level on matters relating to the conception, evolution and implementation of regional development programmes in the context of the Regional Development Strategy of the Czech Republic (July 2000) and the National Development Plan (June 2001). It is a partner for EU pre-accession and structural funds, with implementation based on the preceding frameworks. How will these fundamental tasks be accomplished and proper representation and co-ordination in regions also be ensured? What should the role of this administration be to ensure the success of decentralisation and encourage partnerships across levels of government, along with the measures taken by the Ministry of the Interior in the field of the reform of the civil service, both national and territorial (training, capacity building)? These are the major questions that the on-going restructuring of the ministry will need to address so as to permit it to efficiently fulfil its mission, in particular by initiating and implementing innovative multi-level governance practices.

Partnerships

To respond to the challenges lying ahead (globalisation, EU accession, balanced territorial development), the civil service and public sector alone cannot suffice and adequate responses suppose more and more effective participation of civil society. The burgeoning NGO sector in the Czech Republic should be allowed, by the expression of a strong political will and proper support to partnership creation, to fully participate in undergoing economic and social development processes. The risk, without an adequate mobilisation of these actors, is that of the persistence of a certain distrust of the public sector by citizens, heritage of a past era, and also the loss of precious competencies for achieving sustainable development. Good governance also implies an active participation of NGOs in the development process. To achieve this, it is suggested that national authorities engage in dialogue with NGOs with a view to removing the remaining obstacles to implementation of PPPs, whether legal or in terms of capacity building, both in the public sector and amongst NGOs.

Notes

1. In the context of regional reform, the district level (NUTS IV) ceased to exist since 1 January 2003.
2. South Moravia also has more than 1 million inhabitants but at the NUTS II level it was aggregated with the Region of Vysocina to form the Cohesion Region of the Southeast.
3. The 19 biggest cities enjoy the status of "Statutory Cities", meaning that they have more latitude in their internal organisation and management.
4. The municipal law (Article 46) indicates that co-operation between municipalities can take the form of a contract to perform particular tasks or to form a voluntary association of municipalities or also of a legal entity under a separate law.
5. Financing is linked to the total number of inhabitants (CZK 5 per capita in the Stonavska micro-region in Moravia-Silesia and CZK 22 for Moravska Trebova-Jevicko) and represents a very modest share of the budget of the main town (not more than 0.50%).
6. See proposals made by OECD in the Territorial Review of Moravska Trebova-Jevicko (2002) to improve the functioning of micro-regions and better support their goals.
7. Three NUTS II regions (Prague, Central Bohemia and Moravia–Silesia), contrary to the five others, only comprise one NUTS III region, but they retain distinct NUTS III and NUTS II bodies.
8. See OECD (2003) for a detailed analysis of the Czech Health System and its evolution.
9. Created in 1997.

10. In the case of the three regions which are both at NUTS II and III level, the Regional Council meets in the city which is the NUTS III regional capital. The NUTS III Regional Assembly offices for Central Bohemia are situated in Prague.

11. Before the election of the Regional Councils, preparation, assessment and approval of ROPS was accomplished by Regional Management and Monitoring Committees (RMMCs), now dissolved, composed of members of parliament, district and municipal representatives, national administrations, chambers of commerce and trade unions.

12. The Competence law of 1996 is an amendment to Act 2/1969 Coll on Establishment of Ministries and other Central State Administration Bodies.

13. Amongst the committees set up during the negotiating phase, the MRD chaired the National Programming Committee and the Monitoring Committee for Economic and Social Cohesion, replaced since the year 2000 by the Managing and Coordinating Committee.

14. It is planned to set up regional representations.

15. Since January 2003.

16. There are for the time-being only two permanent representations of the MRD in regions: in the North West and Moravia-Silesia, because of the importance of industrial restructuring. Otherwise, the Ministry maintains staff in the NUTS II regions only for specific programmes or purposes when necessary, such as in the case of the SAPARD agencies directed by the Ministry of Agriculture.

17. Even in the case of the RDA in Ostrava, which has only public stockholders, the employees are not civil servants.

18. RDAs are no longer implementation agencies for pre-accession funds nor is it planned that they would play such a role for structural funds.

19. There are seven EICs in the Czech Republic. The network, managed by DG Enterprise, comprises approximately 300 branches. It aims at disseminating information on the EU to support entrepreneurship and to provide consultancy concerning the single market, EU programmes, funds and legislation.

20. This means proper co-ordination both for territorially delegated state administrative tasks and between regions and municipalities for their own decentralised competencies.

21. The Institute of Local Government oversees the training of local officials.

22. The following developments on capital investment and municipal debt are from Blazek (2000).

23. See Ministry of the Interior, 2002. Draft legislation now under discussion in Parliament would bring up the level of region's own tax incomes to 40% of their expenses (10% of income tax and of VAT).

24. The 11 university and teaching hospitals remain under management of the Ministry of Health.

25. The developments on NGOs are based on information supplied by the Information Centre for Non-Profit Organisations (ICN), based in Prague, whose general mission is to raise the awareness of the public about the sector and strengthen its role. ICN organises training sessions for NGO members in particular and benefits from EU funding for projects (*www.icn.cz*).

26. Activities of non-profit organisations in the Czech Republic (in Czech), Pavol Fric, Information Centre for Non-Profit Organisations, Prague, 1998.
27. By Czech law, 1% of the revenues of privatisation go to the non-profit sector.
28. Czech elections are carried out over a two-day period including a Friday and a Saturday.
29. The main Acts applicable are the following: 199/1994 Coll., on Public Procurement, amended; 128/2000 Coll., on Municipalities; 129/2000 Coll., on Regions; 131/2000 Coll., on the Capital City of Prague; 250/2000 Coll., on Budgetary Rules of Territorial Budgets, amended; 320/2001 Coll., on Financial Control.

APPENDIX

Methodology and criteria for district classification

In this section only the main outline and intuitions of the methods are given (see Jobson, 1992, for a complete explanation). To give a picture of districts, 43 variables called Xi have been selected in this document specifically established on the basis of this methodology for this territorial review. The aim of the **principal components analysis** is to summarise the information contained in the Xi variables in a set of new and fewer variables Yi. The variables Xi are more or less correlated to each other. Let us say for example that the variable FDI is negatively correlated with unemployment and to a lower extent positively correlated with the share of the working force with a university degree. In other words in most cases when a high level of FDI occurs for a district there is also a low level of unemployment and a high share of the working force having a university degree. In such a case one may find useful to combine these three variables defining a new variable called *profile*. The combination is a weighted sum of the variables with a heavier load for unemployment than for the variable share of the working force having a university degree (while the highest correlation is with unemployment). Another characteristic of the new variables is that they are not correlated to each other, therefore a high positive value for example in profile one does not imply any specific value on other profiles. In this study six relevant combinations of variables have been defined.

At this stage, the picture of the districts is given by the six profiles (the new Yj variables of this study). The aim of the cluster analysis is to find in the group of districts those that are relatively similar, those that are facing the same kind of economic, social and environmental conditions. The method chosen is **Ward's minimum variance method**. Again, just the intuition of the procedure is given. There are N districts at the initial step described by six variables, if two districts are similar, then for these two districts the values

of the six variables are the same. If they are close or relatively similar the difference between variables for the two districts are close. *The first step is to find which two districts among the N districts have the smallest difference between the six variables used to describe them*. When the first step is achieved there is a group of two districts and the remaining N-2 other districts. The following step is then to compare, like in the first step, the districts and to assess the two that are similar. But there is a set of two districts to be compared with the other districts. This set includes for each variable two values, while there are two districts. To overcome this problem, the set is then defined by the average values of the variables, and averages are compared with variables of other districts. Using the same decision rule, one finds the next grouping. This step is repeated until all the districts belong to a single set. One may note that very early in the process, sets of districts are compared to sets of districts. There exists a stage at which districts belonging to each set are similar but if they are compared to other districts belonging to other sets they are significantly dissimilar. Then, merging two sets will mix together dissimilar districts. There are various "rules of thumb" and testing procedures to unearth the step at which sets are sets of similar districts and merging two more sets will create a set of districts that are not similar, but this is beyond the scope of this analysis (see Jobson, 1992, for details).

Table A.1. **Typology of districts in the Czech Republic by profile, 2000**

Regional Type	Main features
Dynamic Districts	High concentration of GDP;Qualified labour force; Low unemployment:High level of social capital;Good level of infrastructure;Significant number of large firms;High concentration of FDI.
Lagging Districts	High unemployment rate;Low qualification of the labour force; Low stock of social capital;Small number of large firms;Low level of infrastructure;Significant level of pollution.
Declining Traditional Specialisation	Low population density;High share of agro-industries and wood processing;Low level of infrastructure;Low level of FDI.
Non-dynamic Suburban Districts	High share of public services;Low level of social capital;Low unemployment of unskilled labour force;Small number of large firms.

Source: OECD Secretariat; calculation from Czech Statistical Office data.

Selection of National Czech websites

Government of the Czech Republic: *www.vlada.cz*.
Ministry for Regional Development: *www.mmr.cz*.
Ministry of Foreign Affairs: *www.mzv.cz*.
Ministry of the Interior: *www.mvcr.cz*.
Ministry of Finance: *www.mfr.cz*.
Ministry of Industry and Trade: *www.mpo.cz*.
Ministry of Transport and Communications: *www.mdcr.cz*.
Ministry of the Environment: *www.env.cz*.
Ministry of Education, Youth and Sports: *www.msmt.cz*.
Ministry of Labour and Social Affairs: *www.mpsv.cz*.
Ministry of Agriculture: *www.mze.cz*.
Czech Statistical Office: *www.czso.cz*.
CzechInvest: *www.czechinvest.cz*.
Business Development Agency: *www.arp.cz*.
Czech Tourist Authority: *www.czechtourism.com*.
Radio Prague: *www.radio.cz*.

International Organisation's websites

IMF: *www.imf.org*.
UNESCO: *www.unesco.org*.
World Tourism Organization: *www.world-tourism.org*.

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