

BTI 2014 | Czech Republic Country Report

Status Index	1-10	9.51	# 2 of 129	
Political Transformation	1-10	9.60	# 4 of 129	➔
Economic Transformation	1-10	9.43	# 2 of 129	➔
Management Index	1-10	6.57	# 17 of 129	
	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	10.5	HDI	0.873	GDP p.c.	\$ 26590.2
Pop. growth ¹	% p.a.	0.2	HDI rank of 187	28	Gini Index	-
Life expectancy	years	77.9	UN Education Index	0.916	Poverty ³	% -
Urban population	%	73.4	Gender inequality ²	0.122	Aid per capita	\$ -

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

During the review period, the Czech Republic's political situation was marked by a continuous struggle between a weakened center-right coalition government and an invigorated opposition. Tension between the main political parties further led to the instability of the governing coalition. Reasons for this tension include the emergence of a new political party, the Liberal Democrats (LIDEM), which split from the governmental party Public Affairs (Veci verejne, VV) in May 2012. The remaining members of VV within parliament later left the government to join the opposition. The two major themes that inspired intra- and inter-party struggles stem from disagreements over economic reforms (specifically in pension and health care) and the consequences of the financial and economic crises as well as attitudes over the deepening of the European integration process. These political developments have been accompanied by increasing public disenchantment with political parties and government performance overall.

This broad political struggle escalated amid a historic first direct presidential vote in January 2013, a campaign marked with contentious, populist and xenophobic rhetoric. Among key topics were a critique of governmental reforms and a revival of anti-German sentiments. The election winner, former prime minister and chairman of the Czech Social Democratic Party (Ceska strana socialne-demokraticka, CSSD), Milos Zeman, who ran as a candidate of the Citizens' Rights Party-Zemanites (SPOZ), will replace President Vaclav Klaus in March 2013. His contender in the second round, the foreign minister and leader of the Tradition-Responsibility-Prosperity 09 party (Tradice Odpovednost Prosperita 09, TOP 09), Karel Schwarzenberg, gained wide support among the younger and more educated urban population as he represented a possible break with Klaus's decade-long Eurosceptic presidency. The president-elect, who calls himself as a Eurofederalist, will have to address several sensitive issues inherited from his predecessor.

Corruption, and correspondingly weak anti-corruption measures, were some of the more serious public policy problems in the Czech Republic during the review period. The main areas affected by these concerns were the management of EU funds and public procurement. Several high-profile

issues came to light between 2011 and 2012, including large-scale embezzlement scandals at the Defense Ministry and a fraud case involving a former minister and a regional governor of central Bohemia. Moreover, in June 2012 the European Court of Auditors conducted an audit in northern Bohemia, which led to the freezing of CZK 60 billion (€2.35 billion) in EU funds. The government's anti-corruption strategies (2011 – 2012 and 2013 – 2014) have been aimed at tackling a number of issues; however, there is a lack of political will to introduce effective integrity measures and establish an independent anti-corruption office.

The world financial crisis hit the Czech economy in 2009, slowing growth and leading to an economic recession. Economic growth is expected to remain slow in coming years. Neither continuing foreign direct investment nor the positive balance of trade has been able to compensate for a decrease in demand for consumer goods and services. As a result, the overall investment in construction, mechanical engineering, transport and science has been reduced. However, despite government austerity measures introduced in 2009 and 2010, when compared to the previous review period, total government spending actually increased. The worsening state of public finances in the short- and mid-term forced the government to adopt a fiscal consolidation package, the aim of which was to temporarily stall some mandatory spending and increase tax revenues. These measures contributed to the stagnation or lowering of living standards for a large proportion of the population, which then in turn resulted in a decline in consumer demand. The budget deficit continues to grow, and the likelihood of the Czech Republic meeting EMU criteria is low.

During the review period, the Czech Republic, along with the United Kingdom, did not sign the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union; however, the Czech prime minister did not rule out that the country would sign the treaty in the future. The main reasons for the Czech opt-out were objections to increased liabilities and that states outside of the euro zone are not granted observer status at meetings of the Eurogroup and the Euro summit. Notwithstanding its complicated EU membership, the Czech Republic is fully integrated into international structures. The government sees Czech membership in NATO as a cornerstone of the country's external security.

History and Characteristics of Transformation

The transformation of the former Czechoslovakia was just one part of the sweeping political changes that took place in eastern and central Europe from 1988 to 1989. The end of the cold war caught the relatively economically stable, but politically very rigid, communist regime off guard. Representatives of the opposition movement as well as students and artists formed the revolutionary Civic Forum (Obcanske forum, OF), which became party to transitional power negotiations after the Communist Party gave up its monopoly on power on 28 November 1989. One of the most important immediate results was the reconstruction of (a truly representative) parliament and the co-option of members of the OF to the Czechoslovak National and Federal Assemblies. The newly formed parliament elected Vaclav Havel as president and Alexander

Dubcek, the reformist politician who was instrumental during the Prague Spring (1968), became speaker of the Federal Assembly.

Czechoslovakia's (since the 1993 split with Slovakia, the Czech Republic) transformation has included major political and economic changes, as well as a redefinition of the nation-state. In this period, two major actors shaped the development in the country: the former dissident and well-known representative of the opposition movement Charter 77, Vaclav Havel (president of the Czechoslovak Federative Republic 1990 – 1992 and the Czech Republic 1993 – 2003) and Vaclav Klaus, an economist who became one of the leading figures of the Civic Forum and later the leader of the Civic Democratic Party, holding the offices of the prime minister, speaker of the parliament, and president (since 2003). These two figures often clashed in public over ideological differences and personal disagreements, as they represented strong yet somewhat opposing streams in Czech politics. These differences significantly shaped the nature of Czech politics, resulting in a highly polarized system interlaced with ideological and personal animosities, which in many respects posed a major obstacle to effective governance.

Milos Zeman, a third key political figure, as of March 2013 the president of the republic, is the former leader of the Czech Social Democratic Party (CSSD). Between 1996 and 1998, he was also the chairman of the Chamber of Deputies, the lower house of the Czech parliament, prime minister from 1998 to 2002 and in 2003 an unsuccessful presidential candidate (running against Vaclav Klaus). It was the partisan disunity in the CSSD which led to Klaus's election for president. As a consequence, Zeman turned into an outspoken critic of the new leadership of social democrats. The conflict escalated in March 2007 when Zeman left the party he originally restored after 1989 and founded a new party, under the name Citizens' Rights Party – Zemanites (Strana prav obcanu – Zemanovci).

The Czech party system quickly stabilized during the 1990s. Politically inexperienced intellectual elites and socialist reformers from the period of the Prague Spring steered the initial phase of the political transformation process. However, in the mid-1990s there was a shift away from a system characterized by “political amateurs” to one dominated by a new political class. This was evident in the evolution of political recruitment patterns, which became increasingly similar to those evident in liberal multiparty democracies. However, the extent of the European integration process established a new political dividing line between parties. This led to a re-fragmentation of right-wing political parties.

Since the start of its transformation process, the Czech Republic has aspired for membership in leading international organizations. In March 1999, it became a member of NATO and in May 2004 a member of the European Union. The country's membership in the IMF and the World Bank in 1993 offered credit guarantees, which were necessary for economic and social reforms in a four-phase process. The first phase (1990 – 1993) was characterized by a considerable decline in key economic indicators such as GDP. In the next phase (1994 – 1996), the country witnessed considerable economic growth, which was followed by recession in the third phase (1997 – 1999). Economic growth was re-established only in 2000, at the onset of the four phases. The world economic crisis and the slowdown in global economy in late 2008 had a delayed but significant impact on the Czech economy. The effects of the crisis were first felt in the country in 2009; its effects have not been reversed until the current review period.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The Czech Republic has no major problems related to state integrity. There are no separatist movements or territorial enclaves.

Question
Score

Monopoly on the
use of force
10

The Czech Republic is ethnically and nationally homogenous. The government's relationship toward minorities, especially Roma, has steadily been improving over time. The official goal of all previous governments has been to increase the social and economic integration of minorities into society. In the period under study, minority issues were largely neglected by the government and the portfolio of the former Office for Human Rights and National Minorities was divided across different governmental offices. The goal to complete a new wording of the Act on State Citizenship of the Czech Republic, which would better reflect the country's membership in the European Union, has not been achieved, given the governmental emphasis on economic reforms. For a long time, the country has experienced high rates of emigration. Since the 1990s, and especially after EU accession, immigration rates have risen. However, because of the economic downturn and abandonment of pro-active measures to attract migrants, many unskilled workers have been laid off and the Czech Republic has become less attractive to foreign migrants.

State identity
10

The Czech Republic is one of the most secularized countries in Europe. Religious dogmas have no influence over politics or law. The government acknowledges the historical and unique position of the church and religious communities as traditional institutions, which are part of Czech society. However, the church has not been separated from the state and religious communities are funded from the state budget.

No interference of
religious dogmas
10

The state has a multilayered administrative structure. There are fourteen administrative divisions: thirteen regions and the capital, Prague. All administrative units have an elected regional government. After regional elections in October 2012, the social democrats gained control of nine out of 14 regional governments. The cities

Basic
administration
10

of Prague and Liberec have remained under control of center-right parties. Communists won in two regions, whereby they also participate in coalition governments with social democrats who govern in the remaining nine regions. The budgetary allocation of taxes, tax autonomy and financial decentralization have enabled regional governments to exhibit more autonomy in fulfilling their governing functions and manage basic infrastructure. EU regional funds constitute an important resource for regional development. However, due to severe irregularities in financial administration and misappropriation of EU funds, some regions – in particular in the north – have had their access to EU funds frozen and many regional projects as a result were stalled. This will negatively affect the state deficit, as the government subsidizes projects with cash advances.

2 | Political Participation

Free and fair elections are regularly organized and constitutionally guaranteed. In the period under study, two regular elections were held, together with the first direct presidential vote.

Free and fair
elections
10

The first round of elections was for the upper house of parliament (Senate) in 2012. The electoral turnout dropped significantly in comparison to the 2010 elections, which saw 44.6% turnout in the first round and 24.6% in the second round; whereas in October 2012, it was 34.9% for the first round and 18.6% for the second round. Following this contest were October 2012 regional elections. The turnout oscillated between 31.7% in the Karlovy Vary region and 41.5% in the Vysocina region.

The most important development in the Czech electoral system is the change from an indirect presidential vote by the Electoral College, composed of the two chambers of the Czech parliament, to a direct popular vote. The change to direct presidential election was part of a broader coalition agreement between the governing Civic Democratic Party (ODS), TOP 09 and the then coalition partner, Public Affairs (VV). The new law introducing the direct election of the president was finally adopted in December 2011 and came into force in October 2012. Additional laws were adopted regulating procedural issues, such as nomination, approval of candidates, the possibility of judicial review and other procedures; laws regarding presidential powers, however, remained unchanged.

The two rounds of voting took place on 11 and 12 January and 25 and 26 January 2013. After a contentious and polarizing campaign, Milos Zeman, a former leader of the Czech Social Democratic Party (CSSD), won the second round with 54.8% of the popular vote. The turnout decreased from 61.3% to 59.1% in the second round.

All electoral rounds were conducted in a transparent, impartial and correct manner. There is a universal suffrage guaranteed to all Czech citizens over the age of 18.

However, there are certain limitations for participation of citizens living abroad. Unlike in the national election, there is a restricted timeframe in which citizens can register abroad, and the number of registration points (embassies) is quite limited. Mailing ballots is not permitted. Embassies function as polling stations, which for many citizens meant extensive in-country travel or even travel abroad, in the case of countries overseas.

The democratically elected parliament and government of the Czech Republic have effective power to govern, and are not constrained by any non-democratic veto powers.

Effective power to govern
10

Freedom of association and assembly is fully guaranteed in the Czech Republic. A law on political parties and movements regulates the formation and registration of all political entities. In the period under study, trade unions, interest groups and students organized an unprecedented number of public protests against government reforms and corruption in public procurement.

Association / assembly rights
10

Freedom of speech and the press are guaranteed under Czech law, and there is a strong independent media. During the review period, the influence of political parties on the media has further decreased. However, there is a left-right division among media outlets that reflects the given polarization of party competition. In 2013, media outlets were vocal in their support for individual candidates, especially during the second round of voting (respected publications such as *Hospodarske noviny*, a newspaper, and the weekly *Respekt* magazine, openly supported Karel Schwarzenberg while the tabloid *Blesk* supported Milos Zeman). The ownership structure of private media (i.e., print, radio and television) does not affect news coverage. Investigative journalists continue to uncover important links between politicians and civil servants, and report on embezzlement cases and criminal activities. However, the so-called Muzzle Law from 2009 restricts the work of investigative journalism by its strict requirements on revealing sources. Journalists thus have to be creative in citing evidence, such as police action regarding criminal activities, by excluding verbatim quotes. Under strong public pressure, Prime Minister Petr Necas successfully proposed an amendment to the Muzzle Law in August 2011, which effectively mitigated its scope by allowing for the direct citation of police-acquired information, which is of public interest. This amendment is based on the premise that public interest takes precedence over the rights of privacy of the person to whom the information pertains. However, some politicians complain about this increased transparency. For example, a member of the South-Bohemian regional government, Vaclav Sloup, demurred in January 2013 against the publication of his files from the communist period by the archive of the Ministry of Interior and the Institute for the Study of Totalitarian Regimes. Sloup protested that he never agreed to the public disclosure of his files that outlined his activities before 1989.

Freedom of expression
10

3 | Rule of Law

Collusion between democratic institutions has not been a serious problem in the Czech Republic. However, throughout the review period, tension existed between the president and the fragile center-right coalition government. This affected the legislative process, as the government struggled to find support for its reforms in the lower house of parliament. The intra- and inter-party skirmishes resulted in stalling some important legal amendments, such as a tax reform package, which was halted by six members of parliament from ODS. Furthermore, after significant gains in the 2010 and 2012 senate elections, the opposition now controls the Senate. Therefore a number of governmental bills have been delayed or vetoed in the upper house of parliament. In the period under study, 19 members of parliament left their parties or parliamentary party groups and became independent, voting ad hoc for or against governmental legislative proposals. In the aftermath of the crisis of summer 2012, three ODS members of parliament resigned and were replaced. In all cases, this coincided with their nomination to steering boards of state-owned companies.

Separation of
powers
10

Following scandals in 2009 which linked the Supreme Public Prosecutor Renata Vesecka and high-level governmental politicians, most notably the Deputy Prime Minister Jiri Cunek, serious concerns were raised about (unconstitutional) interventions into politics by other independent state institutions. The Cunek affair resulted in protracted debates in the government about Vesecka's tenure. She was unanimously dismissed from her position in October 2010 and worked as a public prosecutor until February 2011, when she resigned that post as well. In January 2011, Vesecka's previous position was taken over by Pavel Zeman, the former Czech representative at Eurojust (2004 – 2010). He stated as one of his main goals to regain the independence of the Supreme Public Prosecutor's Office. As an external expert and thus disconnected from the existing Czech prosecutor structures, Pavel Zeman gained a lot of legitimacy in the eyes of the public. In 2011 and 2012, Zeman launched significant personnel and structural changes in the office, which have been welcomed by the public and gave credibility to the government's anti-corruption agenda.

Independent
judiciary
9

The long waiting periods prior to a court hearing remains problematic, as more than half of all cases submitted to regional courts sits two years at minimum on the waiting lists.

The Czech judiciary is led by a triumvirate of courts, consisting of the Constitutional Court, which deals with cases of constitutional importance, the Supreme Court, which is the court of highest appeal in most legal cases, and the Supreme Administrative Court, which deals with administrative law cases as well as with political cases involving electoral disputes or the prohibition of political parties. Justices on each of these three courts are appointed by the president and approved by the upper house of parliament. The process of judicial appointments is quite transparent and monitored

by the media. However, as the majority of judges are named in the same period and thus also need to be replaced at the same time, problems arose in 2012 as the regular term of three judges of the Constitutional Court expired. The Senate rejected all candidates proposed by President Vaclav Klaus. One of the candidates was the former deputy supreme public prosecutor, whose links to the previous corrupt era were seen as too close. In the fall of 2012, the president of the Constitutional Court asked Vaclav Klaus to nominate new justices as soon as possible, as understaffing of the court seriously hindered its work. To reach lawful and binding decisions on important issues, the judicial college needs to have at least 12 members. Immediately after his electoral victory in January 2013, President-elect Milos Zeman reassured the public that he would nominate the first candidates to the Constitutional Court within three months of assuming office and that his nominations would be discussed with all party groups in the Senate and the president of the court (who served in Zeman's previous government).

The Conflict of Interest Act (2006) regulates situations where holding several positions is deemed to be in conflict with public interest, and defines sanctions against the abuse of power. However, prosecution of the abuse of office counts among the major weaknesses of the Czech rule of law. Citizens' trust in the justice system is undermined by ongoing political interference in the judiciary and impunity of many top politicians. Only a few high level political representatives were held responsible for abuse of office (mostly on counts of corruption) and such cases were not only contentious but also protracted. In the period under study, high-profile corruption scandals became regular occurrences. The parties most affected by political scandals were the governing ODS and oppositional CSSD. In March 2012, newspapers published wires of the Czech secret service, which revealed phone calls in 2007 between the then Prague mayor and deputy chairman of ODS, Pavel Bem, and the most notorious member of the Prague underworld (called the "Godfather"). In the transcripts it became clear that Prague organized crime had a major influence over political decisions made at the municipal council level, in particular regarding public procurement. Later in 2012, Pavel Bem lost his party position and was forced to resign on all his posts in an attempt to demonstrate Prime Minister's Necas dedication to transparency and active pursuing of anti-corruption politics. During the period under study, several ministers left the government over alleged involvement in corruption. As for social democrats, the then regional governor of central Bohemia and member of parliament, David Rath, was intercepted by police outside of his office in May 2012, carrying CZK 7 million (€280,000) in wine crates. Another CZK 30 million (€1.2 million) was found at his home. The politician was immediately taken into custody after being stripped of immunity, based on the Article 27 Par. 5 of the Czech Constitution that allows for arresting members of parliament if arrested immediately upon committing a serious crime. In June 2012, after an emotional

Prosecution of
office abuse

8

speech of the former governor, the vast majority of deputies (183) voted on allowing the criminal prosecution of Rath.

As demonstrated on these two cases, corruption in the Czech Republic penetrates national, regional as well as local governments. Numerous cases, which surfaced in the period under study, were related to embezzlement of EU funds and politicians accepting bribes from industrial companies and business. The government proposed two strategies in dealing with corruption. One of the first legislative efforts was the 2012 proposed amendment to the constitution, which would allow the Supreme Audit Office to scrutinize the financial management of municipalities and regions together with their businesses. The bill was rejected in the Senate by a coalition of social democratic and civic democratic senators (many of them also mayors) at the end of January 2013. Anti-corruption NGOs were very critical of this veto, which could have ensured more transparency and control over public finances.

Civil liberties are respected and their observance is supervised by the Constitutional Court, the Supreme Administrative Court and the Office of the Ombudsman (Public Defender of Rights). In association with the EU accession, the Czech Republic strengthened the protection of all forms of legal entities against (illegal) interference by public administrative bodies, including new administrative rules, which improve citizens' rights vis-à-vis the state. The delays in judicial proceedings constitute a persistent obstacle for Czech citizens exercising their right of access to the courts.

Regarding the submission of cases, including civil rights violations of judicial review, the number of complaints lodged by Czech citizens to the European Court of Human Rights between 2010 and 2012 sharply decreased in comparison with the previous period. There were 1,379 submissions in 2009 and 803 in 2012. Even if only a small number of submissions were declared admissible (30), the relatively high number of motions reveals that Czech citizens are embarking on legal procedures beyond the Czech judiciary to protect their civil rights.

The Office of the Public Defender of Rights (Ombudsman) continues to serve as a vital protector of civil rights. In 2011, the office registered 6,987 complaints, a 10% increase from 2010. From the received complaints, 62% were within the ombudsman's mandate and 38% fell outside. The structure of received complaints by legal area has not significantly changed and remains consistent over time. Complaints in the area of social security prevail, especially with regard to pensions and social benefits. The second largest group comes from issues of construction and regional development, closely followed by issues related to the army, police and imprisonment. The data available for 2012 confirm these trends.

4 | Stability of Democratic Institutions

The country's democratic institutions are effective and efficient. As a rule, political decisions are prepared, made, implemented and reviewed amid legitimate procedures by the appropriate authorities. The Supreme Audit Office (NKU) is an independent agency which audits the management and performance of state property, institutions and the national budget. Its functioning is regulated by the constitution, whereby the president and vice-president of the NKU are appointed for a period of nine years by the president of the Czech Republic, based on propositions of the lower house of parliament. This post has been vacant since February 2012, due to charges brought against the previous head of the NKU, Frantisek Dohnal, over his refusal to release documents for an audit of the office's financial management to the lower house of parliament. Based on the delivered sentence in 2012, his term was terminated as stipulated by law. The personnel situation of the Constitutional Court has also been unsettling, as three seats of the 15-member court are vacant and in the near future, this situation may pose a problem, as the court will not be able to fill the quorum as required by law. These vacancies were caused by a disagreement between the upper house of parliament (Senate) and the president, who appoints justices to the Constitutional Court.

Performance of
democratic
institutions
10

All democratic institutions are accepted as legitimate by all relevant actors. Most citizens support democratic institutions and there are no important groups seeking to change the Czech political system.

Commitment to
democratic
institutions
10

5 | Political and Social Integration

In the 1990s, the Czech party system quickly stabilized in the form of a multiparty system. The two dominant parties are the Civic Democratic Party (ODS) and the Czech Social Democratic Party (CSSD). The declining number of parties in parliament as well as the number of active political parties indicates that the Czech party system has consolidated. Nonetheless, this stability is not absolute, as there are new parties entering parliament where new political groupings are also formed. In 2012, a new parliamentary political party, Public Affairs (VV), was unable to maintain its unity after several of its members broke away and created a new political party, the Liberal Democrats (LIDEM). Due to several large-scale corruption scandals of high ranking politicians, the public's trust in political parties has all but disappeared.

Party system
9

There are no serious ethnic or religious conflicts in the Czech Republic that would motivate representation by political parties. Political polarization is caused by socioeconomic differences that are reflected amid party competition. In December

2012, there were 151 registered and active political parties and political movements (85 parties and 66 movements), 20 dissolved parties and movements and 16 suspended entities. The number of political parties represented in the parliament varies from five to six, whereby one, the Communist Party, has had no plausible coalition partners. In the review period, though, its coalition potential significantly improved at the regional level during local elections in October 2012. The Communist Party is currently a member of several regional governments (e.g., in southern Bohemia) despite some youth protests. There is a general trend toward a general consolidation of leftist parties. After regional elections in October 2012, the social democrats gained control of nine out of 14 regional governments. Prague and Liberec have remained under control of center-right parties. Communists won in two regions and also participate in coalition governments with social democrats. The Social Democrats also won the Senate by-elections in October 2012 and now control 38 of the 81 seats in the Senate.

Another important feature of the Czech political system is the importance of small political parties during negotiations over coalition governments. The situation is different at the regional and local level, where established political parties are often challenged by regional political groupings. This phenomenon is caused by the country's territorial diversities and locally based identities.

In the Czech Republic, there is a full spectrum of interest groups, ranging from social movements and community organizations to unions and professional organizations.

Interest groups
10

Czech interest groups have been increasingly involved in representing European interest structures through membership in European umbrella organizations. The most influential interest groups are business associations and trade unions, which also have considerable influence regarding labor relations and economic policy. During the economic global crisis, the economic interest associations became important partners for the government in seeking solutions to boost economic prosperity and national societal cohesion. They were also active in organizing or co-organizing anti-government protests and protests against government measures. New platforms, such as Stop Government (Stop vlade), ProAlt and Real Democracy (Skutecna Demokracie) joined forces with trade unions in organizing public demonstrations. The total number of protests organized through these platforms is unknown due to the decentralization of the requirement to notify authorities of protests. In 2011 there were many demonstrations against government reforms, with the largest occurring in May. Trade unions organized a strike to protest reforms in June. Protests continued also in 2012, when in April around 100,000 people gathered in Prague to protest against austerity measures and neoliberal governmental policies, demanding resignation of the government and early elections. In November 2012, during the 23rd anniversary of the Velvet Revolution, trade unions organized demonstrations in Prague and other Czech cities under the motto "Democracy looks different," caused by dissatisfaction with pension reforms, growing VAT, increasing economic gaps in

society and restitutions of church property. Apart from trade unions, students also took to the streets. During the so-called week of unrest, over 10,000 students demonstrated in front of the government seat in Prague against proposed educational reforms, which would lead to restrictions on academic freedom and the introduction of university fees.

In the Czech Republic, there is a clear disparity between the long-term and high general support for democracy and satisfaction with the democratic system, and the existing low satisfaction with institutions of representative democracy. In the recent years, there has been a slight fall in the overall satisfaction with democracy in the Czech Republic, from 51% to 43%. People associate democracy with freedom, participation and socioeconomic security. The level of satisfaction is higher among young and middle-aged people who have higher levels of education and good living standards.

The least trust in political institutions is held by citizens who report the greatest dissatisfaction with the current political and economic situation. In the review period, the percentage of citizens satisfied with the existing political situation in the country ranged according to public opinion polls from 10% (February 2011) to 4% (December 2012), while the percentage of dissatisfied rose from 62% to 79%. It is not only the performance of the government and parliament that underpins such low satisfaction ratings. There is a growing societal dissatisfaction accompanied by a slight fall in the overall belief in equality, justice and respect for human rights. More than half of the population (55%) thinks their freedom of expression is respected; however, only 38% believe they can have any influence over problems facing their municipality and only 8% think they have any say in society in general.

Social cohesion, social empathy and solidarity among social groups as well as between generations has been changing along with the processes of democratization, marketization, and individualization. Analysis of social cohesion, trust and solidarity reveals no change from the previous period, with only 15% of respondents thinking positively about these aspects of Czech society.

There are around 100,000 autonomous, self-organized groups, associations and organizations registered in the Czech Republic (not all are active). The number of organizations in individual regions of the Czech Republic differs, whereby there are “more” and “less” active regions. The difference between these regions is based on structural, cultural, historical and institutional factors. Nongovernmental organizations play an important role in local planning and the creation of regional strategies. The economic crisis has negatively affected the level of funding of many civil society organizations, especially organizations focused on public services, which are funded through local budgets.

Approval of
democracy
8

Social capital
8

As of 2014, a new Civil Code will come into force. It provides legal regulation of nongovernmental and nonprofit organizations, such as civil associations, clubs, foundations and other civil society organizations. The aim is to improve accountability and make funding transparent.

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

The Czech Republic is characterized by high human development, the lowest poverty rate among EU member states, and low inequality when compared with other post-communist countries. However, since 2010 the number of Czech citizens below the poverty line has been rising. In 2011, the percentage of citizens in danger of poverty was 9.8%. The majority are people without full-time or permanent employment, single-parent families and families with three or more children.

Socioeconomic
barriers
10

The gap between rich and poor is widening; there is an increasing proportion of people who live just above the poverty line or may fall below it. Rising unemployment and diminishing social welfare support for underprivileged social groups create economic barriers for significant parts of the population. Income inequalities exist especially between regions and between the capital (Prague) and the rest of the country. Other persistent income disparities are between men and women. On average, women earn only 84% of what men earn, with the same level of education in the same position. This also means that women are more in danger of poverty than men, as apart from lower salaries, they also receive lower pensions.

The unemployment rate increased with the onset of the economic recession. Gender and regional differences in unemployment rates persist; on a regional level, the difference accounts for around 14%. Long-term unemployment remains a serious problem and constitutes about 43% of the unemployed labor force. With the exception of the Roma population, there is no widespread labor exclusion due to poverty, education, ethnic or gender. However, it is an increasingly growing problem for citizens over 50 years old to find a job. Nationals of foreign countries also face labor discrimination as they are often hired through recruitment agencies and are among the first employees to be laid off. Moreover, they cannot rely on state social support and need to seek help among own family members.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	197218.2	198475.4	216011.4	195656.5
GDP growth	%	-4.5	2.5	1.9	-1.3
Inflation (CPI)	%	1.0	1.4	1.9	3.3
Unemployment	%	6.7	7.3	6.7	-
Foreign direct investment	% of GDP	1.5	3.1	1.0	5.4
Export growth	%	-10.9	15.4	9.5	4.0
Import growth	%	-12.1	15.4	7.0	2.3
Current account balance	\$ M	-4848.9	-7601.9	-6113.7	-4731.1
Public debt	% of GDP	34.2	37.8	40.8	43.1
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Cash surplus or deficit	% of GDP	-5.9	-4.7	-4.4	-
Tax revenue	% of GDP	13.0	13.5	13.7	-
Government consumption	% of GDP	21.5	21.3	20.7	20.8
Public expnd. on edu.	% of GDP	4.4	4.2	-	-
Public expnd. on health	% of GDP	6.7	6.3	6.2	-
R&D expenditure	% of GDP	1.48	1.56	-	-
Military expenditure	% of GDP	1.4	1.3	1.1	1.1

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

The Czech Republic has a rather complex legal framework to regulate business competition. In the review period, several problems regarding the market-based structure of the Czech economy surfaced. It takes a significant amount of time and money to set up a business, caused by the complex and rigid legal framework that regulates Czech business. According to the World Bank's Doing Business 2012 report, the Czech Republic ranked 136 out of 185 countries in the ease of starting a business. Complex and opaque bureaucratic procedures and protracted waiting periods negatively affect the development of business. Foreign investors often

Market-based
competition
10

complain about the poor enforcement of laws and a lack of transparency in state authorities' decision-making.

As for foreign direct investment (FDI), the Czech Republic remains an attractive location although the economic recession had slightly curbed this trend. To create more "business-friendly" conditions for foreign investors, an amendment to the law on investment incentives was adopted in 2012. According to its stipulations, investment incentives can be applied to stimulate manufacturing and technological centers as well as centers of strategic services. The amendment also established a new agency, the Institute of Strategic Investment Action, to provide direct capital support.

In 2009, the Act on eGovernment entered into force, which was meant to simplify and speed up the process of business registration. According to the European Commission (2012), the Czech Republic lags behind the average of EU member states in terms of information and communications technology and eGovernment. Corruption is another factor that stymies market-based competition.

The informal economy does not pose a serious economic problem in the Czech Republic. In the analyzed period, activities resulting from this sector constituted about 15% of GDP. Nevertheless, illegal and inexpensive foreign workers from non-EU countries remain an unresolved issue. The government adopted measures to impose high fines on those who employ illegal domestic or foreign workers. This has led to the transfer of several firms into "tax havens." Over 3% of Czech firms have their headquarters in such "tax havens."

Policies and institutions that set competition rules correspond to standards applied in the European Union. The Office for the Protection of Competition was established in 1991 as the central authority of state administration, responsible for creating conditions favoring and protecting competition, supervising public procurement, and consulting and monitoring the provision of state aid. An overview of the current activities of the office and cases it has investigated during the period can be found in publicly available annual reports, which also include statistical data and the agenda for the following period.

The public procurement law was amended in 2012, which also includes stipulations on the powers of the office during the review of public procurement cases. In 2011, the office investigated 171 submitted cases involving the misuse of a market monopoly. It imposed 89 fines, resulting in the total amount of CZK 28,815,000 (approximately €1,152,600). In 2012, in a first-time decision, the office imposed a fine of CZK 96.579 million (approximately €3.825 million) on four waste collection and disposal companies: A.S.A., Van Gansewinkel, SITA CZ and AVE CZ Waste Industry, for entering into prohibited agreements on market sharing that led to the distortion of genuine market competition.

Anti-monopoly
policy
10

The Czech economy is strongly export-oriented, and liberalization of foreign trade was essential for its economic success. Since 1995, the country is a member of the OECD and the WTO. As an EU member, the Czech government cannot negotiate new trade policies and act independently.

Liberalization of
foreign trade
10

The Czech banking system is stable and consolidated, whereby the banking sector was only marginally affected by the financial crisis. The primary bank of the Czech Republic and the supervisor of the Czech financial market is the Czech National Bank (CNB). The conduct of financial market supervision involves a range of activities encompassing licensing and approval proceedings, fulfillment of information duties, on-site and off-site supervision and international cooperation. The CNB is an independent institution and this independence has proven to be a key precondition for the successful implementation of monetary policy and a sustainable non-inflationary economy.

Banking system
10

Besides the CNB, there are several other important banking institutions. During the review period, the number of banks increased from 41 to 46, and none faced any liquidity problems. New small banking institutions have made a market breakthrough, due to the use of information and communications technologies and lower service fees. As for the ownership structure, the Czech banking sector is in the hands of foreign banks – out of the 46 banks on the Czech market, only two are state-owned and six are in the ownership of Czech entities.

In December 2012, the government presented amendments to the Law on CNB that were aimed at removing some legal discrepancies between the current law and the legislature of the European Union. It was later adopted by parliament. The new wording of the law allows for access to branch offices from third countries active in the Czech Republic. It further provides intelligence services with access to information, which was previously subject to strict banking secrecy. This information can be accessed without the client's consent as part of investigations in cases related to financial terrorism.

The term of office of four members of the CNB Board is expiring. As of the time of writing, all the current members were nominated by the current president from a group of candidates opposed to joining the euro zone. President-elect Zeman stated that he will aim to nominate pro-euro-zone candidates.

8 | Currency and Price Stability

The 2012 average inflation rate, expressed in the increase in the general level of prices of goods and services for the previous 12 months, was 3.3%. This is slightly above the tolerance level and 1.4% higher than in 2011. The main cause of the increase was

Anti-inflation /
forex policy
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the surge in prices in housing, water, energy and food. According to the current inflation predictors of the CNB, the inflation rate for 2013 should remain below 3%.

The Czech koruna (CZK) has been continuously stable and did not experience significant shifts during the financial crisis. The annual average for nominal exchange rates of the Czech koruna to the euro was CZK 24.6 (2011) and CZK 24.9 (2012). During the review period, the exchange-rate volatility of the koruna to the euro was quite low, and stable.

The Czech Republic has not fulfilled the criteria of entering the euro zone because of its budget deficit, which totaled 3.3% of GDP in 2011. The deficit was lower in 2012 due to austerity measures and the restrictive fiscal policies of the government.

The Czech economy slowed due to the world financial crisis and a subsequent recession, which has negatively affected growth rates that are expected to remain slow in following years. The initial growth in GDP in the first six months of 2011 was followed by a decline through the end of 2012. The positive balance of trade did not fully compensate for a decrease in demand for consumer goods and services, which lowered investment in construction, mechanical engineering and transport. Economic growth slowed in 2012 and the same is expected in 2013. The Czech National Bank (CNB) reacted to the unfavorable economic developments by lowering interest rates. Financial institutions' share of the total financial assets of Czech GDP was around 155% in 2011, far below the levels of the euro zone.

The government spending totals increased in comparison with the previous period, despite austerity measures introduced in early 2009. Public debt was 40.8% of GDP in 2011. In December 2010 the government adopted another series of austerity measures that curbed social expenses and was meant to reduce the growth of budget deficit. The measures did not bring the expected results however, and the government adopted another austerity package to reduce the budget deficit, consisting of savings starting in 2013. The deficit for 2013 is expected to reach 2.8% of GDP, 1.9% of GDP in 2014 and 0.9% of GDP in 2015. The government also introduced simplified procedures, administrative structures and duplicate procedures in the public sector, which are expected to result in savings. It further plans to reduce investment in renewable energy resources and temporarily lower valorization of pensions; it has already frozen some state expenses for 2013.

The government is committed to protect the Czech economy from the effects of the global economic crisis. It drafted and approved the annually updated National Anti-Crisis Plan (2009), the goal of which is to set targets for 2009 – 2012, and proposed the Anti-Crisis Package (2012). The main objectives target tax measures; fiscal rules; saving measures; anti-corruption measures; and competitiveness. In addition, the government also stresses the need for the coordination of economic policies and directing EU funds. The National Coordination Group (NGC) is tasked with

preparation for euro adoption, and regularly reviews the national plan on the adoption of the euro. However, the entry of the Czech Republic into euro zone is still pending due to a lack of clear political commitment.

9 | Private Property

Private property rights in the Czech Republic are respected, and government authorities regulate the acquisition, use and sale of property. Property rights are sometimes limited by overriding rights of constitutionally defined public interests, for instance by highway construction, the protection of immovable cultural heritage and environmental protection. However, to define what constitutes public interest is a very complicated procedure; the government has tried to push through new legal regulations that would be included in the Civil Code. In this respect, this would be a noticeable positive development in the procedures required for starting a new business.

The highly contested restitution of church property was finally organized in 2012. The Restitution Act was first adopted by the lower house of parliament in July 2012, then rejected by the upper house, the veto of which was overturned by the lower house. The law came into force in November 2012. The legality of the law has been since disputed by members of parliament representing the Public Affairs party, and submitted for review to the Constitutional Court. The court rejected the first proposal, whereby the second, submitted in January 2013, is under review. The total property return is expected to amount to approximately CZK 75 billion (€3 billion). The state will reimburse 56% of the property in estates. In three years – until the end of 2015 – the Czech state will continue to subsidize the church administration and pay the wages of religious representatives. As of 2016, the funding allocated for churches will be reduced by 5% per annum, which should lead to the full financial separation of state and church by 2030.

Private business and enterprises constitute the backbone of the national economy, but some large state companies remain. The privatization of state companies proceeds consistently with market principles. As the current government aims to reduce public budget deficits, it has started selling property. Despite long negotiations, some large state enterprises such as the Czech Post and Czech Airlines (CSA) have still not been privatized. In 2012 the Czech Post lost its monopolist position in the Czech postal market as a number of private entities started to provide postal services. The privatization of Czech Airlines has been such a protracted process that it will be difficult to find a potential buyer.

In general, the privatization process is sometimes influenced by the interests of powerful actors.

Property rights
10

Private enterprise
10

10 | Welfare Regime

The state system of social support is regulated by law and guarantees basic benefits to the whole population. There are no sectors or social groups in principle excluded from the welfare system. During the review period, the Czech social system has undergone some important changes, aimed at reducing the state's budget deficit through targeted initiatives for the reduction of social welfare payments and encouraging Czech citizens to take increased responsibility for their own health and welfare. Important social benefits have been cut or even completely abolished for a vast number of people in need, including parents, single parents, people with disabilities, pensioners and unemployed persons.

In December 2011, a reform of the pension law was adopted. The amended law has divided the Czech pension system into two independent pension pillars, which consist of the existing first PAYG pillar (pay-as-you-go) and a newly created second pillar that will be funded through capital contribution rates. There was no consensus on the proposed amendments to the law, both at the political level and among experts. The president vetoed the law but was outvoted in the lower chamber of parliament. The reform entered into law as of 2013. The pension reform was a reaction to unfavorable demographic trends and the existing unsustainable pension system, in view of a Czech average life expectancy of 77.4 years. The general interest in participating in the new scheme has been low. Interest was highest in the 35- to 44-year-old age group, where 8% was willing to opt for voluntary contributions.

In 2011 a new health reform was adopted, which entered into force in 2012. Given the growing costs of the current public health care system, the primary objective of reform is to ensure its financial sustainability and effectiveness by increasing the level of people's responsibility and participation in financing. In the period under review, 83.7% of health expenditures were funded through public resources.

Apart from maintaining a social security system that covers all risks for all strata of the population, the review period was also characterized by efforts to provide targeted and effective social care as well as preventing its misuse. A new tool, a combination of a payment and social identification card (sKarta), was introduced that will be distributed to all beneficiaries of social allowances, with the exception of pension and sick leave.

A permanent problem is low intergenerational solidarity. 2012 was announced as the European Year of Active Ageing and Intergenerational Solidarity, which sought to raise awareness on the contributions that older people make to society and provide them with better life conditions. Another goal was also to create an employment

Social safety nets
10

environment that would allow people over 55 to have greater job opportunities and chances for longer self-sustained living.

The Czech legal system guarantees equality of access to work, education and social services before the law. The implementation of EU directives has underpinned such guarantees. A legal and institutional system for the protection of people against discrimination based on gender has also been implemented. However, a structured support system allowing marginalized groups to overcome their initial disadvantages has been insufficient. This has been the greatest problem in respect to the Roma minority's access to education and employment. The ratio of Roma pupils in so-called special schools, dedicated to those with learning disabilities, is about 30%, significantly higher than the proportion of Roma overall in the Czech Republic. Such educational streaming means that many Roma children have poor chances to progress to higher education and later to good work opportunities.

Equal opportunity

9

Members of the Roma community are among the most vulnerable groups on the labor market. The employment rate of Roma in the studies during this period has not improved, which can also be because the majority of Roma live in structurally disadvantaged regions with long-term unfavorable job opportunities. Thanks to EU funds, new projects have been launched, which should lead to improvements for Roma and other disadvantaged groups, bettering their inclusion in society and in the labor market.

Due to rising housing prices, low-income Roma families who live at the poverty level have also been unable to find and maintain accommodation. In recent years, low-income Roma families have been moving out of cities into rural areas that provide them with affordable living conditions. On the other hand, there has also been a surge in territorial segregation, a widening social gap and the creation of excluded localities. This has intensified social tensions between socially excluded communities and the majority population in several towns and cities, which has resulted in waves of civil unrest during the review period.

11 | Economic Performance

Macroeconomic development during the period under review was influenced by the repercussions of the world economic crisis. The Czech economy has tempered its fall but the recovery has been slower than expected as industrial output has remained low. Compared to the previous period (until 2011), GDP per capita increased in 2011 but later decreased. The consequences of the recession are especially visible in the labor market. Compared to the previous period, the unemployment rate has increased only moderately and has remained under the average level of the European Union. The number of workplaces has stagnated and the downturn in construction and industrial production has slowed further. The return of some firms, such as Hitachi, in the Czech

Output strength

8

market is however a positive sign. Its renewed interest in the Czech market can be attributed to the country's qualified workforce and good geographical location, which allows for transborder cooperation.

The Czech national debt is moderate and the banking system underwent a consolidation prior to the financial recession. The main sources of banks' income are fees, rather than loans. Monetary indicators in the review period were expansive and the monetary reserve in the Czech economy outgrew nominal GDP. Interest rates also fell to their lowest levels in history.

To reduce the state budget deficit, parliament adopted an austerity package, in force as of 2013, which consists of increasing VAT (from 14% and 20% to 15% and 21%), reducing pension valorization by two-thirds and higher taxation for the highest income groups. The government also approved a series of measures aimed at increasing competitiveness and boosting the overall growth of the Czech economy. The prime minister explained that economic growth cannot be achieved at the expense of increased state debt and a sustainable financial balance of public resources.

Despite the recent economic recession, the government has been successful in maintaining a positive balance of trade by supporting exports through financial incentives without intervening in individual business initiatives and causing market discrimination.

12 | Sustainability

The Czech Republic has battled both a legacy of environmental damage and other ongoing environmental issues during the review period. As the repercussions of the global economic crisis hit in 2009, preference was given to strengthening industry and agriculture over environmental policy. In 2012, ODS members in government advocated a merger of the Ministry of Agriculture with the Ministry for Environmental Protection. In January 2013 the coalition partner TOP 09 firmly stated that such move would be unacceptable.

The cornerstone of Czech environmental policy rests in its obligation to implement EU legislation. Given the clear set of tasks and time schedules officially agreed upon during the EU accession, environmental protection and sustainable development are now an important part of the government agenda. However, the overview provided by the State Environmental Policy of the Czech Republic report offers a rather unsatisfactory picture. In most areas, the country lacks key environmental legislation. An important step was taken in 2011 with the adoption of a law on pollution, which comprehensively addressed the pressing issue of air pollution (in some regions the air pollution regularly surpasses the existing legal limits by hundreds of percent). In

Environmental
policy
9

particular, it focused on companies, which were considered responsible for pollution, and introduced gradual and rising fines. Between 2017 and 2021, fines will be raised by 350% and thereafter will increase on the basis of annual rates. It is expected that the government will be able to claim approximately CZK 870 million (€35 million) of fines per year as of 2021, and double the amount in following years. Most of these funds will be directly allocated to the State Fund for Environmental Protection. According to the government, the main reason for adopting the law was the duty to implement EU legislation.

Following EU accession, overall spending on environmental protection has stalled at CZK 20 billion (€800 million) per annum. Expenditure on environmental protection is close to the EU average of 1% of GDP (it was 0.95% of GDP in 2011). A key element of Czech environmental policy is the transfer of responsibilities to the private sector and local government, that is, to those who are most directly involved in waste management. Between 2009 and 2011, public expenditures for environmental protection increased as well as expenditures by municipalities and the central government, which is co-financing EU projects. The largest part of expenditures is allocated for clean air, followed by water and bio-diversity protection. The volume of EU funding grew significantly from 2006, reaching €800 million in 2013. In November 2012, a program entitled New Green Light was introduced, which consist of subsidies to households and public buildings with improved energy efficiency.

In the period under review, the main topics in the area of education were the introduction of state baccalaureates (maturita) and university tuition fees. Both issues were highly contested by the opposition and by the public and led to popular mobilization and protests. Introduction of a state baccalaureate aims at establishing comparative final exams for students at all institutions of secondary education. However, about 20% of students failed in mathematics during the first trial in 2012. It turned out that the tests were too difficult and students were insufficiently prepared by their schools. Under public pressure, Education Minister Petr Fiala intervened and lowered the pass scores on the test. Numerous other issues emerged, and the overall public evaluation of the program has been negative.

A second and even more contested issue in the area of education is higher education reform. Throughout 2011, protests among academics as well as the general public against spending cuts envisaged by the reform intensified. In June 2012, Fiala withdrew a reform draft, stating that sections on financial support for socially disadvantaged students needed significant re-drafting. He further reached an agreement with universities about accepting fewer students for the upcoming academic year to account for the reduced funding.

The main strengths of the Czech educational system are: increased cooperation between academia and applied sciences; increased involvement of universities in legislative and government decision-making; and the high social prestige of

education in society. The weaknesses of the Czech educational system are: a lack of state resources; steep inequalities in access to higher education; and limited involvement of the private sector. The effects of the global economic crisis led to an effective decrease of public expenditure on education from 2009 to 2011, both in terms of the proportion of GDP and actual volume of funding (according to the Eurostat data, by almost 7%). Public expenditure for research and innovation grew between 2009 and 2011 from 1.47% to 1.84% of GDP. However, over the last several years the structure of state spending on education changed profoundly, as only limited funding goes to applied industrial experimental research and to primary research. Furthermore, funding allocated to universities grew as funds were wired from the Academy of Sciences to higher education institutions. This led to regular open protests by researchers and scientists, warning the government that such a policy would lead to the closing of top research institutions and an effective brain drain, as young scientists would see no future in many Czech research institutions.

Transformation Management

I. Level of Difficulty

Socioeconomic conditions in the Czech Republic are relatively stable yet did markedly deteriorate in the aftermath of the global economic crisis. The Czech Republic does not have serious structural problems, as is the case of some developing states.

Structural constraints

1

The tradition of civil organizations in Czech history dates back to the 19th century. Under communism, civil society organizations were mostly subordinate to the state and in effect were moribund between 1948 and 1989. Following the Velvet Revolution, civil society revived and there are currently the three following types of groups: revived organizations from the pre-communist era; organizations that did not cease to exist under communism; and post-1989, newly created organizations. In the early 1990s, there was a sharp increase in the number of and membership in NGOs. This initial public enthusiasm for participating in civil society was replaced by an equally sharp decline in citizen activism. Within the last decade, membership and participation in civil society activities has been marked by consolidation of some prominent NGOs, while marginal ones have been closed. Consequently, there has been a widening gap between organizations that successfully adapted to the new post-communist conditions as opposed to those which were unable to catch up.

Civil society traditions

2

At present, there are no major ethnic, religious, or social conflicts in the Czech Republic. Most commentators explain Czech party competition by divisions along the left-right political orientation. In the last several years, the support for leftist parties grew, mostly in opposition to government reform initiatives. Social democrats and communists control the majority of regions and the Senate. The 2013 presidential elections highlighted socioeconomic differentiation as the most important determinant of potential conflict, with two important cleavages, between large cities, such as Prague, Brno, Plsen and Liberec, and smaller cities and rural areas. The main support base of President-elect Milos Zeman was people from the suburbs of larger cities, areas which were more affected by the crisis and face numerous economic problems. Where there was more support for Zeman, the region was also economically weaker. Similarly, economical cleavage and polarization can be observed between Bohemia and Moravia. As for key sociohistorical points of dispute

Conflict intensity

1

in the Czech Republic, reconciliation with the communist past and the ongoing disagreement about the so-called Benes decrees are still predominant.

II. Management Performance

14 | Steering Capability

Question
Score

There is neither a governmental office nor a parliamentary committee to deal directly with strategic planning. The framework for short- to medium-term development is based on the government's policy manifesto, which is presented to the Chamber of Deputies by asking for a confidence vote. In the period under review, there were two such presentations of government policy manifestos. The first was submitted by the Necas cabinet in August 2010 and the second followed the split of the Public Affairs party and restructuring of the government in April 2012.

Prioritization
8

There is skepticism toward strategic planning for three reasons. First, the duration of strategic plans spans the lifetime of a number of governments, which are subsequently not guided by one government vision. Second, the prognostic capacity of strategic planning remains weak, which represents a serious flaw for any current proposal. Third, there is no political consensus on what should constitute the core of a national strategic development plan.

There are several policy-advisory expert bodies within the government office, such as the National Economic Council (NERV), which is responsible for the formulation of imminent economic and anti-corruption reforms. Another example is the Research, Development and Innovation Council, responsible for R&D policies. While the former is an advisory body with no direct responsibility, the latter has policy-generating functions and other responsibilities on its agenda. In 2012, NERV proposed 40 concrete steps to improve competitiveness of the Czech Republic, including numerous transparency-related and anti-corruption measures, simplification of bureaucracy and improving the business environment. However, these recommendations are not binding and due to governmental polarization, it is unlikely that they would be implemented in the near future.

The overall implementation of government measures has been slow because of internal divisions in the governing coalition. Although the government set priorities and attempts to pursue them, a substantial gap remains between proposed goals and actual results. Apart from this, Prime Minister Necas lacks the formal means to sanction defecting members of parliament, especially among ministers from other coalition parties. In summer 2012, six members of parliament from the ODS party opposed the tax reform and endangered the very existence of the government. The

Implementation
7

crisis was resolved and the reform passed. However, as of February 2013, there are 19 unaffiliated members of parliament who vote ad hoc on crucial issues, on which the government coalition is in conflict with the opposition.

Three key issues constrained the functioning of the government and impeded its efforts for structural reform. First, the government did not hold a majority in the Senate, since the government parties lost 14 seats to social democrats (12) and independent candidates in the 2010 elections. In the 2012 elections, the civic democrats were able to defend only four of the 14 contested seats, while social democrats (gaining seven seats) and independent candidates were further strengthened.

Second, deep internal divisions within the parties of the governing coalition resurfaced. In May 2012, the Public Affairs party split up and some of its parliamentary members joined the opposition. Moreover, the government coalition was hit by another blow in September 2012 when six members from ODS refused to support the government proposal on a progressive tax reform, which nearly resulted in a vote of confidence. The proposal was previously also vetoed by the Senate, so Prime Minister Necas feared it would also be rejected in the lower house. Therefore, he postponed the vote on the reform for after the ODS party congress. At the party congress, the six party dissenters, who were close to President Vaclav Klaus, failed to substantiate their opposition and convince the party to support their stance. On the contrary, Necas successfully defended his post of party leader. Three of the six members later resigned on their mandate and the tax reform was passed.

Third, the disputes between the original founder and leader of ODS, President Vaclav Klaus, and the new party leadership re-emerged and again threatened to splinter the party.

There have been several severe failures of the government with a negative impact on the quality of provided public services, in employment policy, education and transportation, stemming from insufficient administrative capacity of the central public administration. The Law on Civil Service is still pending.

The organization of government and public administration remains relatively rigid. Much of the practice of governing has been tied in with the nature of coalition governments, reinforced by the inertia of officials and a lack of progress. Following the EU accession, programs were initiated to improve administrative practices and to take advantage of modern methods of management. In connection with the need to address growing budget deficits and to implement budget cuts, individual ministries conducted an analysis of personnel and spending within their portfolio in 2010. The results of this analysis were negative, which led the cabinet to adopt measures restructuring government portfolios. The original proposal went as far as abolishing two ministries and merging four others. However, this proposal met with opposition

from TOP 09 in January 2013. TOP 09 disagreed with the merger of the Ministry of Agriculture and Ministry of Environment and with the abolishment of the Ministry for Regional Development. Unlike other central and eastern European countries, the Czech Republic does not have a ministry dealing with EU issues and funds. As a result, the management of EU funds is scattered across various ministries, and activities and programs are not well-coordinated and many are poorly drafted.

15 | Resource Efficiency

The government makes efficient use of most available human, financial and organizational resources. The budgetary allocation of taxes, tax autonomy and financial decentralization have enabled regional governments to exhibit more autonomy in fulfilling their governing functions and manage basic infrastructure. EU regional funds constitute an important resource for regional development. However, due to severe irregularities in financial administration and misappropriation of EU funds, some regions – in particular in the north – had their access to EU funds frozen and many regional projects have been stalled. This will negatively affect the state deficit, as the government subsidizes the projects with cash advances.

Efficient use of
assets

7

The government tries to reconcile conflicting objectives and interests of coalition partners, but only with partial success. The 2012 regional and subsequent 2013 presidential elections indicate a significant weakening in support for the main coalition partner, the civic democrats, and a strengthening of TOP 09. This threatens the balance of power within the governing coalition, as TOP 09 becomes more ambitious and pushes more strongly for adopting some of its objectives, such as the fiscal compact and the need for a concrete roadmap to joining the euro zone. Tensions in the governing coalition are debilitating the executive power of the government. The necessity to negotiate every vote in the parliament and a reoccurring need for overruling the veto of the Senate force the government to accept numerous compromises and implement only half-hearted reforms. Additionally, these reforms are insufficiently communicated among the different ministries as well as to the public, which led to a strong opposition – especially with the second pillar of pension reform, which has been so far unsuccessful (less than 10% citizens have opted for it and the promotion of the program by relevant insurance institutions is lukewarm).

Policy
coordination

7

The legislative plan of the government divides tasks among ministries and other central bodies of the state administration and sets deadlines for the submission of bills to the cabinet. Along with other ministries, the government takes part in the inter-ministerial consultation process. However, strong barriers among the ministries exist; cross-cutting project groups are rarely established.

The Czech Republic has long been battling against corruption. Although the most recent cabinets have placed fighting corruption high on their agenda (it is at the top of the agenda of the current government), most have failed to propose concrete anti-corruption measures in public administration, police and politics in general. Corruption was the main topic of the 2010 parliamentary elections and was the pillar of the created government coalition. The fight against corruption is also prioritized by the Ministry of Defense, which has identified numerous corruption cases in public tenders in defense spending. Similarly, the Ministry of Interior has aimed to fight corruption in police and public administration.

Anti-corruption
policy
7

In December 2012, the government published a second strategy plan against corruption entitled, “From Corruption to Integrity” (for 2013 and 2014). The strategy plan positively assessed achievements of the first anti-corruption strategy (from 2010 for 2011 – 2012) in the following areas: making available information on the fight against corruption; preventing the manipulation of the allocation of advocates; supervising the execution of activities; preventing the manipulation of notary writings; supervising judicial activities; and strengthening the protection of the public interest in administration. However, the voice of civil society, the media and the public were not as positive.

The 2012 strategy has the following priorities: a law on civil servants; an amendment of the law on the conflict of interest; a law on access to information; a law on making public final owners; the protection of whistleblowers; general financial control and audit; an intellectual property state policy; a strategy and methodology of public procurement; a law on the public prosecutor’s office; and an anti-corruption program. Moving beyond strategies, the government’s success in implementing concrete measures has been limited. In January 2013, the Senate vetoed an amendment to the constitution which would afford the National Audit Office supervision over municipal and regional bodies as well as companies in which they hold majority ownership rights. The fact that the coalition, which vetoed the amendment, was formed by social and civic democrats again highlights the diverging views on anti-corruption policies in the governing coalition.

16 | Consensus-Building

There is a general consensus among the major political actors and the public on the merits of democracy and market economy. Nevertheless, the rising support of the Communist Party in recent elections indicates some resentment of the old regime. After the turmoil of the first and second Topolánek governments, Prime Minister Necas was able to persuade his potential coalition partners that his party was looking for a fresh start. However, two years and multiple corruption scandals later, it became evident that the civic democrats were internally divided and not fully dedicated to government goals. The effects of the global economic crisis, government reforms and

Consensus on goals
10

the first direct presidential elections in 2013 strengthened the confrontational character of Czech politics and deepened the left-right political gap. Furthermore, social democrats aspiring to victory in the next round of elections plan on revoking many adopted reforms. There is thus a lack of general consensus on goals and reforms and the overall course of the political process. This includes the country's participation in the fiscal compact and euro zone membership, as well as the EU integration process. It remains to be seen whether President-elect Milos Zeman, to take office March 2013, will act to bridge or deepen these divides.

In principle, there are no anti-democratic veto players in the Czech Republic. Yet amid Czech political parties, there is a growing tendency to bloc governmental decisions. The main political actors recognize the necessity of reforms. However, experience to date suggests that small governing majorities in the lower chamber, together with the relative fluidity of the party system, do not facilitate the implementation of major long-term reforms. In the last four parliamentary elections, a new political party entered parliament and was part of the governing coalition. The party however was unsuccessful in winning a second term in parliament. A new party even emerged amid the governing coalition itself, and government has been increasingly reliant on unaffiliated members of parliament to pass reforms and overrule Senate vetoes. In 2012, during the Senate and presidential elections, populism strengthened both in major political parties and among smaller groups. However, strong tendencies toward radicalization cannot be observed.

The political management of social cleavages in the Czech Republic is rather poor, as the main political actors contribute greatly to the increased polarization of the underlying socioeconomic divisions in Czech society. The strengthening in 2012 of the Czech Communist Party, which unlike other communist parties in central and eastern European countries has never undergone a reform process, points to the end of the party's isolation at the national level. However, personnel and other policies of the communist party in regions under its control shows that the party failed to address its role in the 1948 – 1989 period, has not changed its views and is willing to intervene in areas such as education only to revise the discussion over its past historical role in the country. For example, a communist member of a regional government in south Bohemia repeatedly intervened into the review process of history curricula in 2012, as he believed the texts erroneously addressed the role of the communist party in the 1950s political processes. A subsequent school inspection did not discover any irregularities, and students, parents and teachers of numerous schools in Ceske Budejovice among other regions repeatedly protested against the participation of communists in the regional government. To date there have been four large-scale demonstrations and several petitions.

Anti-democratic
actors
10

Cleavage /
conflict
management
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With the exception of the Roma community, which has been disproportionately affected by the economic crisis and increasingly targeted by populists, the government has not had to deal with any ethnic conflicts.

The 2013 presidential elections re-opened an important and highly contested identity question, namely the rights of Germans from the border regions who were forced out after World War II. In a highly populist fashion, Milos Zeman used this sensitive issue to reignite fears among many Czechs that if he lost, his contender, Karel Schwarzenberg, would encourage descendants of the expelled Germans to reclaim their property. For many years, Schwarzenberg has been openly critical of the severe human rights violations that Czechoslovakia committed after the end of the war. The situation escalated in a series of media attacks against Schwarzenberg, who was also accused of being a foreigner by his opponent in the presidential debates. The Czech media generally presented the expelled Germans as war criminals who did not deserve any sympathy, and whoever opposed this premise was labeled as unpatriotic. The second topical issue of the presidential election targeted the returned pre-1989 Czech emigrants. According to many key political figures, including President Vaclav Klaus, nationals who had spent a significant part of their life in emigration and did not live through the communist experience were thus unable to identify with the main underlying issues of Czech society. The communist experience was presented as intrinsic to the Czech national identity.

At the time of writing there are more than 100,000 civil society organizations in the country. However, the government only rarely involves civil society in the policy cycle, marginalizing its role and influence in policy-making. Interest groups and civic organizations have the opportunity to express their opinion and make comments on bills when they are under preparation. The government's legislative rules define which entities are considered to be legitimate "commenting actors" during a consultation period. In this respect, trade unions and employer associations have the opportunity to make comments on bills dealing with social and economic issues during tripartite meetings with the government in the Council for Economic and Social Accord. The consultation process has become more open, thanks to the electronic publication of legislative norms and regulations.

Civil society participation
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Reconciliation with the past, or better the lack thereof, became one of the central themes of the 2013 presidential elections. The Benes Decrees, a series of laws most often associated with the deportation of Germans and Hungarians from Czechoslovakia in 1945 to 1947, were criticized by presidential candidate Karel Schwarzenberg as not consistent with contemporary human rights regulations. Schwarzenberg stated that under current international human rights norms, Benes would stand trial at the European Court of Human Rights (ECHR) or the International Court of Justice at The Hague. Schwarzenberg's opponent, Milos Zeman, used the mobilization potential of this highly contested issue and seized his opportunity to misuse the Benes Decrees as the focal point his accusatory campaign. Numerous

Reconciliation
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advertisements appeared in the media (including on the first day of the second round, which is against the law), warning the public that Schwarzenberg was being supported by organizations of deported Germans and would allow for the return of property to descendants of these Germans. Although Schwarzenberg, and numerous other experts, clarified that the Benes Decrees are unchangeable, the irrational fear prevailed. This case demonstrates that Czechs are not willing to open this chapter of its history for public debate and are unwilling to address the issue of the so-called wild deportation, associated with mass violence and murders. However, younger generations are increasingly questioning important chapters of Czech history, including the deportation of the Sudeten Germans, the political processes of the 1950s, the aftermath of the 1968 Soviet invasion and the death of student Jan Palach.

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After accession to the EU, the government's activities have adapted to, and are strongly influenced by, the EU's legislative framework. There was some derogation from specific provisions of the *acquis communautaire*, and this is particularly evident in the case of Czech bureaucracy. In the period under study, the impact of the European Union in promoting domestic reforms was weakened by domestic political struggles. Adoption and implementation of new legislation emanating from Brussels is thus rather slow and encounters persistent Eurosceptic opposition, mostly led and encouraged by Vaclav Klaus. This ought to change with the newly elected President Milos Zeman, who describes himself as Eurofederalist.

Effective use of support

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In general, the government acts as a trustworthy and reliable partner in relation to the international community. By joining the European Union, the Czech Republic acquired greater credibility within the international business community. The Czech Republic is one of the few EU countries which has kept its AA- credit rating. However, in 2011 – 2013, the decision of the Czech Republic to oppose the fiscal compact in combination with a lack of credible plan to implement the euro, inconsistent attitudes toward the European integration process and numerous scandals associated with the use of EU funds, resulted in marginalization of the country in the European structures.

Credibility

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In addition to the membership in the European Union, the Czech Republic is also a member of the Visegrad 4 (V4) group. In the eyes of the European Commission, regional groupings like the V4 are useful in delivering a valuable and effective regional response to the community's policies. Efforts to define common interests in the European Union have resulted in strengthening V4 regional cooperation. For the EU presidency, though, these activities assumed less importance. Under Prime Minister Petr Necas, the government took less pro-European stance than its predecessors, stressing its policy statements on national sovereignty in the European Union. However, both the coalition agreement and the policy statement of the

Regional cooperation

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government were rather abstract in regard to regional cooperation. Reviewing the actual activities within the group in the period under study, we can observe that due to the varying effects of the global economic crisis on central and eastern European countries, regional cooperation decreased in comparison to previous periods, as each country has focused on domestic issues.

The Czech Republic is fully integrated into international structures. The government sees Czech membership in NATO as the cornerstone of the country's external security. External security has been further strengthened by taking part in foreign military missions under the NATO command structures in Afghanistan (from 2008 until present) and the U.N. peacekeeping missions in Kosovo (KFOR, 2002 – 2011) and Syria (UNSMIS, from May 2012 until present). The main internal security issues remain the fight against political extremism.

Historically, the Czech Republic maintains strong and positive relationships with Slovakia. The relationship to Germany is more complex and due to the nature of the presidential campaign, which threatened to negatively affect the relationship with Germany, President-elect Milos Zeman ought to address this issue early on in his term. However, the end of Vaclav Klaus's presidential term could mean a significant decrease in political Euroscepticism and a more active role of the Czech Republic in the EU integration process.

Strategic Outlook

Generally speaking, there is a considerable room for further improvement politically, economically and in regards to the EU membership. Globally, the Czech Republic needs to strengthen its international role, in particular by changing its position on European integration, the fiscal compact and the euro zone. Regarding the sharp partisan division between the left and the right, as well as the deepening party divisions on both sides of the political spectrum, a key goal should be to find consensus on basic goals for Czech society as well as a political agreement on the desired level of state intervention in the economy, the desired level of social welfare provisions and the degree of wealth redistribution. The key areas for reforms are strengthening the capacity, accountability and efficiency of public administration (including the need to update the Czech constitution and enact a Civil Service Act), independence of the judiciary, public procurement, integrity and anti-corruption measures.

The Czech Republic faces a number of important policy challenges. The Czech economy continues to be overly dependent on foreign investment by multinational companies and on the car industry. In both areas, Germany and German companies represent the main partners; it is therefore imperative for the President-elect Zeman to nurture positive relations with Germany. In the wake of the world economic crisis, many international firms have left the Czech Republic, moving eastwards to economies with cheaper and a less-skilled labor force. However, in the period under study, several companies re-opened production in the Czech Republic. The main reasons are the country's skilled workers and a good geographical position, which allows for cross-border transactions and transfers between the various Czech and German branches. To sustain its competitiveness, the Czech Republic must strengthen its vocational training, by introducing dual programs, consisting of training in companies and education in practical skills. Some companies such as Skoda Auto can serve as an example.

Furthermore, to make economic growth sustainable, the Czech government needs to pay more attention to research, innovation and education. Moreover, investment in R&D by both the public and private sectors must be increased from its current underfunded level. An important step here is the promotion of closer cooperation between institutions undertaking primary research and industrial research. The Czech government must also adopt measures to increase the percentage of the population participating in higher education to improve the international competitiveness of the Czech educational system and thus the economy, too. Last but not least, the government must target family policy issues, in particular by strengthening support for families with children and enabling women to return to work after maternity leave. In 2012 and 2013, the first programs, funded by the European Union, were started in Prague, allowing single mothers and women from socially weaker backgrounds to return to work by providing free-of-charge and in-house baby-sitting. Furthermore, the government needs to create a legislative framework conducive to the establishment of on-site company childcare. Undoubtedly, other factors such as immigration will offset some of the negative effects of the demographic change; however, if the offsetting process

is to work, the Czech Republic must become more proactive in attracting skilled migrants and integrating them into Czech society.

Economic development has for a long time been confronted with the need to reduce the budget deficit. Under the current economic crisis, the budget deficit continues to grow as any improvement in the fiscal situation is more strongly associated with reducing mandatory expenditures and social welfare spending than in the past. Unfortunately, establishing firm foundations for fiscal austerity is not aided by a fragile political equilibrium where bold policy reforms can potentially lead to the fall of government. Regardless of such political constraints, the demographic change and increasing unemployment call for the urgent reform of the Czech welfare system. An important goal is to restructure the health care and social security systems, carefully considering the impacts of such reforms on the social and economic conditions of the population. Efforts of Prime Minister Necas in this field met with strong opposition, both in the parliament and among the public.

To increase executive capacity, the Czech government needs to expand its strategic planning capacities and continue with the modernization of public administration and de-politicization of the executive. For policy-making to become more coherent, interministerial coordination needs to be strengthened. This requires a strong governmental position though. Capacity-building would benefit from regular monitoring of institutional arrangements, transparency of public procurement and introduction of strong integrity measures.