Czech republic in the EU – Annual Report Card

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Reality

Our experience after a year's membership in the EU is moderately positive and soberly hopeful. Let's divide the consequences into three groups:

Negative Expectations and Catastrophe Scenarios Proved False

If we start modestly, we can say that throughout the year **there was no significant negative shock to the economy** which could be directly or indirectly attributed to accession to the EU. This is relatively good news, in particular in the light of the number of catastrophe scenarios outlined in the period shortly before accession. Before EU accession, critics of entry most frequently used "arguments" showing that prices would rise without corresponding growth in income, external competition would "crush" our weak, inexperienced producers and retailers, etc. Obviously, nothing like this has happened. Membership has not caused any direct or indirect shocks. **There have been no destructive consequences for price levels,** with the exception of cosmetic price growth caused by the one-off need for tax harmonisation (VAT, excise duties). Tax harmonisation relatively visibly made some services more expensive. Although some providers seem not to have been very opposed to this (telecommunications, information services, legal and advisory services), restaurant owners have still not come to terms with the increase in VAT to 19% and the prospect of a similar step is a nightmare for hotel owners and accommodation providers after 1 January 2006. This led to both an increase in the price of these services and, in particular, a significant reduction in margins, which could ruin restaurant owners. The situation with customs duties is different. The definitive cancellation of customs duties and barriers to trade inside the EU and the transition to a common customs tariff made a number of commodities cheaper – this is clearly visible in terms of wine and alcoholic drinks, as it is with food of exotic origin. However, the general impact on the price level is negligible here. The third type of consequence is not a product of customs or taxation policy, but of EU regulation of another type – for example production quotas. This concerns, for example, sugar, whose production capacity here is higher than the expected ceiling for the next period. This has contributed to an increase in the price of sugar, which was more than cosmetic. **Alterations to the price level, however, were very slight. After a few months inflation started to fall and the Czech Republic again became a low-inflation economy**.

The only more serious problem is the (increasing) deficit in trade in agricultural commodities and food, in particular with Poland. Obviously, we cannot deal with this by imposing customs and non-customs barriers, only by creating conditions similar to those enjoyed by Polish farmers. Analogically, albeit indirectly, our internal market was affected by the rules of the EU Common Trade Policy on trade with third countries. We are specifically thinking of imports of footwear and textile products from China, against which quantity quotas on imports from China were cancelled on 1 January 2005 for the whole Union. These measures could have a destructive impact on domestic producers.

Positive Expectations Proved True

If we don't want to be satisfied with the above, we should point out that, due to EU accession, **our economy is a relatively very decently growing organism** (in particular in comparison with the whole EU-25 and in particular with the EU-15), as is shown by the very positive medium-term outlook. In comparison with the other new countries, however, the dynamism of Czech growth is not that great, and, in particular in the Baltic States, Slovakia and, recently, Poland, we can find a recipe for above-average growth.

It seems that quite a lot of positive expectations have been met. However, we could ask to what extent this relatively good economic growth was influenced by EU accession. Nevertheless, the positive medium-term outlook is another reason for a positive assessment. The impact of accession on this result is clear. Evidently, the greatest positively affected figure is, without a doubt, **foreign trade**. **The reported dynamism in import and export growth is quite enormous and clearly confirms a significant increase in business and commercial transactions involving Czech entities in the enlarged EU.** Even more positive is the fact that exports were even better and, after many years, net exports were a positive contributor to GDP growth. It's clear that purely economic trends affected foreign trade figures, but EU membership undoubtedly made a significant contribution to the trends described above. Strengthening of foreign trade was accompanied by corresponding growth in international freight and passenger transport. The only negative can be seen in the economic consequences of the transport boom and a worsening of the quality of the transport infrastructure. The effect of enlargement can also be seen in the **continuing inflow of direct foreign investment,** which has certainly not stopped; in addition to the usual reasons, companies and their production activities have recently been moving from traditional member countries to new member countries, including the Czech Republic, primarily for cost reasons and due to the markedly simpler administrative procedures after 1 May 2004. No change in foreign investors' behaviour or their view of Czech reality is yet clear; this is a factor which will become evident after some time. Nevertheless, the fact of our membership represents a sort of improved reference for our territory, an improved argument for our good name. But – as we know – it takes a long time to change behaviour and opinions. Even though Portugal has been a member for almost 20 years and Greece for 24 years, these countries are the "poor relations from the south" in the eyes of the "founding fathers".

The first year of our membership confirmed that **EU funds are no chimera, but reality;** despite the fact that there are a number of complaints about the difficulty of getting them and technical, administrative and strategic shortcomings. Approximately 5,000 project solvers with support from these funds will evidently tell you the opposite. A total of over CZK 30 billion found its addressees, although some Operating Programmes registered far more demand than they could cope with and the potential of others was not fully utilised. From the date of accession to the end of this year the realistic figure is approximately CZK 50 billion. This number may not save the economy as a whole, but it can significantly help those who respect the rules and the briefs for the various projects. In any case, it seems that different EU funds were useful to differing degrees.

On the other hand, it can be said that **Czechs are not taking advantage of and are very badly informed about direct grants and loans** awarded directly by the European Commission.

An assessment of drawings on EU funds should certainly not be solely critical. With regard to the fact that we entered the current programming period at the start of the second half and did not have much opportunity to influence it in our favour, it should be pointed out that the volume of funds flowing from EU funds is **much higher** than in the pre-accession period.

Regarding the readiness of Czech operators for the conditions of EU funds, we can say that advance preparation was a rarity. Most Czech operators followed the example of the other countries which acceded to the EU (EC) before us. This means that they knew that there were some funds, but they learnt to recognise and use them **as they went along**. In comparison with the other new members, Czech operators in no way stand out, either for good or for bad reasons. Everybody learns when they face a practical challenge. It is the case that being prepared in advance is good, but preliminary, theoretical preparation cannot replace practical experience.

Unfortunately, there are still areas in which projects cannot be submitted. These are projects within the **Human Resources Development Operating Programme,** where some projects focusing on education activities were opened for submissions at the start of this April and some focusing on long-term, lifelong education and professional training are still not open for submissions.

Certain specialised companies audited the performance of services related to EU funds by government bodies and found some serious errors. They **are being rectified slowly;** here it is also the case that people are learning by experience and have to acquire many new skills. Some errors are being rectified; others, for example related to the quality of the assessment and evaluation of successful projects, will evidently take longer to deal with.

Some experience indicates that assessment is not always objective; some assessors either consciously or subconsciously push some projects or are against others, without this being deserved. It is said that some assessors are linked to some advisory companies which prepare projects for clients. They are also criticised for excessive delays, which block the rapid and flexible approval of projects. It is also the case here that everybody is still learning. And, given the whole picture, I don't think there are a lot of problem cases.

Some Effects Absent Due To Short Time

A year was **too short a period for expectations in the field of structural reforms and a fall in the unemployment rate to be met**. It is probable that new business opportunities will lead to the creation of new job opportunities; a year, however, is too short for this effect to be more visible. At first glance it appears that nothing has happened in these areas. Nevertheless, the demands on the labour market have increased and structural reforms will be made under the pressure of EU policies (New Lisbon, New Financial Framework).

All in all, it is clear that the **overall view and impression are definitely positive**.

Challenges

By coincidence, the first year of our membership of the EU came at a time when the EU itself is dealing with some matters which are key to its future existence. The Czech Republic has this opportunity to help resolve them, in accordance with its real strength and options. There is reason to believe that the key challenges for the EU's future and present include, in particular, the negotiation of appropriate conditions for the **New Financial Framework 2007 – 2013**. This is nothing other than the negotiation of an appropriate amount of resources for EU funds in the future. Current trends indicate that the Czech Republic will be able to receive approximately four to five times more funding in comparison with the present. The second strategic matter is the implementation of the **New Lisbon Strategy.** Future strategic developments in the EU will be based on a connection between the New Lisbon Strategy and the New Financial Framework and each member state can find some inspiration for the creation of its own national strategy based on common European themes. And the third challenge, which the Czech Republic's attempts to meet are not even slightly convincing, is the process of **ratifying the Constitution for Europe**. The Czech executive has not even adopted an opinion on the ratification process, not to mention the total lack of an information campaign by the government. This is very different to the other member countries, never mind the fact that six countries have already smoothly ratified the Constitution.

We believe that the adoption of a clear opinion and a scenario about how the Constitution will be ratified here, leading to its subsequent ratification, would be very desirable. Although it is not formally an optimum document (unreadable, too long, unattractive) and simplifies the previous supreme legislation, it introduces some things necessary for the functioning of the Union and does not limit the role and position of nation states. **It does not contain any fundamental revolution,** as its critics claim.

The Czech Republic should appreciate that it has an opportunity to say something about matters fundamental to the future of the European continent, that it can learn (little Luxembourg could serve as a permanent positive example of how EU membership can be used to best develop the national economy and society) and that it can pass on its own experience to those who are interested in it. Mixing cultures, comparing experience and looking for the best solution in competition with each other are values which should be respected. This is another reason we can view the first year in the EU as a **modest positive and with sober hope**.

The fourth key challenge is **choosing a path to the Euro**. The joint plan by the government and central bank, which assumes a target date of 2009-2010, is still valid, but most people now assume the later date is the right one. So the date is being moved, not visibly, but somewhat furtively. The changes on the CNB's banking board could indicate (or perhaps confirm) that our central bank is not bending over backwards to get into the Eurozone as soon as possible. Intuitively, it seems that the last year of this decade is the soonest possible date for our entry to the Eurozone.

Some neighbouring countries are more active in this regard and are attempting to enter the Eurozone earlier. Slovenia, Lithuania and Estonia became **members of ERM II** two months after their accession to the EU. Even the others, which – in our opinion – are less well prepared than the Czech Republic, are at least verbally demonstrating their readiness to enter the Eurozone earlier than us.

We can see this effect more in the perception (external perception) that those in the Eurozone, or those trying to get there as soon as possible, are somehow "better" than those who are not yet there. We believe that it is not that important economically if we are there a year or two earlier or later. **Real convergence** for membership in the Eurozone could only be prevented by a very few things, if at all, assuming we do not enter at an unrealistically strong exchange rate. On the other hand, even outside the Eurozone we can only dream of monetary autonomy. We would be highly likely to copy the Eurozone's monetary parameters. We think that, with regard to inflation and interest rates (the exchange rate differential is currently negative) and exchange rate stability, we should certainly not hesitate to enter the Eurozone. The issue is compliance with the **Convergence Plan** and the ability to reduce the deficit and significantly not accelerate public debt. At the current time compliance with the Convergence Plan looks relatively very satisfactory. And many of us remember how the Maastricht criteria were assessed at the end of the 1990s; it was diplomatic ability rather than statistical arguments that played a key role.

We should also be aware that there is a certain risk factor in the event some nearby countries adopt the Euro significantly earlier than we do. This risk is relatively realistic, although not so much in the case of our closest neighbours, who are most often compared with us. It is evidently greatest in relation to Slovenia, Lithuania and Estonia. On the other hand, it now seems that the Visegrad Four will enter together, or only with very small time differences.

In addition, the risk does not have a fundamental basis, but is only a risk concerning our good name and reputation. If a country is in the Eurozone, it is attractive for investment and business. It would obviously be a problem if everybody were there apart from us; in this case we would quite probably lose out on a number of business opportunities; purely due to ease, transparency and transaction cost savings investors would prefer countries where the Euro was used.

Both for companies and households the advantages of the Euro are the **elimination of transaction costs** (costs related to transferring money from one currency to another), a common currency environment, greater monetary transparency, **the elimination of exchange rate risks** in the Eurozone, the high probability of permanently low inflation and the fact that, at the current stage of integration, a common currency is a logical supplement to the Single Market (where there are no barriers to trade, capital, and persons, currency differences are not what we need).

It is occasionally claimed that the Euro should not be adopted before we start the necessary **reforms to the pensions system and health care.** Given the distribution of powers in the EU between institutions and nation states, we are of the opinion that they are two parallel matters. A number of countries in the Eurozone still face the challenge of starting to reform health care and pensions. Health care and pensions will long remain autonomous parts of each nation state; EMU, the Euro and the common monetary policy are, however, the sole province of EU institutions. In addition, from the long-term viewpoint, under the Stability and Growth Pact the costs of these reforms will be shifted in time and will not be included in the deficit in the first period, which may facilitate some countries' entry into the Eurozone in the short term.

Conclusion

There is reason to believe that **EU accession has certainly helped the Czech Republic.** New business opportunities have opened up, students have gone to study in other countries, EU funds have become a reality. We have become members of a club whose rules will help us, provided we observe them. Membership is also never-ending inspiration to follow successful models (Luxembourg, Ireland, Finland). Some effects will take years or decades to be felt and one year is too short a time for them to be appreciated – we are thinking of changes to the economic structure, increases in wealth, more efficient science and research, new, modern jobs, etc.