

## 2 Economic Policy

### 2.1 Objectives

The economic policy of the Czech government focuses on promoting growth, reducing unemployment and increasing the economy's competitive edge. During 2005, the government adopted two important strategic documents defining the economic policy objectives and priorities for the upcoming years: the Economic Growth Strategy for 2006 to 2013 and the National Reform Programme. In keeping with the re-launched objectives of the Lisbon strategy, which the government has fully endorsed, the reforms are geared to strengthening economic growth and creating jobs.

### 2.2 Priorities

#### Fiscal policy

The most important priority of the Czech Republic in the macroeconomic area is the consolidation of public finances. The ongoing process of public finance reform is focused on gradually reducing the Maastricht public deficit to GDP ratio so that a sustainable level of under 3% of GDP may be reached by 2008. During the next three years, the government has committed itself to adopting a strategic decision for stabilising the pension system and the system of healthcare financing.

#### Monetary policy

Monetary policy, based on the inflation targeting regime formulated in the Long-Term Monetary Strategy of the Czech National Bank (CNB), should help sustain low and stable inflation. For the period starting from January 2006, the inflation target is defined as 3% year-on-year CPI growth with a maximum deviation of one percentage point in either direction. Such an inflation target creates conditions for meeting the convergence criteria for inflation and consequently helps to maintain the desirable space for a positive inflation differential vis-à-vis EU countries.

The Czech Republic is preparing to join the Eurozone in 2010. In the period leading up to this date, it intends to remain in ERM II (Exchange Rate Mechanism II) for the required two-year period. Preparations for membership were already launched formally in 2003 upon adoption of the Czech Republic's Strategy for Eurozone Accession. On the basis of this document, an assessment is made every year on compliance with the Maastricht criteria and on whether the country is prepared for accession.

The recent results of these analyses show that the Czech economy is converging with the economic level of Eurozone countries and that the process of cyclical adjustment has accelerated as well. Interest rates are very close to Eurozone rates, and the exchange rate of the Czech koruna vis-à-vis the euro is relatively stable.

Thanks to close economic relations with the Eurozone, we expect this convergence to develop further. However, the level of economic alignment with the Eurozone is still not high enough for the Czech economy to reap clear benefits from adopting the single currency and common monetary policy.

### Structural policies

The microeconomic part of the National Reform Programme is focused on strengthening and increasing the competitive advantages of the Czech economy during sustained use of resources. Thanks to the accelerated growth of macroeconomic labour productivity, this allows the gap to close between the Czech economy and the EU average. The most important reform measures are: creating an environment for stimulating science, research and innovation, including their commercial application; modernisation and development of transportation, information and communication networks; and a quality corporate environment facilitating market entry and promoting new businesses as well as measures relating to termination of business activities and an overall reduction in corporate bureaucracy.

#### Box 2.1: Improving the business environment

Starting in January 2005, the process of accelerated depreciation of movable property has been speeded up, and the tax support for corporate science and research expenditures has increased. In July 2005, the amount of time for registration in commercial registers has been reduced, which simplifies to a significant extent the process of establishing a company. As mentioned already in previous Convergence Programmes, corporate income taxes will be reduced to 24% starting in 2006.

By the end of 2006, a proposal will be filed for legislative changes leading to another reduction of at least 20% in administrative costs. The obligation to evaluate the impact on businesses relating to all draft acts prepared by the ministries and other state authorities will be introduced in 2007. A system of central registration sites for businesses (i.e. one-stop shops) will be implemented over time. These will assume the issues of entrepreneurs associated with starting up a business or with any eventual changes. Bankruptcy legislation, which has been the subject of justified criticism for many years, will also undergo comprehensive re-codification. The new legislation will come into effect in 2007.

In research and development, the Czech Republic is significantly behind the EU average in the volume of invested resources as well as the protection of intellectual property rights, innovation and its practical application. Besides the gradual increase in public expenditures for research and development, new tax measures were introduced that should stimulate these private investments. Innovation and innovative infrastructure will be supported by programmes co-financed with EU funds.

### Labour market policy

Another priority of economic policy is the labour market and, in particular, increasing market flexibility. By European standards, the Czech labour market is characterised by its somewhat average ability to absorb shocks, its low level of flexibility and low labour force mobility. These factors keep the structural rate of unemployment at a relatively high level.

The National Reform Programme focuses primarily on expanding contractual freedom, reducing statutory non-wage labour costs and increasing the territorial mobility of the labour force. As for labour market inclusion, attention is focused on persons at the start and end of their professional careers. Reforms in the area of education increase the quality of the labour force, increase educational opportunities and support the ability to adapt to demanding conditions on a changing labour market. The new Labour Code, adopted by the government and currently being deliberated in Parliament, should strengthen market flexibility.

### **Box 2.2: Improving labour market flexibility**

As far as reducing labour costs is concerned, ceilings for social security premiums will be introduced and then gradually reduced between 2007 and 2009 ( from five times the average wage in 2007 to three times the average wage in 2009). Effective from 2006, taxation for families with low and middle incomes should be reduced by changing the parameters of personal income taxes (reduction in the two lowest rate categories – from 15% to 12% and from 20% to 19%, valorisation of the first tax brackets by about 11%) and replacing the standard deductible entries with tax credits. In addition, measures have been taken to make social benefit payments to the unemployed more stringent, and a reform of the labour legislation is also in preparation. The system of requalification geared to reducing unemployment and strengthening professional mobility will be improved with the help of the European Social Fund, among others. A wider range of short-term and more practical forms of tertiary education contributes to increasing the number of persons attaining higher educational qualifications or university degrees in the Czech Republic. Adoption of the act on lifetime education, computer literacy and the development of an information society should play an important role as well.