

CZECH BUSINESS today

3/2003

Association Maison Tchèque

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CZECH BUSINESS REPRESENTATION



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- Structural Funds in the Czech Republic
- Czech YES to Joining EU

Minister
of Informatics
Vladimír Mlynář



On 1 January 2003 a Ministry of Informatics was created in the Czech Republic. The activities of the MI have three basic aims - the construction of a functioning e-government, the development of e-business, and increasing the availability of communications technology to the general public. How would you evaluate progress in the realm of e-government after the seven months your ministry has been operating?

After approximately seven months of the operations of the Ministry of Informatics and thanks to cooperation with the appropriate ministries, we have achieved the following concrete results in the realm of e-government: since March of this year it has been possible to submit VAT, highway tax and conveyance tax returns by email, as well as to inform individuals of rebates. We have amended the Criminal Register Act in order that an electronic extract from the register be possi-

E-BUSINESS IN THE CZECH REPUBLIC
"The greatest barrier to the development of e-business in the Czech Republic are the prejudices and anxiety that people suffer from when it comes to using ICT, and the price of access to the Internet", says the Minister of Informatics Vladimír Mlynář

le. We are holding discussions with the Land Registry and Surveillance Office regarding remote access to information held on the Property Register. We have initiated the registration of trade licences in cooperation with the Ministry of Trade and Industry.

In September of last year the Public Administration Portal was launched, which permits better contact between local authorities and the public. In the first phase the portal will contain the current wording of acts, EU regulations, the Commercial Bulletin, a full list of public administration addresses, and a catalogue of approximately 100 "life situations", i.e. examples and model resolutions to the interaction between the public and the local authorities.

The "National Computer Literacy Programme" is underway with the aim of increasing access to and knowledge of communications

technology. What are the results so far? Are there any fundamental modifications or amendments being prepared on the basis of experience acquired?

The programme met with a fantastic response, with more than 16,000 people enrolling for its courses. New regional training centres were created of which there are now more than 240. The programme will continue next year, and the Ministry of Informatics intends not only to continue to support it but is intending to expand it to a total of five courses. Graduates would receive a certificate of computer literacy.

In March 2003 the White Book on e-business was published, which describes the possibilities of removing legislative barriers to the development of electronic commerce. What do you regard as the greatest barrier to the development of e-business in the Czech Republic?

Structural Funds The Hunt for Billions

Member states are trying to ensure that their regions come away with the largest slice of the EU solidarity cake. In the Czech Republic the state is keen to help.

With its acceptance into the European Union the Czech Republic will have the right to avail itself of the financial resource of the four EU structural funds. We are not talking peanuts - Czechs could receive some euro 950 million (30 billion crowns) in the first three years of membership.

The joke is that they could, but they don't have to. The billions of euros which Brussels is willing to invest in the development of the poor regions in the individual members countries is an offer, not a guaranteed handout.

A Lot Hangs in the Balance. In the present six-year budget period more than 200 billion euros have been earmarked for structural funds. In the year 2006 this will be 28 percent of total EU expenditure.

However, experience up till now would indicate that this will be no beanfeast. Not even the most advanced countries have managed to extract the maximum permitted allocation, i.e. a level of four percent of their own gross domestic product. Some countries have actually had to return money on which they had been counting.

Nevertheless, there is a real opportunity of receiving at least something from the common treasury. Especially in regions whose gross domestic product is lower than three quarters of the average GDP of the EU when calculated per capita. Except Prague all other regions of the Czech Republic have GDP less than three quarters of the average of the EU.

The Czech Republic is aware of this and wants to ensure that people are not caught short.

So far it has done what it has had to: it has submitted to Brussels the basic programme documents in which it argues where and why there should be an injection of finance from the EU. The document is entitled the National Development Plan 2004-

2006, and contains six priority axes (the political priorities) and five operational programmes (including social and regional). The material was compiled on the basis of consultations with EU officials and at present their suggestions are being worked into it and discussed.

And the state has also entered areas it did not have to. Despite resistance on the part of district authority leaders, the state will decide by 2006 where the money from the Union will go. The Ministry of Finance and six other resorts have put together a scenario regarding how the contributions from the state budget will be channelled to the regions, towns, municipalities and private funds. Not only in terms of cooperation, but right from the start of the entire project. The study, entitled "The Financing of the Structural Funds" is ready, has gone through government and specific aspects are being debated in connection with preparations of the budget for 2004.

The well-intended helping hand of the state has prosaic roots. Only next year will the regions start to receive the income from tax. This means that come January, when it will be possible to apply for structural fund money, many of them will not have the funds to allow them to participate.

If the state contribution to the (co)financing of structural support, which is regarded as a priority, survives the red pen of the reform of public finances and makes it all the way to the budget, this will involve significant expenses. Well-informed sources anticipate that the suggested extent of this aid over 7 billion crowns (219 million euros) from 2004-2006 will not be significantly curtailed.

Watch out for the Projects. The second prerequisite for drawing down of structural funds is good quality projects. Several specialists believe that this will be no problem. After all, the Czech Republic did pretty well out of the pre-accession funds, so why should it have any difficulty with formulating its applications for structural grants?

The more cautious reply that successes up till now in using the pre-accession instruments should not be overestimated. You can not compare the incomparable. The forms for applying for structural support are much more complex, they say. What is more the applicant will need to provide accompanying documents and detailed plans prepared by a specialist advisors, none which comes cheap.

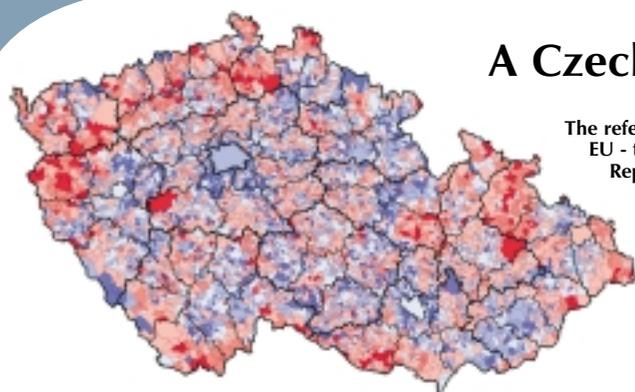
The most sceptical evaluate the chance of candidate countries availing themselves of structural aid as fifty-fifty. Other sources speak of a roughly 62 percent success rate. With these probabilities flying around the costs for the process of expansion dwindle from the original planned 40 billion euros plus to some 25 billion. The estimates of lecturers at the Economic University in Prague and civil servants attached to the Ministry for Local Development speak of 75 percent.

Change is Needed. The competition for resources from the structural funds will kick off by 2006. The European Union has already invited the acceding countries to discussions centred around how the entire system of provision of subsidies (including agricultural) can be simplified. The aim is maximum simplicity and minimum bureaucracy.

Except that voices have started to be heard questioning the very sense of "solidarity in practice". The respected British weekly *The Economist* some time ago wrote that regional aid deforms priorities. As an example it cited Portugal, which under the pressure of the Stability Pact is trying to cut budgetary expenditure, while at the same time stubbornly participating in new structural programmes of negligible significance. The question of whether EU contributions for poor regions is exactly what the doctor ordered is something that Brussels, for the time being, refuses to answer.

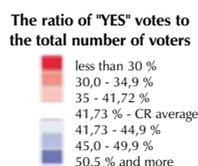
Igor Záruba,

Editor-in-Chief of The Magazine EKONOM



A Czech YES to joining the European Union

The referendum on accession to the EU - the situation in the Czech Republic region-by-region



On 13 and 14 June 2003 a referendum was held in the Czech Republic on entry into the European Union, the results of which will have a fundamental impact on the future development and alignment of the CR. In contrast to the other candidate countries (Poland, Slovenia), the validity of this first referendum in the country's history was not conditional upon the majority participation of all voters, though there was fear in political circles of a lower turnout which would threaten the legitimacy of the

result. Luckily these fears proved groundless, since 55.21% of those entitled to vote did so, of which 77.33% (3,446,758 voters) cast their vote for entry into the EU, with 22.67% against. What was surprising was not so much the positive result but the high turnout, which many had not foreseen.

Prior to the referendum Czech farmers had mounted a strong protest against the restrictions they will be placed under after accession, especially against the fact that they would not be able to

draw down direct payments from the common agricultural policy of 100% immediately after accession. This made the high support for entry into the EU in rural areas even more surprising, where the share of yes votes was 77%. The difference between town and country was thus minimal, since in the urban areas the figure was 79%. Looking at the structure of voting according to education, the greatest support for the EU came from the university educated (83%) and the least from voters with only a vocational certificate (74%). In terms of distribution of professions, students were pro (83%), along with businesspeople (80%), while accession was viewed least favourably by the unemployed, of whom only 66% voted in favour. Regionally accession enjoyed its greatest support in the Zlín district and Prague. The people of Liberec and Central Bohemia were least enthusiastic at the prospect of entering the EU.

Adéla Vychodilová,

Centre for European Integration ECCR

(source: Regional Development Agency of south Moravia)

The Reform of Public Finances

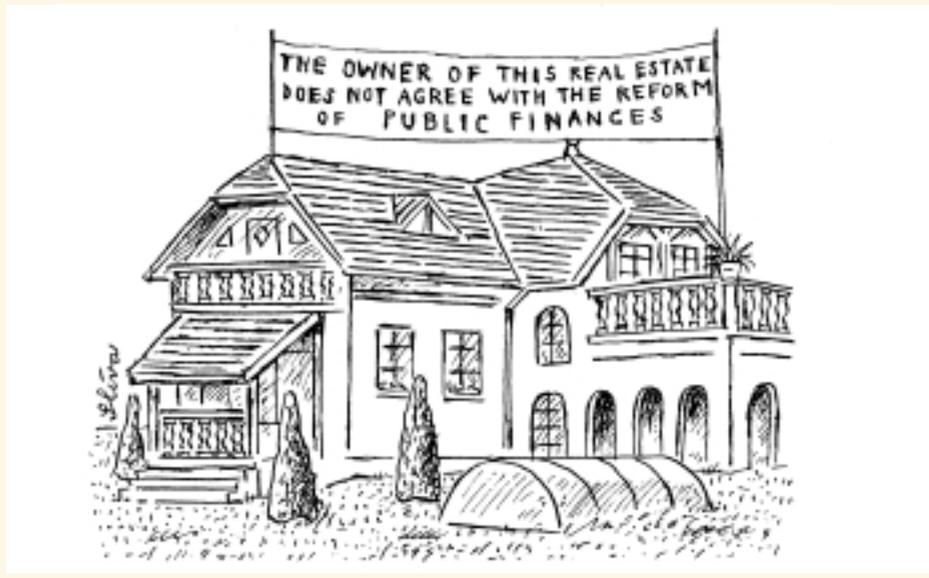
By signing the Treaty of Accession the Czech Republic has undertaken to become a member of the Economic and Currency Union and will take all the steps leading to introduction of the euro. However, this is conditional upon five convergence criteria (Maastrich) being satisfied. Even though we can only realistically expect the euro to be introduced in the Czech Republic sometime around 2010, already it is becoming clear that the greatest problems will probably be associated with budget deficits. While the CR already meets some of the criteria, this year's public finance deficit will be 7.6 percent of GDP according to Ministry of Finance forecasts.

This was once of the reasons why the government decided to introduce a set of measures aimed at increasing the effectiveness and gradual consolidation of public finances. In December of last year the Ministry of Finance inaugurated a debate amongst both the specialist and general public by publishing a document entitled "Budgetary outlook 2003 - 2006: a Conception of the Reform of Public Finances". The conclusion arrived at in the document is that the budget deficits are of a structural character and that, despite significant utilisation of income from privatisation and other one-off revenue-creating measures, public-sector borrowing is accelerating. On one hand the tax quota is falling autonomously and on the other mandatory and quasi-mandatory expenses are increasing at an unsustainable rate. The gap between income and expenditure grows ever larger and thus the opportunities for an active budgetary policy are shrinking.

After several rounds of discussions within the ruling coalition the governing parties arrived at agreement on the form of the reform. After being debated in government, draft amendments of the first

The aim of all of these measures is to lower the level of the public-sector deficit to 4 percent of GDP by 2006 and less than 3 percent two years later. Reform should lead to stabilisation of the tax quota while a reduction of the rate of direct tax would be balanced by an increase in the rates of indirect taxation.

twelve acts were sent to parliament in June and July. During the course of this and next year the government is planning to submit other amendments to acts which will relate to the overall transformation of budgetary rules (amongst other things, the introduction of the principle of fiscal targeting and stipulation of the government's medium-term expenditure), changes to legislation in the social sphere, the termination of the activities of several transformational institutions, amendments to the Employment Act, etc. The government anticipates that over the following three years it will receive 62 billion crowns (1,9 billion euros) and save 189 billion crowns



(5,9 billion euros) in expenditure. The aim of all of these measures is to lower the level of the public-sector deficit to 4 percent of GDP by 2006 and less than 3 percent two years later. Reform should lead to stabilisation of the tax quota while a reduction of the rate of direct tax would be balanced by an increase in the rates of indirect taxation.

At the end of July all twelve amendments to the law were given their first reading in parliament. In the second reading, which is planned for September, MPs will be able to submit amendments, a step which several of them, even those on the government benches, are preparing to do. Since the government's majority in the 200-strong parliament is but a slim 101 votes, it is going to be very difficult for it to push through the proposed amendments in a form which will not seriously compromise their reform character. The opposition has already declared that it will not support any of the government proposals (e.g. the Civil Democratic Party), or only some of them (e.g. the communists).

As things stand at present the acts under discussion contain, amongst other things, the following measures:

- an increase in the present rate of VAT on services from its present 5 percent to a basic rate of 22 percent (the draft act was debated and approved by parliament, but President Klaus vetoed it and sent it back for more debate),
- a lowering of conveyance tax from 5 % to 3 %,
- a reduction in corporate tax from 31 percent to 24 percent over the course of three years,
- an extension of the period of time over which administrative buildings can be amortised from 30 to 50 years,
- granting tax concessions to trade unions and employer's organisations covering the contributions of their members,
- the introduction of a minimum tax base for entrepreneurs of half the average wage,
- making double-entry bookkeeping a statutory duty for all companies with an annual turnover of more than 3 million crowns (93.000 euros): companies with a lower turnover could keep simplified accounts showing income and expenditure,

though the system of single-entry bookkeeping would be abolished,

- the introduction of statutory pension insurance contributions to apply to self-employed people whose income derives mainly from freelance activities,
- a gradual increase of the minimum annual assessment base for health and social insurance premiums paid by self-employed people from 35 % to 50 % of the difference between income and expenses, and at least half of the average wage,
- a reduction in the daily assessment base for calculation of sickness benefit for the first three days of absence from work caused by illness from 50 % to 25 % (in the longer-term the government anticipates shifting responsibility for payment of the first fourteen days of sickness benefit onto the shoulders of the employers, which would at the same time lower the statutory deduction for social insurance by a corresponding amount),
- the statutory introduction of registration boxes at market stalls,
- an increase on the non-taxable part of the tax base for children within the framework of supporting families with children,
- changes to the basic parameters of building society saving: a) an increase of the maximum level supported from 18,000 to 20,000 crowns (560 to 625 euros), b) a reduction of the percentage rate of state support from 25 % to 12 % of the amount saved annually, c) providing incentives to people to use the resources they have in building society savings to buy an apartments or for construction purposes,
- an increase of the statutory retirement age to 63 in the case of both men and women,
- abolition of the so-called temporary reduced early retirement pension leaving only the possibility of a permanent reduced early retirement pension of up to three years prior to attaining retirement age.

*Aleš Fischer,
Confederation of Employers
and Entrepreneurs' Associations of the CR*

E-business in the Czech Republic - Problem-Free?

The situation in the Czech Republic vis á vis e-business can be assessed from at least two points of view. The first is the overall perspective and the second is based on the experience of the individual suppliers of information technology (IT) of the customer environment in which they operate. Let us attempt to examine both points of view, always bearing in mind that the general is always a reflection of individual experiences.

Firstly, what do we mean by e-business? There are dozens of definitions, so let us stick with the most technological.

In the light of the development of information and communication technology and the liberalisation of the telecommunications environment the market environment is achieving a higher global level in terms of quality. What is more the general availability of information by means of the globally standardised environment of the Internet is becoming one of the most important factors of change. However, the Internet does not only represent the transfer of statistical information - commercial processes are gradually infiltrating its environment. Above all processes are being applied which impact significantly on the structure and size of the customer segment and the forming of relations with said customers by means of a differentiated and personal approach. The core of e-business is the so-called CRM (Customer Relationship Management) system supporting these processes. Generally we can include all commercial processes taking place by means of Internet technology in the category e-business. This applies to mutual interaction with the customers, ascertaining market requirements, the online compilation and ordering of products or services, as well as processes supporting, for instance, customer - contractor relations.

Let us now move to the reality of the situation as experienced by Czech businesses, which report many and various experiences. In general business with big ambitions exceeding the borders of the Czech republic regard investment in the technology of e-business as a priority. The result is savings on expenses, the compatibility of processes with business in EU countries and with bodies of the state administration, control over large amounts of information regarding customers and other subjects on the market, and market requirements. Logically, after all, the speed of changes on the market and their accurate observation and comprehension will impact on the product and service portfolio, and he who reacts most quickly comes ... first. On the other hand there is the issue of the resources available for such investment. Which brings us to the first problem faced by Czech businesses as far as development of e-business is concerned. With falling revenues investment into IT takes second place and is decreased or sometimes even suspended. At the same time the technology of e-business has and should have a decisive significance on the effective and genuinely market-based functioning of a company. In this area generalisations have no sense. Every company does battle with its specific problems, and these problems correspond to the level of the company's development.

Another problem is the fact that many companies have not yet grasped the strengths and possi-

bilities of IT as far as the development and management of business activities is concerned. If we look for a moment at the realm of costs, the automation of certain processes results in big financial savings in terms of labour, increased reliability, less time spent in dealing with the operations in question, especially as regards the exchange of data between partner businesses, and even allows processes to be realised which otherwise could not be. Cost efficiency is simply but one of the advantages which e-business can bring. The analysis of market requirements and speed of reaction to these requirements is a key factor of success, as well as ensuring that there will be no drop in revenues or reductions in crucial areas of investment. It is necessary to point out that the level of awareness of the possibility of e-business is a reliable indicator in the Czech Republic of the overall situation as regards the development of society itself, which for many years was isolated from the development of the automation of companies in the advanced countries and could not confront this fact directly. Now, thanks to huge foreign investment in our companies and the imminent accession of the Czech Republic to the European Union, this situation is clearly and quickly improving. A positive signal is the establishment of a Ministry of Informatics which should help push through the necessary legalisation allowing for the development of electronic communication in the business environment.

A solution, which is fast becoming a trend, to the problem of companies genuinely understanding the significance of e-business for their activities, involves cooperation with a technological partner. And here we move over to purely individual experience. The form of any symbiosis, a partnership, is growing in importance. Already it is not only about an IT supplier providing the one isolated information system in which he specialises, but the supplier/partner understanding the business activities of its partner. Only on this basis is it able, together with the customer, to identify the processes which are crucial for the business activities in question, to propose their automation and to suggest modifications of processes. We call this ability a combination of vertical (or branch-specific) and IT expertise. This does not mean that the technological partner will understand the customer's business activities better than the customer themselves. It means that the technological partner is able to look at customer processes from a certain perspective and apply his branch-specific and technologically based experience. Such a symbiosis has various forms and various levels depending on how advanced the internal IT section of company is. However, the aim must always be to attain the most effective internal company processes and the processes which link this company to the outside world. And the technology of e-business plays a crucial role in this respect.

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The reform of public finances is linked with many amendments of tax legislation. The tax commission of the Confederation of Industry has processed into these draft bills the suggestions which ensued from the discussions of representatives of the commission with the Ministry of Finance. Talks held between the deputy Minister of Finance, Yvona Legierská, and the Managing Director of the Confederation of Industry, Zdeněk Liška, included a summary of these discussions. Below we publish the authorised minutes of that meeting:



Z.L.: The Confederation of Industry has already been conducting talks with the Ministry of Finance for many years with the aim of improving the business environment in respect of tax. Recently these discussions have been more frequent, have had a broader purview and been more fruitful. Despite this, as you know, our Confederation has many reservations regarding most of the new tax legislation. In our opinion the legislation does not do much to help the business sphere. It fails to create the conditions of a level playing field and thus improve the competitiveness of our companies, and it does not create conditions for growth.

Y.L.: You are clearly referring to the last amendment of the Income Tax Act and the tax rules being prepared which are to replace on the Administration of Tax and Payments Act. However, at present a very important change to practically all tax legislation is underway which is finding its way into the government reform of public finances as well as the changes related to our entry into the EU. The overall change of tax legislation represents a system of mutually connected measures the overall impact of which should entail a fundamental reversal of the unfavourable development of public finances and which are conceived of in such a way that their impact will not have serious consequences for the business sphere nor for private citizens, i.e. for the purchasing force of the population, which is so important for businesses.

Z.L.: Ok, let's look in more detail at the two acts you mentioned from the point of view of the business sphere and begin with corporate income tax. While there is a positive reduction of the tax rate, the categorisation of significant items as taxable expenses will have an unfavourable effect on the business sphere. I refer, for instance, to reinvestment, the prolongation of amortisation on buildings, etc. These measures in many cases have the effect of worsening the investment activities of the business sphere.

Reform of Public Finances

Minutes of a meeting of the Managing Director of Confederation of Industry of the Czech Republic, Zdeněk Liška and the Deputy Minister of Finance, Yvon Legierská

Y.L.: At present parliament is debating an amendment to the Income Tax Act, which should become effective on 1st January 2004. This amendment proposes a gradual reduction in the rate of corporate income tax from its present level of 31 % to only 24% in 2006. This is a reaction to the level of tax in neighbouring countries, especially the candidate countries, Poland, Hungary and Slovakia, which are our largest competitors from the point of view of the allocation of capital from foreign investors. Lowering the rates in these countries is frequently accompanied by an extension of the tax base. Our Ministry of Finance should have been working on a similar plan some time ago. One of the partial resolutions concerns the amortisation of administrative buildings. Next year we anticipate the introduction of a 6th amortisation group for these building with an amortisation period of 50 years. Given the fact that the reduction of the rate of tax to 28% results in a fall of tax revenue of some 12 billion crowns (375 million euros), it is clear, is it not, that this is not a complete compensation, but simply a more realistic amortisation rate for this group. By introducing the 6th amortisation group we are reacting to the possibilities outlined by the new Classification of Construction Works published by the Czech Statistical Authority and trying to bring our framework into line with those valid in the member states of the EU, as well as paying heed to the indubitably higher service life of administrative buildings.

The preliminary plan of legislative work of the government for 2004 gives consideration to the processing of a new legal income tax regime with effect from 1st January 2005. In light of the current situation, i.e. the extensive amendment to the Income Tax Act and the need for a link to several other important legal norms being prepared, e.g. the Civil Code and the Labour Code, a more realistic deadline for the new Income Tax Act to become effective is 1st January 2006. This fundamental change is intended to link up with the proposed reduction in the consequent rate for physical persons and aims to do away with most of the non-systemic tax measures which have found their way into this Act over the course of the year. The result will be a law which will lead overall to significant clarification and simplification. Within the framework of this stage the reinvestment you mention should be cancelled or revaluated.

Z.L.: "Theory is grey, the tree of life is green". In the Czech Republic entire branches are undercapitalised and thus their technological equipment is considerably depreciated, not only as regards tax, but also morally. The measures specified, however they may be theoretically "equal", will destroy competitiveness, and not only in respect of investment. Many companies resolve their technological problems by modernisation and reconstruction, a path which is almost handicapped by tax.

Y.L.: I would first of all point out that modernisation and reconstruction are not handicapped, they are simply not favoured as are certain other institutions, and this is the difference from the point of view of creating the Act.

We have discussed this problem in detail with your experts and arrived at the joint conclusion that one of the paths would be a modification of

amortisation in the case of the implementation of technical improvements. The possibility will be considered of speeding up the amortisation of technical improvements implemented on selected long-term fixed assets in the year the improvements were realised.

In other words we are talking of gradual steps improving the investment capacity of each business subject which can be prepared for in advance.

Z.L.: I concede that speeding up the amortisation rates as well as the replacement of reinvestment with the expansion of technical improvements could be a resolution of sorts. However, I have to note that our idea of pro-investment and thus growth-motivating tax measures are much stronger in character. In the media we have repeatedly declared that we favour tax of 22% and a retention of the current reinvestments, expanded by the modernisation and reconstruction, a fixing of the prioritisation of research and development, a tax base which pays heed to increasing the qualifications of human resources, including stipends, etc.

Y.L.: Your reaction has to be divided into two points. Tax of 22 % is at present unacceptable, not only for fiscal reasons, but it is not justified even from the point of view of the oft-heard argument of comparability with neighbouring states (Poland, Hungary and especially Slovakia). According to our calculations as well as those of independent institutions the rates of corporate tax proposed by us are in reality lower than in these countries allowing for the extent of the items included in costs or governing the actual tax base.

As far as reinvestment, modernisation and reconstruction are concerned, we have already spoken of this and I believe that together we can find an acceptable resolution. The question of research and development and certain forms of support for the qualification of employees is a different one altogether. We have also discussed this with your experts and agreed that one solution could be an increase in the items lowering the tax

base, i.e. the value of donations, which the law allows. Business would then have the opportunity of reinforcing cooperation with universities and research organisations, etc. However, I must also point out that the Ministry of Finance has no signals that the business sphere has any great problems in this area from the point of view of tax. Accordingly I would like you to specify this problem in more detail and I can promise that we shall address ourselves to it seriously.

Z.L.: Unfortunately I cannot wholly accept even the changes of the law which can be put down to our entry into the EU and accession agreements, such as the VAT Act. This involves initiatives on the part of MPs which parliament has approved. If I pass over the shift in services to a basic rate from 1 January 2004, which barely relates to businesspeople - taxpayers - what about this strange deposit for VAT in April 2004?

Y.L.: The duty you mention to pay a deposit for VAT in April 2004, though not ensuing from the regulations of the European Union, nevertheless relates to the European Union. A change to the method of collecting tax on the acquisition of goods from other member states will have a negative impact on the cash balance of state budget income. While up until the entry of the Czech Republic into the EU tax is first collected by customs bodies and in the succeeding tax period its balance is applied by the payer, after entry into the EU tax on the acquisition of goods from other member countries will not be collected by the customs bodies, because the same payers will submit a return in the same tax period and will enforce the right to a deduction of tax. The proposal is to limit this negative impact on the cash balance of the state budget in 2004 of 14 billion crowns (430 million euros) by a one-off temporary measure contained in the amendment of the VAT Act according to which until 25 April 2004 tax payers will be obliged to pay a deposit for their own tax duties for the tax period of the month of April 2004 in the case of monthly payments, or the 2nd quarter of 2004 in the case of quarterly payers, this to a level of 50% of their actual tax duty for the period March 2004 in the case of monthly payers and for the 1st quarter of 2004 in the case of quarterly payers. In the tax return for April 2004 which both monthly payers and quarterly payers will submit under the proposed temporary regulation in the VAT Act, this deposit will be adjusted against the tax duty of payers of tax for this tax period. This means that this deposit should not be a long-term burden for payers who have to pay it if the amendment to the VAT Act, which was returned by the president of the Czech Republic to Parliament, is definitely approved by the chamber. This amendment lowers the anticipated loss of 14 billion crowns (430 million euros) to only a half.

Z.L.: I believe that our dialogue, despite all our differences of opinion, will continue and I would like to request that you continue to pay high-

This amendment proposes a gradual reduction in the rate of corporate income tax from its present level of 31 % to only 24% in 2006.

tened attention to the point of view of the Confederation of Industry of CR. We are not interested in any kind of lobbying profit for a particular business group: our aim is the ongoing growth of the Czech economy.

Y.L.: Within the framework of the committee proceedings which all Acts have to go through we regard your point of view as very serious and motivating. I would like to assure you that we shall continue to work closely with you and your experts. On the other hand you must understand that the Acts prepared by us cannot express simply one point of view, but must reflect the political agreements, national economic aims and the economic reality of all legal subjects and citizens of our country. This is a moment at which it is very difficult to find an intersecting point acceptable across the board.

The Road to EU Accession - Rockier than Many Believe

Introduction

The progress of eight of the ten accession countries from command economies to free-market economies may on the surface appear to have been relatively smooth. Whilst the magnitude of the transformation since 1989 cannot be denied, this should not be the cause of complacency or a feeling that accession to the European Union will be equally smooth. On the contrary, the path to accession is strewn with pitfalls that will catch many businesses unawares and may result in a significant bottom-line impact. Some of these difficulties are already visible and can be avoided with careful planning; others are as yet not clearly defined and can only be navigated as they materialise.

The findings of a PricewaterhouseCoopers (PwC) survey entitled "The Impact of EU Enlargement", which focused on the readiness of business for accession, along with my own experience serving clients in Central Europe, lead me to believe that the majority of companies operating in Central Europe are underestimating the planning required to ensure that they are fully compliant with the legal and regulatory requirements that accession will bring.

Below I offer some of the findings of the survey and my experience and highlight certain areas in which businesses need to plan now in order to be fully prepared for the accession of ten countries to the EU on 1 May 2004.

Survey Findings

PwC commissioned an independent pan-European survey to determine the extent to which 100 of the major investors in the Central Europe region are preparing for accession to the EU. Not surprisingly, the majority (89%) confirmed that EU enlargement will affect their business and that they need to plan for the resulting changes. **However, two-thirds of respondents have only just begun**

"One major electronics company estimates the cost in systems changes alone will be in the region of USD 2 million."

or will only start considering and preparing for the effects of enlargement this year. This suggests that businesses are underestimating not only the scope of the changes resulting from accession but also the time required to implement solutions to these changes. This impression is reinforced when the personnel and financial resources being dedicated to managing the accession process are examined. Almost half the respondents believe they will not be able to handle the preparation process internally and will require external assistance. However, 86% of respondents have provided no budget to cover the costs of preparation. Only 7% have set aside a budget of 50,000 euros (1,6 million crowns) or more for this purpose.

This apparent lack of financial planning is brought into sharper focus when the scale of the changes that are required are considered. Major changes to Enterprise Resource Planning systems (ERP) will be required to produce the information

required for statutory reporting. Eighty-eight percent of respondents believe that their accounting systems will need to be adjusted, compared to 58% who believe that reporting systems will have to change. Forty-six percent of respondents said that both domains would require adjustment. Since few companies have provided a budget for this, it follows that these changes will be administered internally. This standpoint may be driven by the view that, as companies already have EU reporting systems in place, it will not be difficult to adapt these to the requirements of the accession countries. Though this may be true to some extent, areas remain where national jurisdictions can choose to interpret individual legislation.

As stated above, a lack of financial planning is not true of all businesses operating in Central Europe. Those companies that have mapped their business flows across a number of countries have in the main set aside significant sums to ensuring that their reporting systems will be ready by 1 May 2004. One major electronics company estimates the cost in systems changes alone will be in the region of Euro 2 million (64 million crowns). This particular business already has a major presence in the existing EU and is familiar with reporting obligations in a single market. It clearly does not believe that simply tinkering with its existing reporting systems will be sufficient to prepare it for EU accession.

Client Experiences

This is just one example of how the survey findings tie in with my own experience of assisting clients in the Central Europe region. Other concrete examples provide further evidence of the extent to which EU accession will affect business:

- As a result of EU customs duty being higher than current accession duty rates, one company will have to pay an extra Euro 1 million (32 million crowns) on raw materials.
- The social security costs of one service company will increase by Euro 2 million (64 million crowns) for its expatriate staff.
- VAT will not be fully recoverable and will result in extra payments of Euro 3 million (96 million crowns) for one organisation and Euro 16 million (512 million crowns) for another.

These examples all relate to direct costs that will affect the bottom line on an annual basis if not managed properly. There are also indirect costs associated with accession that will have to be borne, e.g. training staff to be fully conversant with the new regulatory requirements, modifications to or the implementation of new ERP systems, HR costs relating to compliance with the social chapter, etc.

Not only are most companies underestimating the cost of changes, but the timing of them too. With regard to trade reporting, for example, a company's systems must be able to produce compatible reporting information on day one of accession, i.e., 1 May 2004. There is no transition period available for those who have not planned ahead.

So what will be the downside of not planning for accession? Extra costs will be incurred to make the necessary changes, plus financial penalties for non-compliance. In certain jurisdictions it is a criminal offence for a company to be non-compatible with reporting requirements, and there is a very real possibility that the CEO could go to prison.

This raises the question of why so many businesses operating in Central Europe are underestimating the scope, time and resources required to be prepared for accession. The preparation process may be undertaken on a functional basis within businesses, which can create difficulties in raising awareness internally. The continuing development of legislation and knowing exactly how this will affect specific areas of the business can also pose difficulties. Furthermore, calls for extra resources are not always welcome or heeded. However, as one business with which I am cooperating has realised, the cost of preparing for accession is significantly lower than the cost of not preparing.

Business Strategy (Opportunities)

The prospect of greater consistency across the region and certain tax drivers resulting from accession is allowing some companies to simplify their structures and benefit from the opportunities that accession will bring. A number of companies operate commissionaires and agency structures across the EU, but because of tax issues these structures have largely not found their way into Central European countries. These tax anomalies will disappear upon accession so that some business models will now be able to be used in Central Europe.

In another example, a company is bringing forward its system implementation in order to be consistent with the regulations applying in a number of Central European countries. Even though this is creating costs that were not budgeted for, the driver is to comply from day 1 so as not to incur both unnecessary penalties and corporate governance issues (c.f. above). A number of major players in the region have started discussing shared service centres as a way of effectively and efficiently managing the administrative obligations that they will face in a number of accession countries.

Another area for rationalisation and opportunity will be logistics. When the single market was created in 1993 in Western Europe, regional distribution hubs and fewer in-country warehouses became the norm. This resulted in savings on costs and shorter supply chains. We can expect a similar process to take place after accession, with the added possibility of the main European distribution centre heading east to lower-cost areas.

Conclusion

Those businesses that began planning the accession process some time in advance have recognised the scope of the changes to be made and the time and resources required to implement the necessary solutions. These businesses are also better placed to understand the opportunities and risks that accession will bring to their operations and thus are more able to steer a steady course along the road to accession. Those businesses that have not planned adequately, if at all, may find themselves floundering in the difficulties that are already visible. They may not be in a position to respond to the difficulties yet to materialise in a timely and effective manner.

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Amendment to the Telecommunications Act

On 20 August an amendment to the Telecommunications Act came into force aimed at completing liberalisation of the Czech telecommunications market. The amendment obliges Czech Telecom (a formal monopoly) to lease its lines to other operators when requested. However, customers will have to wait until at least the end of the year before competition takes effect. According to the Managing Director of Telecom the company will submit the Czech telecommunication regulator a specimen offer for leasing of lines to other operators by 19 September at the latest. The company would then have 60 days during which to reach agreement on conditions with other operators. Were Telecom not to reach agreement within this two-month deadline, the telecommunication regulator would step in.

Last Call for Privatisation

The National Property Fund (FNM) made almost 5,722 billion crowns (180 million euro) for companies privatised in the first half of 2003. It acquired most of the money from the regional electricity distributors Nová Huť. The Fund should be seeing further income in the second half of this year. In July the Fund made 1.3 billion crowns (40 million euros) by selling its three-percent interest in Transgas to the Germany concern RWE. By the end of the year the Fund may have received payments for the privatised majority state interests in its coalmines, the Unipetrol holding and Czech Telecom. The lack of resources for the state budget could be resolved during 2004 - 2006 by income from the privatisation of other companies, such as ČSA (Czech Airlines), ČSL (Czech Airport Authority), the Czech Post Office, ČEZ (Czech Electricity Board) and Budvar. Talk of the possible privatisation of Budvar has caused a commotion since the company is regarded as something of a national standard bearer which should remain in Czech hands.

A Flood of Foreign Investment

The Czech Republic still maintains the strongest position in Central and Eastern Europe as far as foreign investment per inhabitant is concerned. Investment calculated per capita exceeded 4,000 dollars in the first quarter. Hungary comes second in the region, though its share of investment does not even reach three thousand dollars per capita. The investment position of the CR, i.e. the difference between the total of foreign assets and liabilities, recorded a negative balance of 399.5 billion crowns (12,4 billion euros) in the 1st quarter of the year.

The largest investors include companies from Holland, Netherlands Antilles, and Japan. Close on their heels, as is traditional, are German, Austrian and French companies. The highest levels of investment are aimed at the automobile and electronic sectors. A large volume of direct foreign investment is also targeted at the chemical and textile industries. The most important companies investing in the Czech Republic include the Japanese Showa, Mercedes-Benz, Siemens, and Volkswagen from Germany, and the Dutch Metal Progres.

The Catastrophic Floods: a Year on

One year after the flooding which paralysed large areas of the Czech Republic, all the damage has yet to be cleared up. Immediately after last year's catastrophic flooding the organisation People in Need decided to organise a national SOS Flood Appeal to help people afflicted by the floods. The appeal at present is the largest in the ten-year history of the organisation. It brought in almost 269 million crowns (8,4 million euros) over the year, and small donations are still arriving. The money went straight to families who had seen their homes destroyed by the water for the reconstruction of buildings and smaller projects. Of the money collected some 152 million crowns (4,75 million euros) have been earmarked for households. Some 3,170 families and individuals have received grants of between 10 thousand crowns (320 euros) and 350 thousand crowns (11,000 euros) for such purposes.

Insurance companies have obviously been involved in providing compensation too. According to the Czech Association of Insurance Companies, its members had paid 27.5 billion crowns (860 million euros) by the end of July to those of their clients affected by August's flooding. The estimated damage is 36.8 billion crowns (1,15 billion euros). In just under a year since the catastrophe insurance companies settled more than 91 percent of flood-related claims. As a result of these floods, the second such in the Czech Republic in the last five years (1997 - Moravia, 2002 - Bohemia), premiums have gone up by some 20%, though in the most several threatened regions this figure is as much as 40%.

E-government

Starting 30 October of this year the Office of the Government, the Ministry of Informatics and several other authorities will begin testing a pilot project known as e-government, i.e. the sending and commenting on government documents by electronic post. Communication of state authorities via the Internet should speed up the work of the government and will involve savings of some five million crowns a year, which the state at present spends on printing and copying documents. The Minister of Informatics, Vladimír Mlynář, after a meeting of the cabinet, said that by the end of the year the commission which he heads would propose a start-up date for all departments. Mlynář explained that the Office of the Government server would work on the basis of centralised access, by means of which the ministries and other bodies of the state administration would be able to add their comments to government materials.

An Information System for Awarding Public Contracts

An information system for the awarding of public contracts has been created in the Czech Republic with support from the European Union, with the aim of reducing the room for corruption. This is one of the results of the twinning project which came to a close at the end of August after almost two years. The project budget was 900 thousand euros and was fully financed by the EU. The project also provided training to public contract applicants and helped the amendment of the Public Contract Act

through its first reading in Parliament. In September Parliament will give the new amendment its second reading, and it is expected to be passed by the end of the year. Without the Act the Czech Republic would not be in a position to draw down the financial resources offered by EU structural funds. The new information and monitoring system will check on where public money is being directed and what the results are of a particular contract.

Support for NGOs

Ministries are offering around 3 billion crowns (93 million euro) a year for support of non-profit organisations. However, state support falls well short of the rapid growth in the number of such organisations, and the non-profit sector receives less money than certain government agencies providing the same services. Non-profit organisations are also at a disadvantage in that they have to reapply for their money each year. Such is what ensues from the survey carried out in June by the Donors' Forum. The largest contributor is the Ministry of Education, Youth and Physical Training, with a 50 percent share of the total of government grants offered to NGOs. The Ministry of Employment and Social Security came next with 30 percent, and 11 percent was provided by the Ministry of Health.

Economic Indicators

The Czech Republic receivables decreased at the end of last year from 5.7 billion dollars to three billion dollars (91.6 billion crowns). Some of this reduction of CZK 113.4 billion was due to the settlement of some of the receivables for the Russian Federation, and partly due to currency fluctuations. The Czech Republic's foreign debt was almost without change year-on-year in the 1st quarter. The ratio of foreign indebtedness to GDP fell to 33.3 percent. The state budget deficit at the end of July this year had increased to 62.1 billion crowns (1,9 billion euros) from June's level of 53.4 billion crowns (1,6 billion euros). In seven months the deficit reached almost 56 percent of the level of deficit approved for the whole of this year. The most recent forecasts by the Ministry of Finance have hiked up the deficit to a historical 7.6 % of GDP. Net direct foreign investment, including the anticipated reinvestment of profits, was 10.3 billion crowns (0,3 billion euros).

The unemployment level increased in July to 9.9 percent from June's figure of 9.5 percent, with 520,366 people seeking employment in July. In comparison with July 2002 the number of job applicants increased by 41,125, though school-leavers considerably swelled these figures. Industrial production in June rose year-on-year by 6.2 percent, a significant acceleration of the rate of growth. In May companies increased industrial output by 3.2 percent, which is the tenth consecutive month of growth. Producers of rubber and plastic products and machines and equipment did especially well in June, and growth was also recorded in the revenues from raw materials for the power industry and the production and distribution of electricity. The month was not so kind to manufacturers of coke, nuclear fuels and oil processing companies. A year-on-year growth in construction production for June was recorded of 12 percent, the most dynamic increase since last February and exceeding market expectations. In the opinion of analysts the cause of the extraordinarily good results is a combination of the good weather, the relatively poor results of last year, and above all invoicing of construction work from the previous months.

(source: Market Research Centre, ekomail, Hospodářské noviny, www.ihned.cz, www.businessinfo.cz, the Analysis Department of the Economic Chamber of the CR)

(interview with Vladimír Mlynář from page 1)

The prejudices and anxiety that people suffer from when it comes to using ICT, and the price of access to the Internet. The legislative framework is also a problem, which either ignores certain topics or resolves them in a way which is not in line with EU legislation. This relates, for instance, to the problem of spam and the regulation of advertising.

In what areas of e-business does the Czech legal system most diverge from legislation valid in the EU? Is it in respect of the Electronic Signature Act, part of which excludes the possibility of an electronic signature authorisation certificate being issued anywhere but in the Czech Republic?

The Czech legal system diverges from that of the EU above all as regards the transposition of a certain directive (No. 200/33/ES) on electronic commerce. The Ministry is preparing the transposition of these regulations at present and the government will be presented with its proposal come autumn. The Electronic Post Act is problematic vis à vis the EU as far as issuing certificates of authorisation, though the appropriate amendment is already being drawn up.

One of the prerequisites for the successful development of e-business is reasonably priced access to the Internet and telecommunications services. In January 2003 the government approved an amendment to the Telecommunications Bill which allows competing operators to

lease local lines from Czech Telecom and to use them for non-voice services, including broadband services (ADSL). When does this amendment become effective and what do you think its impact on the development of e-business will be?

The amended Telecommunications Bill became effective in August, i.e. 20 days after its entry in the Law Digest. The amendment contributed to the further liberalisation and improvement of conditions for a competitive environment on the telecommunications market, though any possible effect it has on prices for Internet access and e-business tends to be indirect and gradual.

The amendment allows alternative operators of fixed networks to lease subscriber lines (copper wire) from Czech Telecom. The amendment answers the requirements of the EU and its aim is to increase competition on the market for fixed networks and the possibility of establishing broadband services, above all access to the Internet. In EU member countries this system is viable to a greater or lesser extent, depending on the extent of cable television networks, wireless services, etc. and of course on implementation of the requirements of the regulators (especially as regards sufficient information regarding the company, a punctual bid being submitted for access to be granted, and, above all, the price of access). While drafting the amendment the Ministry of Informatics was aware that expectations of a dramatic increase in the num-

ber of ADSL connections were too idealistic and that these expectations would be disappointed. The new Telecommunications Bill offers opportunities whose use depends to a large extent on the practical application of the authority bestowed by the Bill on the Czech Telecommunications Authority.

The amendment will not be enough to ensure the harmonisation of Czech and European legislation, and for this reason a new Electronic Communications Bill is being drafted. What stage are preparations of this Bill at and what problems have reared their heads during discussion of the draft bill amongst specialist bodies?

By the end of November the suggestions of the Czech Telecommunication Authority, specialist bodies, and the Legislative Council of the government will have processed, along with proposals deriving from the inter-departmental committee stage. The government will be submitted with the draft on 1 December 2003.

Discussions with specialists regarding the principles of the Electronic Communications Bill have not resulted in any great arguments, since we are sticking strictly to EU directives. A detailed discussion on the concrete regulations of the draft bill is set to begin and should be completed in October.

Thank you very much for the interview

Adéla Vychodilová
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Economic Chamber of the Czech Republic (ECCR)

The Economic Chamber of the Czech Republic is the self-governance institution in the Czech Republic. Within its structure it embraces more than 60 active district chambers and regional chambers, as well as 70 professional associations covering the entire territory of the Czech Republic and the entire scale of enterprises, from the largest to the smallest. This network ensures daily contact with the entrepreneurs, the monitoring of their interests, and efficient representation vis à vis the Czech Government. The ECCR provides customs and certification services, legal and legislative services, and representative and information services. It plays an important role in supporting exports, European integration, and SMEs. Its Court of Arbitration resolves commercial disputes relating to foreign and domestic trade.

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Confederation of Employers' and Entrepreneurs' Associations of the Czech Republic

The Confederation of Employers' and Entrepreneurs' Associations of the Czech Republic is an independent, voluntary and open lobby group promoting and co-ordinating entrepreneurial, employers' and professional interests in negotiations with Parliament, the Government, public administration and the Trade Unions. At present the organisation has the following members: the Association of Entrepreneurs of the Czech Republic, the Union of Employers' Associations of the Czech Republic, the Union of Agriculture of the Czech Republic, the Association of Textile, Clothing and Leather Industries, the Confederation of Commerce and Tourism of the Czech Republic, the Association of Building Entrepreneurs of the Czech Republic, the Union of the Czech and Moravian Producer Cooperatives.

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Confederation of Industry of the Czech Republic

The Confederation of Industry of the Czech Republic is a non-governmental, voluntary federation of employers and entrepreneurs in the Czech Republic. It represents and defends the interests of employers in the sphere of social policy during tripartite negotiations with the Government and Trade Unions. It strives to define, support and assert its members' interests in order to achieve prosperity and a favourable business environment. It also provides consultation and information services for its members which focus on international relations, trade opportunities, production co-operation, legislation, collective bargaining, European integration, education, and training. It is a full member of the International Organisation of Employers (UNICE).

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Czech Business Today

Quarterly; September 2003 issue

Publisher: Economic Chamber of the Czech Republic, Freyova 27, 190 00 Prague 9, IČ : 49279530; in co-operation with Confederation of Employers and Entrepreneurs Association of the Czech Republic and Confederation of Industry of the Czech Republic; **Editorial Board:** Štafaj Ota, Fischer Aleš, Hradil Ondřej; **Editor:** Centre for European Integration, Economic Chamber of the Czech Republic, Adéla Vychodilová, e-mail: vychodilova@komora.cz; **Advertising:** Centre for European Integration, Economic Chamber of the Czech Republic, Adéla Vychodilová, Freyova 27, 190 00 Prague 9, tel.: +420 224 096 356, fax: +420 224 096 227, e-mail: cebre@komora.cz,

Registration: Ministry of Culture of the Czech Republic - MK ČR E 13767; **Publisher service:** Q-art-s; klenik@q-art.cz **Edition:** 1200 printouts