DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR
THE CZECH REPUBLIC

As approved by the Board of Directors on 4 October 2005

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ABBREVIATIONS

ATC	Assessment of Transition Challenges
CEZ	Ceske Energeticky Zavody (the largest Czech energy company)
CNB	Czech National Bank
CSC	Czech Security Commission
CSOB	Ceskoslovenska Obchodni Banka
CSSD	Czech Social Democratic Party
CTO	Czech Telecommunication Office
CZK	Czech Crown
DHL	Logistics Company
EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
ERMII	Exchange Rate Mechanism II.
ESCO	Energy Savings Company
ETS	Emissions Trading System
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
GSM	Global System for Mobile Communications
IAIS	International Association of Insurance Supervisors
IFC	International Finance Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPB	Investicni a Postovni Banka
IPO	Initial Private Offering
IPPC	Integrated Pollution Prevention and Control
IT	Information Technology
JSCs	Joint Stock Companies
KBC	Belgian bank (owner of CSOB)
KDU-CSL	Christian Democratic Union-Czechoslovak People's Party
KSCM	Communist Party
MEI	Municipal and Environmental Infrastructure
MoI	Ministry of Informatics
MSME	Municipal and Small and Medium Enterprises
MTC	Ministry of Transport and Communication
NBFI	Non Bank Financial Institution
ODS	Civic Democratic Union
OECD	Organization for Economic Co-operation and Development
OKD	Ostravsko Karvinske Doly (mining company)
PAYG	Pay As You Go
PPP	Public Private Partnership
SKV	Siemens Kolejova Vozidla
SME	Small and Medium Enterprises
SMP	Significant Market Power
UCITS	Undertakings for the Collective Investment of Transferable Securities
US$	United States Dollar

EXECUTIVE SUMMARY

The Czech Republic continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Over the last 15 years the Czech Republic has made considerable progress in transition with 85 per cent of economic activity in private hands, a large degree of price liberalisation, an open foreign trade regime and no major constraints to foreign investment.

The macroeconomic environment has recently improved. The economy grew by 4.4 per cent in 2004, the highest growth rate since 1996, and is expected to grow at 5 per cent in 2005. The general government deficit declined sharply from 11.7 per cent in 2003 to 3.3 per cent in 2004. This has been mostly due to one-off factors, such as significantly reduced budget expenditure for covering banking sector restructuring costs in 2004 and increased tax collection. It is forecast to remain significant at 3-5 per cent of GDP in the next strategy period, above the level consistent with participation in ERMII and the Maastricht criteria. The current account deficit declined to 5.2 per cent of GDP in 2004, largely due to accelerating exports. Net foreign direct investment (FDI) inflows more than doubled in 2004, compared with the previous year, to US$ 3.9 billion, and are expected to be even higher this year. Unemployment remained at about 8.3 per cent in 2004.

On the reform front, the government has continued with the privatisation of a number of high-profile companies and the process is nearing completion. Recent privatisations have included the completion of the sale of Unipetrol to Polish PKN Orlen, Cesky Telecom to Telefonica of Spain (which is the second largest privatisation to date), and Vitkovice Steel to Russia's Evraz Holding. The restructuring of the state-owned companies in the railway and energy sectors is also continuing. Moreover, there has been some progress in improving the business environment, including the simplification of company registration.

Although the political environment has been difficult and elections are looming next year, the Czech authorities are conscious that a number of key reforms are needed to further enhance the competitiveness of the country and to manage and control the budget deficit. Looking forward, a number of key challenges still require attention:

- Improvements to the business climate (more specifically the general law enforcement; the granting of licences and permits; and the parliamentary adoption of the bankruptcy code). This should also include increased transparency in awarding state contracts, including at municipal level and in the privatisation process and creation of an environment in which corruption is fought effectively.

- Fiscal reforms that address shortcomings of the pension system, inefficiencies in the health care system and the social safety net in order to reduce the fiscal deficit below the level required by the Maastricht criteria. The share of public spending on special savings and mortgage subsidies, health, education, housing, social security and welfare remains one of the highest among OECD countries. Regional reform needs to continue with clarification of rules on local government financing.

- More attention needs to be focussed on agribusiness and the rural environment. Agroprocessors still need to improve efficiency and standards. Some of the largest companies still have poor corporate governance structures. There is limited finance available to the sector.

- The creation of alternative employment opportunities is a key in order to address the continued high unemployment rate. Local SMEs should get more attention in terms of financial instruments available to them and improvement of the environment they operate in. They continue to have limited access to equity capital and find it difficult to list on the stock market.

- Energy efficiency remains a priority. The country has ratified the Kyoto Protocol and is part of the EU Emissions Trading System (ETS). However, energy intensity remains high by international standards.

- Transport infrastructure needs further improvement. Railway restructuring is progressing, but there continues to be limited private sector participation (e.g. some local passenger lines). There has only been one, unsuccessful attempt for a road concession (i.e. the D47).

As of 31 August 2005 the Bank had committed EUR 1.007 billion in 50 direct and 39 regional projects which attracted a further EUR 3.585 billion from sponsors and co-financiers. While expectations of the new business in 2005 are limited, the Bank can continue to play a role over the strategy period by focusing selectively on transition challenges where it is additional.

The Bank's activities in the Czech Republic will be based on the following operational objectives:

- Continue to work closely with local financial intermediaries on providing funding to the SME sector and small municipalities with a focus on rural areas.

- Provide higher risk products such as equity and structured debt for local corporations to fund their growth, in particular in the context of cross border expansion. Support foreign direct investments by medium-sized companies in regions of higher unemployment with higher risk products not offered by the private sector.

- Work on a limited number of high quality public-private partnerships in the infrastructure area, in conjunction with Cohesion/Structural Funds.

- Identify and fund energy savings projects and renewable energy projects.

The Bank will continue to ensure that all EBRD operations in the Czech Republic meet sound banking principles have, transition impact, are additional and are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans.

1. THE BANK'S PORTFOLIO

1.1 Overview of activities to date

As of the end of August 2005, the Bank's cumulative commitments in the Czech Republic (including regional projects) had reached EUR 1.007 billion representing 3.6% of the Bank's net cumulative commitment volume. The Bank helped to mobilise a further EUR 3.6 billion of co-investment, representing a multiplier of 3.52.

The table below gives an overview of the Bank's current portfolio in the Czech Republic by sector as of end of August 2005. Totalling EUR 488.2 million, it represented 3.2% of the overall portfolio. Both, the private/state ratio and the non-sovereign/sovereign ratio stood at 100%, as the only sovereign project was repaid.

Table 1: Current Portfolio by Industry (including regional projects)
(as of 31 August 2005)

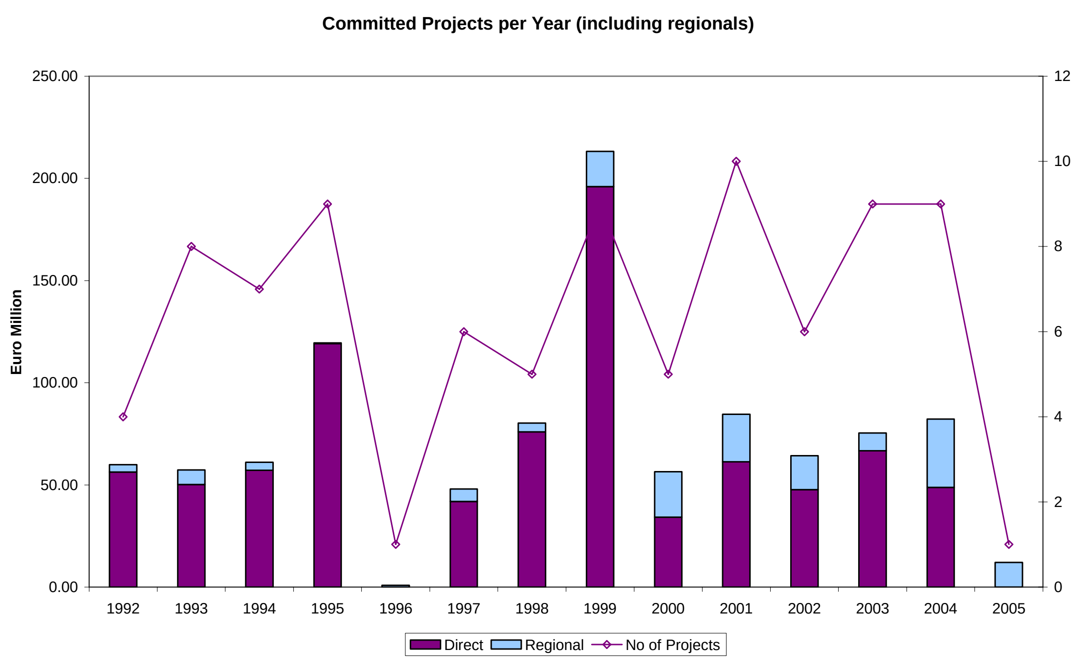
Sector	No of Projects	EBRD finance (EUR million)	Portfolio share (%)
General Industry	**2**	**40.4**	**8%**
Industry and Commerce	**15**	**96.6**	**20%**
Agribusiness	4	18.0	
Property Tourism and Shipping	8	74.0	
Telecom Informatics & Media	3	4.6	
Financial Institutions	**39**	**305.9**	**63%**
Bank Equity	1	117.4	
Bank Lending	8	50.8	
Non Banking Financial Institutions	8	62.9	
Equity Funds	22	74.8	
Infrastructure	**6**	**45.3**	**9%**
Transport	1	3.8	
Municipal & Environment Infrastructure	2	25.3	
Energy Efficiency	2	15.2	
Power & Energy	1	1.0	
TOTAL	**62**	**488.2**	**100%**
of which debt	24	245.6	50%
of which equity	36	235.3	49%
of which guarantee	2	7.3	1%
of which private	62	488.2	100%
of which state	0	0.0	0%
of which direct	24	379.4	78%
of which regional	38	108.8	22%
of which non-sovereign	62	488.2	100%
of which sovereign	0	0.00	0%

A major portion of the current portfolio (63%) relates to Financial Institutions, a reflection of the EBRD's significant role in the privatisation of the Czech banking sector, its support of SMEs through credit lines and the support of non-banking financial institutions and venture funds. Projects in Industry and Commerce sub-sectors represent

20% of the portfolio, General Industry accounts for 8%. The exposure to the infrastructure sector represents 9% of the portfolio reflecting the fact that the high needs in this sector are served mainly by the EIB and commercial banks, often using sovereign guarantees.

Chart 1 illustrates the history of the Bank's activities in the Czech Republic in terms of number of projects signed and amounts financed by the Bank in each year (no project was signed in 1991). In the early years the amounts were above the EUR 50 million level per year with substantial growth in 1995 to EUR 124 million. During years 1996-97 problems in the local industry have become obvious and there were no on-going privatisations, which resulted in a lack of financially sound business opportunities for the Bank. From 1998 the situation has changed, banks started to be privatised and investment incentives have been introduced motivating foreign investors to pursue opportunities in the country. The Bank's projects of recent years are usually of smaller size in different sectors of the economy demonstrating the Bank's flexibility in offering new products addressing the changing needs of the economy. Average volumes achieved during the period 2001-2004 are rather balanced at the level of an average of EUR 76 million (for project-related details see Annex 1).

Chart 1:



1.2 Implementation of the previous country strategy

The last Czech Strategy has been implemented in a highly competitive environment with excess liquidity available on the market. Due to its innovative approach the Bank has been able to continue to fulfil its mission and provide financing to various sectors of the economy with a focus on SMEs. The 2003 country strategy outlined the following strategic priorities for the Bank in the Czech Republic:

- The development of broader range of financing products with the focus on SMEs directly and via local intermediaries;

- Support of restructuring and consolidation of the local private sector mainly through provision of equity; support of foreign direct investments;

- Support of infrastructure investments through financing structures without sovereign guarantees and promote involvement of private sector in the infrastructure and environmental projects.

Since 2003, the Bank has signed 20 projects (including relevant regional projects), representing total commitments of approximately EUR 157 million. The new projects, though smaller in size, represent a good mixture of products serving the competitive Czech market (equity, subordinated debt, acquisition finance, and SME lines).

The Bank's contribution was most significant in the financial sector with respect to the provision of equity and equity-type funds to local companies including SMEs. In addition, the Bank managed to support SMEs by providing credit lines to banks and leasing companies. Further credit lines are expected to be signed in the course of 2005. Subordinated debt was provided to a smaller bank to strengthen its capital structure.

With respect to the restructuring of the private local corporate sector, the Bank was able to get involved in a highly successful restructuring of a bankrupt local company in co-operation with the strategic investor. The Bank participated in the financing of the expansion of the third mobile operator contributing thus to the competition in the sector. Long term equity funding was provided for the rehabilitation of several railway stations in the country supporting a foreign sponsor coming to the Czech market for the first time.

The concentrated effort of the Bank to take part in infrastructure projects being implemented in the country has not been fruitful during the last two years. The reasons are that large road and railway projects continued to be funded from the state budget and EIB loans without the use of PPP structures. The Bank explored financing options in the municipal sector in relation to EU structural funds, but achieved no success in this field so far, mainly due to small size of commercial funding needed for such projects. Local banks offer financing to municipalities on highly aggressive terms (margins below 10 basis points).

1.3 Transition Impact of the Bank’s Portfolio and Lessons Learnt

1.3.1 Relevance and transition impact of previous country strategies

Financial Sector
During the last decade the Bank has played a significant role in the overall development of the banking sector through its instrumental role in the privatisation of two large banks (Ceska Sporitelna and CSOB). Policy dialogue between the Bank and foreign investors and the authorities has supported financial restructuring of the sector. In the case of Ceska Sporitelna (CS), one of the largest banks in the country, the Bank took a pre-privatisation equity stake with a view to strengthen its balance sheet and contribute to the enhancement of corporate governance. CS has been successfully privatised to Erste Bank and the Bank exited the investment in 2002. In the case of CSOB, the Bank facilitated completion of the privatisation by purchasing a stake held by the Slovak Government. The Bank was also instrumental in stabilizing CSOB after it took over certain assets of the failed bank IPB after the government stepped in.

Projects in the non-banking financial sector include minority stakes in a pension fund and two insurance companies, anchor equity investments in two mutual funds focused on Czech equities and bonds managed by Ceska sporitelna.

Accessibility of financing to the SME sector has been improved through three EU EBRD SME credit lines to banks and two to leasing companies. The Bank played an important role in setting up the venture capital industry and is a significant investor in the Czech private equity sector via several Czech-focused as well as regional private equity funds. The Bank's continuing support to venture capital industry is essential for the raising of a second generation of funds as proved by several closings during the period 2003/2004.

Overall, the Bank achieved high transition impact in the Financial Sector.

Enterprise Sector
In the early years the Bank was successful in industrial and agribusiness sector projects (Cokoladovny, Dobrovice Sugar, Karosa, Barum, Sepap), helping to attract foreign investors into local companies. Several industrial projects with local sponsors proved to be very difficult and resulted in a high volume of impaired assets and significant resources needed for their restructuring (Korado, Skoda).

In later years the Bank was successful in supporting foreign direct investments leading to restructuring of bankrupted local companies: Bank's funding of Soufflet's acquisitions of bankrupted major malting plants helped to prevent collapse of the local suppliers of malt. Capital participation to support Siemens’ restructuring of a failed local producer of the rolling stock contributed to maintaining of qualified jobs and further development of the company.

In the telecommunication sector the equity support of operations of the third mobile operator followed last year by a debt subscription for its further expansion contributed to the increase of competition in the sector. The acquisition financing the Bank provided to the cable TV operator supported the consolidation of the sector.

Involvement of the Bank in the real estate sector attracted co-financiers and is instrumental in development of a secondary property market.

A number of regional and country specific private equity funds in which the EBRD invested over the past years have in turn invested in excess of USD 200 million in approximately 60 small to medium Czech companies.

Overall, the Bank achieved moderate transition impact in the Enterprise Sector

Infrastructure and Environment

The only sovereign project the Bank funded in the country was a small portion of financing for a major railway infrastructure project in parallel with EIB and other lenders in 1995.

The Bank has financed just one municipal project to date, a long-term limited-recourse loan to Brno Water Company BVK to rehabilitate and extend a wastewater treatment plant. As part of the project, the Bank assisted the city in the amendment of an existing long-term concession contract between the city and a joint stock company minority-owned by an international operator.

Two projects have been signed to date in the energy efficiency sector: one is the first EBRD ESCO (Landis & Gyr); the other one is a portfolio of small district heating projects with Harpen as sponsor. While the ESCO concept has been slow to start and found it difficult to establish a customer base, these two projects have however improved the general awareness about this type of projects.

Overall, the impact of Bank's involvement in the Infrastructure and Environment Sector has been limited.

Overall assessment and rating

Generally, the Strategies of the Bank for the Czech Republic proved to reflect the changing needs of the economy and define the areas for the Bank's involvement reasonably well. Infrastructure financing efforts did not materialise as anticipated due to the prevailing sovereign funding of this sector. Also the market proved to fill several gaps identified in recent Bank's Strategies rather quickly (funding of consolidation of local industry, financing of municipal projects).

The Bank's role in the transition of the Czech economy is perceived as moderate.

Policy dialogue

In 2003 -2004 the Bank was involved in a dialogue with the Ministry of Finance and the Ministry of Justice relating to EBRD's potential support for the preparation and implementation of the new Insolvency Law. This initiative has not brought any specific results yet, as there is no political consensus concerning the principles this law should be based on.

Legal technical assistance was provided by the EBRD in 2005 for the development of the PPP enabling law, which would make implementation of PPP projects more simple and transparent. In a parallel technical cooperation project, PPP policy issues have been examined with a view to comparing current practices in Central Europe, including in particular in the Czech Republic, with those of countries where PPPs are a well-established mechanism.

1.3.2. Selected lessons learnt

The Bank's experience in the Czech Republic to date has resulted in a number of lessons learned, the most important of which are the following:

Equity participation in local banks and other non-banking financial institutions proved to successfully contribute to the development of the private financial sector providing wide range of financing instruments to the market. Pre-privatisation equity can significantly contribute to a successful privatisation (Ceska sporitelna).

Attention and support provided to local banks through EU/EBRD SME programme helped to change the attitude of banks to SME lending and thus contributed to increased availability of funding to this segment.

Transparency and adherence to good corporate governance and standards of business conduct are essential considerations. Difficulties encountered in implementing projects missing an alliance with a strategic investor representing a guarantee of such practices should not be underestimated.

In case of equity investments, the Bank should protect its minority position through carefully defined shareholders agreement including exit arrangements if possible. Relying on a small local stock exchange as an exit option proved to be unrealistic.

Turn around situations need mobilisation of adequate expertise early after identification of the problem. Revitalisation of bad assets is achievable mainly in co-operation with dedicated strategic partners (Souflett, Siemens SKV).

1.4 Financial performance of the existing portfolio

During the last two years the quality of the Czech portfolio remained stable on a very good level. The overall portfolio risk category is 4.88, same as in 2003. New assets of high quality have been added during the period, while one project deteriorated from risk rating 6 to 7.

1.5 Mobilisation of co-financing

The Bank has mobilised EUR 3.58 billion of additional funds during its operations in the country achieving the overall mobilisation ratio (total project cost/EBRD financing) 4.53.

The EBRD has worked with over 20 commercial banks, including both foreign and local, in co-financing of projects in the Czech Republic, recent examples of which are projects Vltava and Raiffeisenbank Czech Republic. Total syndicated amount reached EUR 546 million. Among the financing institutions involved are: Ceska Sporitelna, CSOB, Zivnostenska banka, Komercni banka, BNP Paribas, Bank Austria Creditanstalt, Commerzbank, Credit Lyonnais/Calyon, Dexia, Deutsche Bank, EIB, ING Bank, IFC, JBIC, JAIDO, KfW, NIB Capital Bank, Norddeutsche Landesbank, Caja Madrid.

2. OPERATIONAL ENVIRONMENT

2.1. Political Environment

The Czech Republic continues to meet the conditions specified in Article I of the Agreement Establishing the Bank. It is a constitutional democracy with a bicameral parliament made up of the Chamber of Deputies and the Senate. The President is elected by parliament for a maximum of two five-year terms by the Chamber of Deputies and the Senate in any of three two-stage rounds, with the size of the majority required in run-offs between the two top candidates reduced in second and third round of the election. Vaclav Klaus, a former Prime Minister, was elected President in 2003 upon the expiry of Vaclav Havel's second term of office. The President, who has limited powers that include oversight of foreign policy and the right to attend Cabinet meetings, nominates the Prime Minister who selects his Cabinet, which is then accepted through a vote of confidence in parliament. Following the resignation of Stanislav Gross, Jiri Paroubek became Prime Minister in April 2005 at the head of a coalition made up of the Czech Social Democratic Party (CSSD) and two small centrist parties, the Christian Democratic Union-Czechoslovak People's Party (KDU-CSL) and the Freedom Union. The second largest party in parliament is the opposition centre-right Civic Democratic Union (ODS). The (also opposition) Communist Party (KSCM) is the third largest in parliament. The judiciary is independent and the government respects human rights. The Ministry of the Interior oversees the police force. The Czech Republic became a member of the European Union on 1 May 2004. It has been a member of NATO since 1999. A more detailed analysis of political and social issues is provided in Annex 7.

2.2 The General Reform Environment

The Czech Republic successfully implemented major transition reforms in the early 1990s. After the 1997 currency crisis, reforms gained further momentum – a very successful investment incentives scheme was launched and the banking sector was restructured and privatised. Attention in recent years has focused on the adoption of the EU acquis communautaire and entry to the EU in May 2004. Since EU accession there has been significant progress with privatisation of remaining state-owned companies (e.g. Unipetrol and Cesky Telecom) and some improvements have been made to enterprise registration.

The main challenges for the next strategy period include: i) making further progress with enterprise restructuring and improving labour market mobility; ii) introducing further improvements to the business environment and reducing corruption, in particular by adopting the new bankruptcy code, simplifying tax codes, enhancing the transparency of public administration, and improving the general legal environment; and iii) initiating comprehensive reform of the education, health care, social security and pension systems to make public finances and debt levels sustainable over the medium term.

2.2.1. Macroeconomic conditions relevant for Bank operations

The economy grew by 4.4 per cent in 2004, the highest growth rate since 1996 (please refer to Annex 4 containing the Selected Economic Indicators table). In the first and second quarters of 2005 growth remained robust at 4.7 and 5.1 per cent respectively. Growth has been mostly driven by particularly strong growth in exports and robust growth in gross capital formation. Private and government consumption have remained subdued. Sustaining this level of growth over the medium term will depend on developments in the EU, the extent and speed of fiscal adjustment as well as improvements to the business environment.

As expected, inflation increased from mid-2004 to reach 2.8 per cent in December 2004, compared with 1.0 per cent at the end of 2003. This was mainly because of tax changes implemented earlier in the year. However, inflation has since declined reaching less than 2 per cent in August 2005 and the CNB interest rates are now 25 basis points below ECB rates. Exchange rate developments will continue to be driven by large capital account transactions, political tensions, and speculative flows in advance of the adoption of the Euro. The government's and the CNB's joint strategy for adopting the Euro targets EMU membership in 2009-2010. The trend will further be for the real exchange rate to appreciate although some fluctuations can be expected in the medium term until the entry into ERMII.

The unemployment rate (which amounted to 8.3 per cent in 2004) and non-wage labour costs continue to be high. There continue to be large regional differences in unemployment and regional shortages of skilled labour. Reform measures are needed to address the regional disparities, rising youth and long-term unemployment, skills mismatches and low labour force mobility. The government has started to tackle this issue by limiting the rate of increases in social benefits. Moreover the government announced in July 2005 the cutting of the subsistence level benefits in order to encourage more active job-seeking. In addition, however, reforms to the rent control system, better road access to regions with high unemployment and investment in the old housing stock are urgently needed to encourage mobility.

The general government deficit declined sharply from 11.7 per cent in 2003 to 3 per cent in 2004. This was mostly due to one-off factors, such as significantly reduced banking sector restructuring costs in 2004 than in 2003, as well as revised new budgetary rules allowing carryover of unspent allocations. The state budget deficit was also smaller as a result of higher revenues and changes in the tax system. Current plans envisage an increase in the general government deficit of 1.5 to 2 percentage points to reach 4.5 to 5 per cent of GDP in 2005, representing a significant pro-cyclical stimulus, although. The IMF has urged the government to keep the general government deficit at last year's level to diminish macroeconomic risks. Indeed, developments so far this year suggest that the increase in the deficit could be smaller. In addition, however, significant fiscal reforms

are necessary over the medium term to ward against the fast rate of population aging. Recent discussions about fiscal reforms have focussed on social welfare expenditure cuts, pension and health care reform, and further lowering of direct taxes. However both the political consensus and popular support for fiscal reform are lacking. Public debt has more than doubled since 2000, reaching 37.4 per cent of GDP at the end of 2004.
The current account deficit declined to 5.2 per cent of GDP in 2004, largely due to a fall in the trade deficit to less then 1 per cent of GDP as a result of strong export growth. The income balance, consisting mostly of reinvested earnings and dividends of foreign-owned enterprises, widened further to 5.1 per cent of GDP. Net foreign direct investment (FDI) inflows more than doubled in 2004, compared with the previous year, to US$3.9 billion. Net FDI levels are expected to increase even more significantly in 2005 (to an estimated US$8.5 billion) as a result of the recent privatisations. External debt has increased as a share of GDP to about 37 per cent by the end of 2004. International reserves still exceeded four months of imports in 2004.

Record FDI inflows should result in robust GDP growth over the medium term, while consumer prices and the exchange rate are expected to remain stable. However, there still remain significant reform challenges to underpin this growth. In particular, the slow speed of fiscal consolidation remains the main macroeconomic risk going forward. More determined action regarding labour mobility, the business environment, as well as the pensions/health/ and social security systems are necessary to avoid the exacerbation of imbalances and the escalation of adjustment costs.

2.2.2 Transition Success and Transition Challenges

The 2005 Assessment of Transition Challenges highlighted the following challenges for the Czech Republic. Please refer to the ATC Snapshot Table in Annex 5 for individual sector-by-sector ratings, and to the table on comparative Structural Change Indicators in Annex 6 for more detailed transition indicators.

Specialised Industries

In the ***general industry*** sector there has been significant progress with privatisation in the last strategy period, which has most recently included the sale of Unipetrol, Cesky Telecom and Vitkovice Steel (see below). Restructuring of large formerly state owned enterprises is ongoing and the enterprise sector is now dominated by efficient foreign owned enterprises. There are however, continued problems in the business environment, in particular with regard to the protection of property rights, business regulation, and the functioning of the judiciary. In February 2005 the government simplified company registration through the introduction of standardised forms and an automatic five-day registration deadline. Progress has also been made in establishing a one-stop shop for trade licensing. However, although the long-awaited new draft law on bankruptcy, which seeks to strengthen creditor rights, has been approved by the government in August 2005, it is awaiting approval by parliament. Moreover, the simplification of the cumbersome tax code and tax administration is still necessary. Irregularities in public procurement and corruption in all parts of public administration, while smaller than in most other transition countries, are still significant and only slowly being addressed. Measures to increase transparency in awarding public contracts, a conflict of interest law and legislation to reduce political immunity are still pending. The planned winding down of the Czech Consolidation Agency (which has taken on bad loans from the banking sector following the 1997 crisis) by the end of 2007 will be welcome in order to limit the moral hazard that is inherent in providing a bail out for private sector debts.

There has been significant progress with privatisation and restructuring in the ***natural resource sector.*** Recent sales include the remaining minority stakes in two coal mining companies, OKD and Sokolovska Uhelna. Moreoever, the privatisation of the petrochemicals company Unipetrol was completed in May 2005, with the sale of a 62.99% stake to Polish PKN Orlen for CZK 13.1 billion. In July 2005 the government also announced the sale of Vitkovice Steel, the country's third largest steel producer, to Russia's Evraz Holding for just over CZK 7 billion (US$278 million) in a tender from which the Penta Group and Mittal Steel were eliminated. Moreover, in July 2005 the government decided to finally open exclusive talks with the state-owned power company Ceske energeticke zavody (CEZ) on the sale of the state's 55% stake in the leading brown coal mining company Severoceske doly.

The ***real estate*** sector is developing fast, including new types of property as well as financing instruments. However, a significant part of the residential market is subject to non-targeted rent control (approximately one third of the market, most importantly in Prague), and the government is providing substantial non targeted subsidies vaguely associated with the housing market.

In ***agribusiness*** the land market still does not function properly. Farm debts are hampering performance and farm consolidation and restructuring are proceeding slowly. The privatisation of agro-processing and services has been completed, but new owners still have to reduce costs, improve efficiency and upgrade hygiene standards in order to become internationally competitive. Some of the largest agribusiness companies are non-transparent, have poor corporate governance and are over-indebted. The high levels of debt and the poor credit history have hampered access to finance for the farm sector.

Infrastructure

The Czech ***power sector*** has been unbundled to a large extent (CEZ still owns five distribution companies) and is characterised by widespread private sector participation in generation and distribution. In July 2005 CEZ announced a restructuring which envisages a reduction in staff by about 1,500 and in operating costs by over CZK 5 billion. Under the restructuring plan, assets and staff of the five power distributors in the CEZ group will be transformed into ten new firms, with each of the current distributors serving as home to two of the new divisions. The restructuring plan will comply with a law requiring the separation of distribution and sales activities. Tariffs are cost reflective and the independent regulator is characterised by high standards in accountability and transparency.

As for the ***MEI sector,*** there is widespread private sector participation in the district heating and water utilities. Significant progress has been achieved in tariffs reforms, but ongoing work at creating incentives for efficiency remains to be implemented, and utilities have been corporatised and commercialised. The institutional framework for local finance is advanced, but successful implementation of public private partnerships or revenue-based financing for capital investment is limited.

The basic institutions for the ***energy efficiency*** sector are in place. An energy efficiency law has been adopted by the parliament. The ESCO sector is expanding and energy efficiency incentives for households are being introduced. The Czech Republic has ratified the Kyoto protocol and as a new EU member is part of the Emissions Trading System (ETS). Energy intensity remains high, which is only partly due to the high share of energy intensive industries in the economy.

The Czech ***telecom market*** is one of the most competitive in the region. Also, the government finalised in June 2005 the sale of its 51.1% stake in the dominant fixed line operator Cesky Telecom to Telefonica of Spain for CZK 83 billion (around US$ 3.2 billion), which is the second largest privatisation in the country to date. Following the completion of the deal, Telefonica has two months to arrange a mandatory stock buyout of minority shareholders. There is a strong telecom regulator that has reached high standards. Tariffs are among the highest and have been rebalanced. Advanced services are not well developed, given the country context.

In ***railways,*** operating and policy setting functions are separated and the infrastructure company is separated from operating companies (passenger, freight, etc.). In January 2005 the European Commission approved the Czech Republic's plans to financially compensate those who will be hit by the restructuring of the Czech national 100 per cent state owned rail operator Ceske drahy. The Czech government expects to spend a total of CZK 1.86 billion to compensate employees who will have to be laid off. The number of employees eligible for the grant is estimated to be 11,100 of the 16,000 to be dismissed in 2004-2008. Some 6,000 of CD's 70,000 employees are scheduled to be dismissed in 2005 (following the dismissal of 6,800 employees in 2004). The restructuring of the railways companies envisages the transfer of the entire freight and passenger transport divisions into separate holding subsidiaries. There is limited private sector participation (e.g. some local passenger lines). An independent regulator for licensing was established, but prices are regulated by the Ministry of Transport. In ***roads,*** road and motorway directorate is semi-independent. Ancillary services have been divested. There was an attempt for a road concession (i.e. D47), but the tendering process was not transparent and subsequently cancelled.

Financial institutions

The basic regulatory framework in the ***banking sector*** has been harmonised with the European Community Law. The number of banks seems consolidated and a majority is foreign-owned. Three large foreign owned banks (CSOB owned by Belgian KBC, Ceska Sporitelna owned by Austrian Erste Bank, Komercni banka owned by French Société Générale) dominate the banking sector. Domestic credit to private sector is however low. Though the sector is relatively well-capitalised, levels of financial intermediation are still quite low compared to Western European levels. Efficiency of financial intermediation still remains below its Western peers. In July 2005 the Central Bank and the Ministry of

Finance signed an agreement to establish a single regulator for financial market supervision next year.

In the ***non-bank financial sector***, securities markets legislation and regulation almost meet IOSCO standards but there are remaining weaknesses in the legislation on self regulating organisations and prudential requirements in the areas of clearance and settlement and the secondary market. Insurance legislation and regulation almost meet IAIS standards. Stock markets in terms of market capitalisation have been declining for years, but there is a strong reverse trend visible since 2004 (with three IPOs and a high growth in utility shares) so that they are now comparable to some of the other EU members in CEB. Czech capital markets are characterised by relatively developed corporate bond market. Insurance penetration is comparable to the average rate of OECD member countries. There are voluntary supplementary pension funds used by a large part of working age population. Leasing and consumer finance markets are fully developed.

Despite the well developed banking sector, it has been perceived that the Czech Republic remains one of the most challenging markets for the ***private equity fund sectors*** in transition economies. Private equity investment as percentage of GDP in the Czech Republic is comparable to that in Greece, which is considered lagging far behind its EU peers. Further legal changes and successful high profile projects are needed to increase the visibility of the sector. The local stock exchange does not yet offer a realistic exit route from private equity investments and there has only been one IPO of a local private company since the beginning of transition. The share of investments from domestic sources remains significantly below (or non-existent) the level in developed economies and the equity funds are yet to offer a broader range of financial products.

SMEs continue to suffer from a lack of finance. Starting a business is not excessively burdensome: it takes 10 different procedures, an average of 40 days and 10.8 per cent of GNI to register a company, which compares well with other countries in the region (see, for example, the World Bank Doing Business in 2004 report). A credit registry is in place providing information on 25% of the population, as well as private credit bureaus. The cost of registering collateral is low. However, the bankruptcy legislation has to be improved to protect creditor rights better. Following the cleanup of commercial banks, these have shifted their preference to lending to households (30% growth rate) whilst lending to enterprises decreased in nominal terms in 2000-2002 by a cumulative 20 per cent and has since stagnated. Commercial banks and leasing companies have extended some loans/leases to SMEs, often under dedicated IFI-supported credit lines.

Access to capital and investment requirements

Domestic credit

Following the 1997 currency crisis and the ensuing clean-up of commercial banks, domestic credit to the private sector fell in 1999-2000 and has since then increased at a very slow pace year-on-year. According to survey data, domestic credit to the corporate private sector stood at 27 per cent in 2004, which is relatively low compared to some of its other new EU member states peers. In particular the credit to enterprises has been falling in the past few years as a result of the banking sector restructuring, the tightening of credit criteria after privatisation and funding provided to foreign owned companies from their centres abroad. The household credit market (consumer loans, credit cards and mortgage market) is however developing fast. The leasing market is also already well developed and the ratio of leased assets to GDP exceeds the EU average.

Capital market
One sign of the growing maturity of the economy is the much-awaited revival in IPO activity as of last year. Although the country ended up with a large number of listed companies in connection with the mass privatisations, the first IPO (by pharmaceuticals group Zentiva) only happened in June 2004. Now, three of the nine blue chips on the Prague Stock Exchange are the result of IPOs since last year. While this is partly due to growing foreign investor interest in the region and the strong performance of the stock exchange, the pick-up also reflects growing confidence in the country's regulations and institutions. Among other things, the regulatory framework has been comprehensively overhauled, listing rules simplified, and the operations of the market supervisor, the Securities Commission, modernised. Nevertheless, stock market capitalisation represented only 17 per cent of GDP at the end of 2004 (with total stock and bond market capitalisation representing 42 per cent). Moreoever, the market remains very illiquid.

Foreign direct investment
According to the CNB, the cumulative stock of FDI in the Czech Republic amounted to US$ 42.5 billion at the end of 2004. This results in a per capita value of US$ 4,167 and places the Czech Republic at the highest position among Central and Eastern European countries. About 80 percent of FDI has come from EU countries. The surge in FDI inflows was particularly notable in the period 1998-2001, mainly due to the privatisations of large banks and utilities, but also due to the introduction of investment incentives that boosted the inflow of greenfield FDI. However, net FDI inflows increased sharply again in 2004 (to reach US$ 3.9 billion) and are expected to increased further (to around US$8.5 billion) in 2005 following the sale of the remaining state shares in Czech Telecom and the petrochemical conglomerate Unipetrol.

2.3 Legal Environment

The Czech Republic has made significant reforms to its legal framework, which has led to major improvements in the country’s legal environment. The Czech Republic is one of the countries of Central Europe that joined the European Union (EU) on 1 May 2004. Despite the success of the country towards the establishment of a market-oriented economy and stable democratic institutions, efforts are needed to overcome existing challenges.

The Czech Republic is a parliamentary democracy where separation of powers and independence of the judiciary are recognised. However, there are important issues that need be addressed by the authorities. Although the judiciary is legally independent, deficiencies regarding training and resources for the courts generate problems and a lack of confidence from the business community. However, as regards personal freedoms and human rights, the Czech Republic is viewed as one of the best performing transition countries, which positively affects the economic and legal reforms in the country.

Alignment of Czech laws with EU laws (both pre- and post-EU accession) helped to improve the quality of the legal environment in the country. However, as described in Annex 10, there are challenges that ought to be addressed, in particular in the area of commercial legislation and specifically the securities markets, corporate governance, concessions, insolvency, secured transactions and telecommunications legislation.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

In response to the analysis of the remaining transition challenges of the Czech Republic and reflecting the ability of the Bank to address them, the main focus of the Bank's activities in the country during the strategy period will be the following:

- Continue to work closely with local financial intermediaries on providing funding to the SME sector and small municipalities with a focus on rural areas.

- Provide higher risk products such as equity and structured debt for local corporations to fund their growth, in particular in the context of cross border expansion. Support foreign direct investments by medium sized companies in regions of higher unemployment with higher risk products not offered by the private sector.

- Work on a limited number of high quality public private partnerships in the infrastructure area, in conjunction with Cohesion/Structural Funds.

- Identify and fund energy savings projects and renewable energy projects.

The Bank will be responsive to various opportunities that may arise, but will clearly concentrate on the priorities defined above. The Bank's additionality and transition impact will be demonstrated on a case-by-case basis.

3.2 Sectoral Challenges and Bank Objectives

In line with the transition challenges identified above and in Annex 5, the EBRD will focus on the following sectoral priorities.

3.2.1 Financial Sector

Transition Goals

- The banking sector is fully functional with a consolidated number of banks, most of them foreign owned. However, financial intermediation is still one of the lowest in the region and substantially below Western European levels. In particular, SMEs still suffer from lack of finance. The Bank will aim to contribute to a higher financial intermediation in the SME sector and small municipal sector through co-operation with commercial banks and leasing companies.

- The financial institutions in the Czech Republic do not offer the full range of financial products. Commercial banks focus on senior loans and the development of equity funds is hampered as the Prague stock exchange does not offer a realistic exit route from private equity investments. The Bank will contribute to the promotion of higher risk products in form of equity, quasi equity and mezzanine financing via non banking financial intermediaries.

Operational Priorities

- Implement the Rural SME facility with two smaller leasing companies operating mostly in rural areas.
- Implement the Municipal Finance Facility with one of the banks involved in this sector.
- Develop a mezzanine programme for SMEs with a leading local bank.
- Selectively commit capital to new equity funds with a focus on SMEs.

3.2.2 Enterprise Sector

Transition Goals

- Support sustained growth and competitiveness of the corporate sector in the new conditions following the EU entry. In particular, SMEs need risk capital so that they can fund their local and regional expansion.
- Development of higher value added activities through support to FDIs preferably in distressed regions to help to combat unemployment.

Operational Priorities

- Provide higher risk products such as equity and mezzanine financing to the private sector for local operations as well as cross border expansion targeting countries of East and South East Europe.
- Support FDI targeting green-field and brown-field projects in less developed regions of the country and acquisitions/expansions of their existing local operations. Provide guidance to investors with limited country experience.
- Develop a bond programme for the medium size corporations in order to help them get ready for approaching capital markets in the future.

3.2.3 Infrastructure and Environment

Transition Goals

- Contribute to the increase of the absorption capacity of the country with respect to EU funding of infrastructure projects necessary for development of economy and private sector growth.
- Contribute to the success of the new Public Private Partnership initiative with the aim to deliver infrastructure in a cost effective and timely manner including its operation and maintenance over a long period of time.

- Support improvement of energy efficiency of the economy through promotion and implementation of ESCO projects. Contribute to the fulfilment of national targets concerning increase of percentage of renewable energy in overall energy consumption.

Operational Priorities

- Support of private sector participation in financing of at least one major infrastructure or municipal services project through an off budget structure, providing long term financing or equity. For smaller municipalities, wherever possible, use financial intermediaries.
- Support ESCO projects in the private sector as well as the public sector working closely with regional authorities to improve energy efficiency of schools and hospitals. Consider a risk sharing scheme for a portfolio of smaller energy savings projects funded by a local bank.
- Identify and provide funding for efficient renewable power projects working with local entrepreneurs as well as foreign sponsors.

4. CO-OPERATION WITH OTHER IFI's

- **European Union (EU) –** The EU committed a total EUR 2,327 million in structural and cohesion funds for the period 2004-2006. Cohesion funds will amount to EUR 836 million and will finance transport and environmental infrastructure projects. Structural funds will amount to EUR 1,491 million and will be used to fund the following priority areas: increase of competitiveness of the industry, development of transport infrastructure, human resources development, rural development, development of tourism. Number of projects submitted for financing suggests that these funds will be fully used.

- **The International Monetary Fund (IMF) -** The Czech Republic joined the IMF in January 1993. The latest stand-by facility expired in March 1994. The Article IV consultations are held on the standard 12-month cycle. The Czech Republic has been the recipient of several technical assistance missions and in recent years experts of the Czech National Bank have also participated in technical assistance missions abroad. The most recent Article IV consultation with the Czech Republic was concluded by Executive Board of IMF on August 1, 2005. Medium term recommendations for the country include the need for fiscal consolidation, as well as pension, health care and benefits reforms.

- **The World Bank –** The World Bank has not made any loans to the Czech Republic since September 1993. WB provided technical support on selected issues (prevention of money laundering and financing of terrorism, health care, pension system) and continues to do so at the behest of the Czech authorities. WB provided grants to the area of environment (Global Environmental Facility). WB co-organised the regional PPP forum held in Prague in 2004. In 2005, Czech Republic graduated from the borrower status and transited to providing of development assistance.

- **The International Finance Corporation (IFC) –** The IFC financed 18 projects in the Czech Republic in an amount of USD 402.2 million, the last one was co-financing of the purchase of a portfolio of distressed assets sold by Consolidation Agency in 2001. IFC has closed its offices in Prague and manages its activities in the CR from Bratislava.

- **The European Investment Bank (EIB) –** Since 1992, the EIB committed in total EUR 5.5 billion for projects in the Czech Republic, of which EUR 2.9 billion to the public sector, mainly for infrastructure projects (roads, rail-corridors, Prague airport, water systems). The EIB co-finances a green-field automobile plant sponsored by strategic investors. During recent years the EIB provided funding to banks to support SME lending. Recently the EIB signed a facility with a Region to bridge financial needs for EU funded projects of that Region (road maintenance, regional airport).

ANNEX 1: COMMITTED PROJECTS PER YEAR

Year	Op Name	Direct/ Regional	Total Project Value	EBRD Finance	Debt	Equity
1992	CSA	Direct	23.9	23.9	0.0	23.9
1992	Cokoladovny	Direct	178.4	23.3	0.0	23.3
1992	Eurotel Praha spol. s.r.o.	Direct	55.9	9.1	9.1	0.0
1992	Czech & Slovak Investment Corp	Regional	7.0	3.6	0.0	3.6
1992	**4**		**265.2**	**59.9**	**9.1**	**50.8**
1993	CES Uniweb A.S. (ING)	Direct	6.1	1.5	1.5	0.0
1993	CZ-Cagiva a.s.	Direct	36.9	5.9	5.9	0.0
1993	Czech Telecommunications Project	Direct	264.8	37.8	37.8	0.0
1993	TTD/Dobrovice Sugar Factory	Direct	27.0	4.2	0.0	4.2
1993	Tatrarex spol.s.r.o. (ING Bank Vienna-CEAL)	Direct	2.0	0.8	0.8	0.0
1993	Dun & Bradstreet	Regional	0.3	0.3	0.0	0.3
1993	New Europe East Investment Fund	Regional	15.4	3.3	0.0	3.3
1993	Renaissance Fund	Regional	13.1	3.5	0.0	3.5
1993	**8**		**365.6**	**57.3**	**46.0**	**11.3**
1994	Barum / Continental	Direct	155.7	29.6	29.6	0.0
1994	Kabel Net	Direct	13.1	2.5	0.0	2.5
1994	Karosa	Direct	42.6	6.5	0.0	6.5
1994	TFP: Komercni Banka	Direct	12.4	12.4	12.4	0.0
1994	Tesla - Y.S.	Direct	16.3	6.1	6.1	0.0
1994	Advent Private Equity Fund - Central Europe LP	Regional	5.4	1.5	0.0	1.5
1994	Alliance ScanEast Fund	Regional	7.4	2.5	0.0	2.5
1994	**7**		**252.9**	**61.1**	**48.1**	**13.0**
1995	Advent International (addition to Advent Private Equity)	Direct	9.9	9.9	0.0	9.9
1995	Ceske Drahy s.p. - Czech Railway Corridor	Direct	1,113.5	15.4	15.4	0.0
1995	Investicni a Postovni Banka	Direct	6.4	6.4	6.4	0.0
1995	Sepap Steti a.s	Direct	180.4	56.8	56.8	0.0
1995	Skoda Kovarny (Forge) a.s.	Direct	22.2	13.4	13.4	0.0
1995	Technolen WF a.s	Direct	22.2	8.6	8.6	0.0
1995	Winterthur MPF/CS L&P Penzijni Fond as (equity)	Direct	2.9	0.9	0.0	0.9
1995	Winterthur MPF/CS L&P Pojistovna (equity)	Direct	24.9	7.8	0.0	7.8
1995	MBA Loan Project (guarantee)	Regional	0.8	0.3	0.3	0.0
1995	**9**		**1,383.2**	**119.5**	**100.9**	**18.6**
1996	New Europe Insurance Ventures	Regional	3.3	0.9	0.0	0.9
1996	**1**		**3.3**	**0.9**	**0.0**	**0.9**
1997	Czech Private Equity Fund	Direct	21.7	2.3	0.0	2.3
1997	Korado	Direct	136.4	29.9	0.0	29.9
1997	SIS Funds (equity)	Direct	36.6	9.7	0.0	9.7
1997	Baring Communications Equity	Regional	12.7	2.5	0.0	2.5
1997	DBG Osteuropa Holding GmbH	Regional	7.1	2.6	0.0	2.6
1997	Environmental Investment Fund	Regional	4.4	1.0	0.0	1.0
1997	**6**		**218.9**	**48.0**	**0.0**	**48.0**
1998	Ceska Sporitelna Equity	Direct	67.0	67.0	0.0	67.0
1998	Czech Direct Equity Fund	Direct	38.4	9.0	0.0	9.0
1998	Advent Central & Eastern Europe II - Regional Fund	Regional	6.6	2.3	0.0	2.3
1998	Innova/98 LP	Regional	9.8	2.0	0.0	2.0
1998	MBA Loan Project II (guarantee)	Regional	0.1	0.0	0.0	0.0
1998	**5**		**121.9**	**80.3**	**0.0**	**80.3**
1999	Brno Waste Water Treatment Plant Upgrading	Direct	82.8	27.5	27.5	0.0
1999	CSOB Privatisation (portage equity)	Direct	187.1	125.0	125.0	0.0
1999	European Property Group	Direct	145.3	40.7	0.0	40.7
1999	UNIQA - Uniqa Pojistovna (equity)	Direct	2.8	2.8	0.0	2.8
1999	AIG New Europe Fund	Regional	40.7	7.1	0.0	7.1
1999	Central & Eastern Europe Power Fund	Regional	4.9	1.3	0.0	1.3
1999	Emerging Europe Capital Investors LDC	Regional	12.3	3.3	0.0	3.3
1999	Energy Efficiency and Emissions Reduction Fund	Regional	10.7	3.0	0.0	3.0
1999	Info. and Comm. Tech & Industrial Electronic Fund Ltd.	Regional	11.3	2.5	0.0	2.5
1999	**9**		**497.9**	**213.2**	**152.5**	**60.7**

Year	Op Name	Direct/ Regional	Total Project Value	EBRD Finance	Debt	Equity
2000	EU/EBRD Phase I - Ext. - Ceska Sporitelna	Direct	20.0	20.0	20.0	0.0
2000	Harpen District Heating	Direct	36.2	14.2	14.2	0.0
2000	Argus Capital Partners	Regional	47.4	11.4	0.0	11.4
2000	EU/EBRD Phase I - GIMV Czech and Slovak SME Fund	Regional	7.5	1.5	0.0	1.5
2000	Heitman Central Europe Property Partners Fund	Regional	38.0	9.3	0.0	9.3
2000	**5**		**149.1**	**56.4**	**34.2**	**22.2**
2001	Dalkia Usti Nad Labem	Direct	62.0	16.8	16.8	0.0
2001	Soufflet Malting Czech	Direct	29.0	10.0	8.0	2.0
2001	TIW Czech N.V	Direct	341.6	30.4	0.0	30.4
2001	Winterthur MPF/CS L&P Pojistovna - Capital Increase	Direct	11.7	4.1	0.0	4.1
2001	DVI, Inc. (debt)	Regional	4.3	1.1	1.1	0.0
2001	IKB Co-Financing Risk Participation Agreement	Regional	7.0	7.0	7.0	0.0
2001	Innova/3	Regional	37.7	4.5	0.0	4.5
2001	Raiffeisen EU Enlargement Fund	Regional	7.3	3.8	0.0	3.8
2001	Regional/Private Equity Fund Facility - Trigranit II	Regional	2.3	0.8	0.0	0.8
2001	Spearhead International	Regional	6.0	6.0	6.0	0.0
2001	**10**		**508.9**	**84.5**	**38.9**	**45.6**
2002	EU/EBRD Phase II - Ext. - Raiffeisenbank a.s. (Czech R.)	Direct	10.0	3.5	3.5	0.0
2002	Sladovny Soufflet Czech Republic	Direct	38.4	13.4	13.4	0.0
2002	TES Media	Direct	59.8	10.1	10.1	0.0
2002	Winterthur MPF/CS L&P Penzijni Fond	Direct	25.7	20.7	0.0	20.7
2002	Accession Mezzanine Capital LP	Regional	16.6	7.8	0.0	7.8
2002	Heitman Central Europe Property Partners Fund II	Regional	28.8	8.8	0.0	8.8
2002	**6**		**179.3**	**64.3**	**27.0**	**37.3**
2003	EU/EBRD Phase II - Ext. - Raiffeisen Leasing	Direct	5.0	5.0	5.0	0.0
2003	Genesis Private Equity Fund	Direct	30.0	6.0	0.0	6.0
2003	DBG Osteuropa Holding II	Regional	22.4	6.8	0.0	6.8
2003	ORCO APARTHOTELS	Regional	17.7	1.9	0.0	1.9
2003	Siemens - SKV	Direct	10.4	10.4	5.7	4.7
2003	Volksbank FW - Volksbank CZ Subordinated Loan	Direct	10.0	10.0	10.0	0.0
2003	EU/EBRD Phase II Extn 2 - SG Equipment Finance Czech Rep.	Direct	20.6	20.6	20.6	0.0
2003	Spearhead (Eurofarms)	Direct	4.7	4.7	4.7	0.0
2003	EU/EBRD Phase II Extn 2 - Ceska Sporitelna Extension	Direct	10.0	10.0	10.0	0.0
2003	**9**		**130.8**	**75.4**	**56.0**	**19.4**
2004	Polish Enterprise Fund V	Regional	2.8	2.8	0.0	2.8
2004	Accession Fund	Regional	60.0	15.0	0.0	15.0
2004	TriGranit III	Regional	17.1	3.8	0.0	3.8
2004	Advent Central & Eastern Europe Successor Fund	Regional	33.0	5.0	0.0	5.0
2004	Project Vltava	Direct	325.0	25.0	25.0	0.0
2004	Raiffeisen International	Regional	6.0	3.0	0.0	3.0
2004	EU/EBRD PHASE II SME Komercni Banka	Direct	20.0	20.0	20.0	0.0
2004	Europolis II	Regional	15.0	3.8	2.8	1.0
2004	Grandi Stazioni CR	Direct	31.3	3.8	0.0	3.8
2004	**6**		**510.2**	**82.2**	**47.8**	**34.4**
2005	Emerging Europe Convergence Fund II	Regional	4.2	4.2	0.0	4.2
2005	**1**		**4.2**	**4.2**	**0.0**	**4.2**
TOTAL	**89**		**4,592**	**1,007**	**560**	**447**

ANNEX 2: NET CUMMULATIVE BUSINESS BY INDUSTRY

(in million EUR as of 31 August 2005)

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Energy Efficiency	2.2	110	35	32	3	3%
	Power and Energy	0.3	5	1	0	1	0%
Sub-total Energy		**2.5**	**115**	**36**	**32**	**4**	**4%**
Financial Institutions	Bank Equity	2.0	259	195	125	70	19%
	Bank Lending	2.8	96	89	89	0	9%
	Equity Funds	7.7	401	106	0	106	10%
	Non Bank Financial Institutions	2.5	139	74	27	47	7%
Sub-total Financial Institutions		**15.0**	**896**	**465**	**241**	**224**	**46%**
General Industry	General Industry	9.5	625	159	123	36	16%
Sub-total General Industry		**9.5**	**625**	**159**	**123**	**36**	**16%**
Infrastructure	Municipal & Env Inf	1.2	87	29	28	1	3%
	Transport	4.0	1,182	53	21	32	5%
Sub-total Infrastructure		**5.2**	**1,269**	**82**	**48**	**33**	**8%**
Specialised Industries	Agribusiness	4.0	287	62	32	30	6%
	Property and Tourism	2.1	323	84	3	81	8%
	Telecoms Informatics & Media	6.8	1,077	119	82	38	13%
Sub-total Specialised Industries		**12.9**	**1,687**	**265**	**117**	**149**	**27%**
CZECH REPUBLIC TOTAL		**45.0**	**4,592**	**1,007**	**560**	**447**	**100%**

ANNEX 3: SELECTED ECONOMIC INDICATORS

Czech Republic

	1999	2000	2001	2002	2003	2004 *Estimate*	2005 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	1.2	3.9	2.6	1.5	3.2	4.4	5.0
Private consumption	2.2	2.9	2.8	2.7	4.6	2.0	na
Public consumption	2.3	-1.0	5.3	4.5	3.8	-2.0	na
Gross fixed capital formation	-3.5	4.9	5.4	3.4	4.7	7.6	na
Exports of goods and services	5.5	16.5	11.5	2.1	7.5	21.9	na
Imports of goods and services	5.0	16.3	13.0	4.9	7.9	18.4	na
Industrial gross output	-0.4	5.1	6.8	4.8	5.8	9.9	na
Agricultural gross output	2.3	-4.5	2.5	-4.4	0.0	2.3	na
Employment			*(Percentage change)*				
Labour force (end-year)	0.4	0.2	0.0	1.0	0.4	0.0	na
Employment (end-year)	-2.1	-0.7	-0.1	0.8	-0.7	-0.6	na
			(In per cent of labour force)				
Unemployment (end-year)	8.7	8.8	8.1	7.3	7.8	8.3	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	2.1	4.0	4.7	1.8	0.2	2.8	2.0
Consumer prices (end-year)	2.6	4.1	4.2	0.6	1.1	2.8	2.8
Producer prices (annual average)	1.0	4.9	2.9	-0.5	-0.3	5.7	na
Producer prices (end-year)	3.4	5.0	0.8	-0.7	0.9	7.7	na
Gross average monthly earnings in economy (annual average)	8.2	7.0	8.6	7.5	7.0	6.6	na
Government sector[1]			*(In per cent of GDP)*				
General government balance	-3.4	-4.5	-5.9	-6.8	-11.6	-3.3	-4.5
General government expenditure	39.0	40.4	41.6	43.9	43.7	41.9	na
General government debt	13.5	18.5	27.2	30.7	38.3	37.4	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	8.1	6.8	7.9	3.2	7.2	4.4	na
Domestic credit (end-year)	-2.0	1.0	-5.3	-7.1	21.9	0.1	na
			(In per cent of GDP)				
Broad money (M2, end-year)	67.8	68.8	68.9	68.2	69.1	67.1	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
2-week repo rate	5.3	5.3	4.8	2.8	2.0	2.5	na
3-month PRIBOR	5.6	5.4	4.7	2.6	2.1	2.6	na
Deposit rate	4.5	3.4	2.6	1.7	1.3	1.4	na
Lending rate	8.7	7.2	8.7	8.8	8.2	8.0	na
			(Korunas per US dollar)				
Exchange rate (end-year)	35.7	38.8	36.5	30.7	26.3	22.9	na
Exchange rate (annual average)	34.6	38.6	38.0	32.7	28.2	25.7	na
External sector			*(In millions of US dollars)*				
Current account	-1,462	-2,718	-3,273	-4,166	-5,690	-5,574	-4,400
Trade balance	-1,903	-3,131	-3,068	-2,179	-2,473	-869	500
Merchandise exports	26,265	29,052	33,378	38,319	48,568	66,678	81,000
Merchandise imports	28,167	32,183	36,446	40,497	51,041	67,547	80,500
Foreign direct investment, net	6,234	4,943	5,476	8,276	1,895	3,917	8,500
Gross reserves, excluding gold (end-year)	12,825	13,139	14,464	23,709	26,955	28,448	na
External debt stock	22,861	21,608	22,374	26,983	34,861	45,303	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.5	4.2	4.1	6.1	5.5	4.4	na
			(In per cent of exports of goods and services)				
Debt service	12.7	12.3	8.6	9.1	6.4	4.7	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	10.3	10.3	10.2	10.2	10.2	10.2	na
GDP (in millions of korunas)	2,041,400	2,150,100	2,315,300	2,414,700	2,555,783	2,750,256	2,945,180
GDP per capita (in US dollar)	5,722	5,422	5,964	7,229	8,873	10,471	na
Share of industry in GDP (in per cent)	35.5	36.0	37.5	38.7	39.7	41.8	na
Share of agriculture in GDP (in per cent)	3.9	3.9	3.9	3.7	3.6	3.5	na
Current account/GDP (in per cent)	-2.5	-4.9	-5.4	-5.6	-6.3	-5.2	-3.5
External debt - reserves (in US$ million)	10,036	8,469	7,910	3,274	7,906	16,855	na
External debt/GDP (in per cent)	38.7	38.8	36.8	36.6	38.5	42.3	na
External debt/current account revenues, excluding transfers (in per cent)	68.6	60.2	55.3	59.5	61.9	59.3	na

[1] Calculated according to Eurostat methodology (ESA95).

ANNEX 4: RATINGS FROM THE 2005 ASSESMENT OF TRANSITION CHALLENGES

CZECH REPUBLIC	Structure	Institutions	Conduct	Comments
Agribusiness	*Small*	*Small*	*Medium*	Poorly functioning land market. Farm restructuring proceeding slowly. Agroprocessors still need to improve efficiency and standards. Some of the largest companies still have poor corporate governance structures. Improvements to distribution and traceability are necessary. Limited finance to the sector.
Banking	*Negligible*	*Small*	*Small*	Regulatory framework in place. Number of banks consolidated and majority foreign owned. Financial intermediation is amongst the lowest in the region. There is a need to broaden access to financial services and to increase the diversity of financial products.
Energy Efficiency	*Small*	*Medium*	*Medium*	Basic institutions in place. Energy efficiency law adopted. ESCO sector is small but expanding and energy efficiency incentives are being introduced for households. Ratified Kyoto Protocol and is part of the EU Emissions Trading System (ETS). Energy intensity remains high.
General Industry	*Small*	*Small*	*Small*	Enterprise registry, bankruptcy process, and resolution of commercial disputes are unnecessarily complex. Irregularities in public procurement and corruption in public administration still significant. Restructuring largely completed and the enterprise sector is dominated by efficient, often foreign-owned enterprises.
MEI	*Negligible*	*Medium*	*Small*	Widespread private sector participation particularly in the water sector. Further incentives for efficiency remain to be implemented. The institutional framework for local finance is advanced, but successful implementation of public private partnerships or revenue-based financing for capital investment is limited.
MSMEs	*Medium*	*Small*	*Medium*	Starting a business is not excessively burdensome. A credit registry and private credit bureaus exist. Existing collateral and bankruptcy legislation support lending to MSMEs. The cost of registering collateral is low. However, bank lending to enterprises is relatively low and has stagnated in recent years.
Natural Resources	*Small*	*Small*	*Small*	Privatisation of coal mining companies close to completion. Oil refinery privatisation was completed in 2004. Restructuring of natural resource related companies and transparency improvements still necessary.
NBFIs	*Negligible*	*Small*	*Small*	Securities and insurance markets legislation/regulation almost meet IOSCO/ IAIS standards. Stock markets capitalisation has increased significantly in 2004. Insurance penetration is comparable to the OECD average. Voluntary supplementary pension funds. Leasing /consumer finance markets are fully developed.
Power	*Small*	*Small*	*Small*	Sector has been unbundled to a large extent (CEZ still owns five distribution companies); widespread private sector participation in generation and distribution. Tariffs are cost reflective and the independent regulator is characterised by high standards in accountability and transparency.
Private Equity Funds	*Medium*	*Small*	*Medium*	One of the most developed sectors in region. Private equity investment as %of GDP comparable to that of Greece. Share of investments from domestic sources remains significantly below level in developed economies + equity funds yet to offer a broader range of instruments. Small pool of experienced managers.

Property + Tourism	*Small*	*Small*	*Negligible*	Full tradability of land except foreigners. The real estate sector is well developed in Prague and developing fast elsewhere, including new types property as well as financing instruments. However, a significant part of the residential market is subject to non-targeted rent control and benefiting from subsidies.
Telecoms	*Small*	*Small*	*Small*	Market is one of the most competitive in the region. Privatisation of the dominant fixed line operator is expected to be finalised in 2005. There is a strong telecom regulator. Tariffs are among the highest and have been rebalanced. Advanced services are not yet well developed.
Transport	*Medium*	*Medium*	*Medium*	In railways, infrastructure company is separated from operating companies (passenger, freight, etc.). Limited private sector participation (e.g. some local passenger lines). An independent regulator for licensing was established, but prices are regulated by the MoT. Road and motorway directorate is semi-independent. Ancillary services have been divested. Only one, unsuccessful attempt for a road concession (i.e. D47).

ANNEX 5: COMPARATIVE STRUCTURAL CHANGE INDICATORS

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Liberalisation								
Share of administered prices in CPI (in per cent)	10.9	26.7	17.9*	14.3	19.8*	1.2	19.9*	16.7
Number of goods with administered prices in EBRD-15 basket	1*	3.0	2*	2.0*	1*	0*	2*	1*
Share of trade with non-transition countries (in per cent)	80.6**	72**	84**	65.5**	63.6**	na	66.1**	77.7**
Share of trade in GDP (in per cent)	117.4	124.7	119.1	89.1	101.8	60.3	138.6*	101.8
Tariff revenues (in per cent of imports)	0.2	0.2*	0.4*	0.4	0.5	0.5	0.5**	1.2**
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Privatisation								
Privatisation revenues (cumulative, in per cent of GDP)	24.3	7.5*	31.7*	5.5	13.8	14.3	35**	4.7**
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	65.0
Private sector share in employment (in per cent)	70**	na	na	76*	na	71.0	na	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	3.7	4.0	3.3	4.0	3.0
Enterprise and markets								
Budgetary subsidies and current transfers (in per cent of GDP)[1]	9.3	1.7*	2.2	5.1	0.3	3.6*	1.5	1.5**
Share of industry in total employment (in per cent)	29.9*	27*	32.9*	19.7*	20.1*	20.5	29.2*	36.3**
Change in labour productivity in industry (in per cent)	11.1*	1.1*	5*	8.2*	11.9*	11.9	2.9*	8.8**
Investment/GDP (in per cent)	35.7**	28.8*	22.5*	32.6*	21.9**	20.2	na	25.3**
EBRD index of enterprise reform	3.3	3.3	3.7	3.0	3.0	3.7	3.7	3.0
EBRD index of competition policy	3.0	2.7	3.0	2.7	3.0	3.0	3.0	2.7
Infrastructure								
Fixed-line (mobile) penetration rate (per 100 inhabitants)	33.7 (105.3)*	34.0 (96.0)*	36.4 (88.8)*	27.6 (67.2)*	23.8 (99.3)*	17.0 (59.9)*	23.1 (79.1)*	40.7 (87.1)*
Internet penetration rate (per 10,000 inhabitants)	376.1*	486.3*	492.1*	258.7*	274.3*	70.5*	226.3*	269.7*
Railway labour productivity (1989=100)	72.4*	294.4*	145.1*	125.9*	71*	103.3*	61.5*	163.2*
Electricity tariffs, USc kWh (collection rate in per cent)	8.4 (na)**	6.5 (na)**	11.4 (99)**	7.1 (99)**	9.4 (90)**	9.8 (na)**	10.9 (na)**	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.2***	2.8***	4.7***	4.1***	3.7***	3.9***	3.1***	4.5***
EBRD index of infrastructure reform	3.3	3.3	3.7	3.0	2.7	3.3	3.0	3.0
Electric power	3.3	3.0	4.0	3.3	3.3	3.3	4.0	3.0
Railways	3.0	4.3	3.3	3.3	2.3	4.0	2.7	3.0
Roads	2.3	2.7	3.3	2.3	2.3	3.0	2.3	3.0
Telecommunications	4.3	4.0	4.0	3.0	3.3	4.0	3.3	3.0
Water and waste water	4.0	4.0	4.0	3.3	3.3	3.3	2.7	4.0
Financial sector								
Number of banks (foreign-owned)	35 (26)*	9 (6)*	38 (27)*	23 (9)*	12 (6)*	57 (44)*	21 (19)*	22 (7)*
Asset share of state-owned banks (in per cent)	2.9*	0*	6.6*	4*	0*	19.4*	1.3*	12.6*
Non-performing loans (in per cent of total loans)[2]	4.1*	0.3*	3.7*	1.1*	2.4*	17.5*	7.2*	7.5*
Domestic credit to private sector (in per cent of GDP)	27.1*	43.3*	46*	49.9*	25.1*	22.5*	25.8*	48.3*
Stock market capitalisation (in per cent of GDP)	25.7*	50.3*	25.5*	11.7*	26.4*	24.9*	9.5*	27.5*
EBRD index of banking sector reform	4.0	4.0	4.0	3.7	3.7	3.7	3.7	3.3
EBRD index of reform of non-bank financial institutions	3.7	3.3	4.0	3.0	3.0	3.7	2.7	2.7

[1] Subsidies to enterprises and financial institutions, including the Czech Consolidation Agency.

* Data is for 2004
**Data is for 2003.
***Data for 2001

ANNEX 6: POLITICAL AND SOCIAL ASSESSMENT

Political developments

The Czech Republic came into being on 1 January 1993 following the break-up of the Czechoslovak Federation. The first Czechoslovak state had been founded by Thomas Masaryk in 1918 in the wake of the collapse of the Austro-Hungarian Empire and had in, March 1939, been occupied and dismembered by Nazi Germany, with the Czech lands being incorporated into the German Reich and Slovakia becoming a state allied to Germany. Restored in May 1945, Czechoslovakia came under Communist rule in a bloodless coup in February 1948. In August 1968 the reformist movement known as the Prague Spring was crushed by the Soviet Union. In April 1969 a new federal structure was introduced. The Communist regime surrendered its monopoly of political power at the end of 1989. Disagreements emerged between Prague and Bratislava over whether the state should be a federation with a strong central government, as Prime Minister Vaclav Klaus, leader of the centre-right Democratic Civic Union (ODS) wanted, or whether it should become a loose confederation advocated by Vladimir Meciar, his counterpart in Slovakia and leader of the populist Movement for a Democratic Slovakia (HZDS). On 25 November 1992 the required three-fifths majority in the Federal Assembly adopted a law dissolving the federation.

In the mid-1990s, widespread corruption, weak corporate governance, mounting enterprise debt and the alarming rise in the number of bad debts in the banking sector exposed serious flaws in the reform process and weakened Klaus's position. In April and June 1997 Klaus was forced by the deteriorating economic and financial situation to introduce austerity measures. He resigned in November 1997 following revelations of financial irregularities within his ODS. A caretaker government under Josef Tosovsky, the Central Bank governor, stayed in office until the June 1998 elections that brought to power a minority government under Milos Zeman. His Social Democratic (CSSD) government formed an 'opposition agreement' with the Klaus's ODS. This gave the ODS leadership positions in parliament, state administration and state-owned enterprises in return for support on key legislation. Despite widespread public disillusionment reflected in a low 58% turnout in the 2002 elections (compared with 74% in 1998), the CSSD won under the leadership of Vladimir Spidla. But his government failed to capitalise on the country's accession to the EU in May 2004. It performed badly in the elections for the European Parliament in June. The CSSD won only two out of the Czech Republic's 24 seats whereas the ODS won nine and the Communists took six. Spidla was replaced as Prime Minister by Stanislav Gross in August 2004. The CSSD suffered further losses in the elections for regional assemblies and one-third of the Senate in November 2004. In April 2005 Gross resigned as Prime Minister following media disclosures of his own and his wife's non-transparent financial dealings. He was replaced by Jiri Paroubek, whose appointment led to some improvement in the CSSD's position in the opinion polls. But the ODS continues to be ahead. The parliamentary elections are due in the spring or early summer 2006.

International relations

In the early 1990s Czechoslovakia made integration with the West's political, economic and security structures a primary foreign policy goal. It joined the Council of Europe shortly after the political change in 1989 and in 1991 it signed an association agreement with the then EC. After the break-up of Czech and Slovak Federation in 1993, the two governments took over the international agreements concluded by the federation. Political instability and declining government effectiveness after 1996 led to a slowdown in legislative harmonisation with the EU. After 1998 the push for EU integration was revived, Relations with Slovakia improved following the electoral defeat of the authoritarian nationalist Vladimir Meciar in 1998 and made possible improved though limited cooperation among the so-called Visegrad countries (Czech Republic, Hungary, Slovakia and Poland) on issues regarding EU accession. The pace of EU harmonisation improved after 2000 following the two consecutive annual reports by the European Commission of the Czech Republic's EU accession preparations. Formal legal harmonisation was completed in December 2002 when the EU invited the Czech Republic, together with seven other post-Communist accession candidates (as well as Cyprus and Malta) to join the EU in May 2004.Following the rejection at referendums in France and the Netherlands of the draft EU Constitution, the government in Prague has decided to suspend the ratification process amidst public disagreement between a Euro-sceptic President Klaus and pro-EU Prime Minister Paroubek. Czechoslovakia, a founding member of the Soviet-dominated Warsaw Pact, turned firmly westwards towards NATO following Warsaw Pact's dissolution in March 1991. Czech Republic was formally invited in 1997 to join NATO together with Poland and Hungary and was received into membership in March 1999. Czech forces have participated in UN peacekeeping operations in Bosnia, Croatia, Ethiopia/Eritrea, Kosovo, Georgia, Serbia and Montenegro and Sierra Leones. Since the start of the US-led war on terror in 2001, Czech troops have taken part in operations in Afghanistan, Iraq and Kuwait. The Czech contingent in Iraq will be withdrawn in the course of 2005 but that in Afghanistan will be re-enforced.

Integrity issues

The Czech Republic occupies the 51st place – together with El Salvador and Trinidad and Tobago - in the 2004 Transparency International's Corruption Perceptions Index for 145 countries. Corruption remains a problem. The so-called 'Opposition Agreement' between the ruling Social Democrats and the opposition ODS between 1998 and 2002, which divided spheres of influence in public life, provided a fertile ground for corruption. The government of Vladimir Spidla which took office in July 2002 took energetic steps to respond to widespread public demand to curb corruption. He requested his Ministers to declare all their assets on taking office and to be ready to have them inspected on leaving office. Specialised units on corruption and crime were set up at the Supreme Public Prosecutor's office in Brno, with branches in Prague, Ostrava and Olomouc. An amendment adopted in 2002 strictly limited the use of emergency 'fast-track' procedures in public procurement The circumstances under which Spidla's successor as Prime Minister, Stanislav Gross was – under strong media pressure - obliged to leave office in April 2005 suggested that anti-corruption campaigns enjoy public support. The jailing for corruption in 2005 of a former Finance Minister, Ivan Svoboda was also interpreted in the media as a positive sign that people in high places were not immune to prosecution for wrongdoing. In 2004 allegations that a bribe was offered to a member of parliament to bring down the government led to an effort to adopt a Code of Ethics. Legislation to extend the scope of public officials covered by the Act on conflicts of interests and strengthen its enforcement has been prepared by the government. The crackdown on corruption is also taking place lower down the administrative structure. In April 2004 the police anti-corruption unit charged 19 customs officials working at the South Moravia border with taking bribes from truck drivers. The Justice, Agriculture, Finance and other Ministries have for some time had hotlines citizens may call to report instances of corruption by Ministry employees. The Labour Ministry established such a hotline in September 2004.

Trafficking in persons, primarily for the purpose of sexual exploitation, continues to be a problem. But, according to the US State Department's 2005 Country Report on Human Rights Practices in the Czech Republic, the Czech Republic is a "Tier 1" country fully complying with the minimum standards for the elimination of trafficking. In 2004, the Czech Government strengthened its anti-trafficking legislation and turned its pilot victim assistance programme into a nationwide government-funded programme. While enforcement statistics improved during the reporting period, sentences imposed on traffickers remained low.

Social conditions

Population

The Czech Republic's population has been declining since 1990 following two decades of high growth encouraged by the Communist regime's family policies (in 1990 the census recorded 10.363 million; in 1999, 10.283 million; while the last census taken in the first quarter of 2001 recorded 10.298 million). The rate of natural increase (the birth rate minus the death rate) has declined sharply. It was 6.7 per 1,000 inhabitants in 1975 and came down to 0.1 per 1,000 in 1992. It turned negative in 1994. The population has fallen since then by about 100,000. Infant mortality and life expectancy are roughly on a par with most advanced economies. The ageing of the population has caused a steady rise in the proportion of pensioners to active labour, with 15% aged over 65 in 2004. According to demographic projections, the situation is only likely to worsen and highlights the urgency of pension reform. A state-funded PAYG pension system has been supplemented since 1994 by a voluntary private pension scheme to which the state contributes. The PAYG system is financed from general revenue, via a 28% social security charge, increased from 26% at the beginning of 2004. The population is spread evenly, with little urban concentration.

Ethnic factor

There is little ethnic diversity. The once-large German minority accounts for only 0.2% of the population since its 'transfer' to Germany in 1945-46. An estimated 300,000 Slovaks remained in the Czech Republic after the break-up of the federation in 1993. More Slovaks – particularly various categories of professionals - have come over since. Ethnic Poles, mostly in north Moravia and Silesia, make up only 0.6% of the population.

Only 11,000 people declared themselves as Roma at the 2001 census, but expert assessments put the real number of Roma at 100-200,000. The unemployment rate among the Roma is estimated at 70-90% and roughly 70% of Roma children are placed in special schools for the mentally handicapped because of their poor language skills. The Roma were particularly hard hit by the economic transition, not least the closure of state-owned firms. Hundreds of Roma have sought asylum in Western countries but few succeeded because of the lack of systematic political persecution or formal social segregation. There are constitutional and legal prohibitions against discrimination, but a framework to implement those provisions in all areas of law has not yet been incorporated to address specific offences under the Criminal Code. The government is working towards replacing existing laws that make discrimination illegal with one complex anti-discrimination law. In the past year the government has allocated several million dollars as part of its Plan for Roma Integration to projects designed to promote integration of the Roma community.

Education

The Czech Republic's literacy rate is on a par with advanced Western countries. Its students score highly on international tests of science and mathematics. The educational system is based on nine-year primary schooling feeding into secondary schools with either a technical or an academic focus. There has been a rapid fall in apprenticeship training as a result of the closure of state-owned enterprises. Vocational enrolments of those attending secondary schools have declined from over 60% to 40%. This reflects curriculum adjustments aimed at meeting growing demand for professional skills. Education funding has been decentralised, with allocations based on pupil numbers and the majority of financing for schools from the national budget channelled through local authorities. In 2003 public expenditure on education stood at 110.5 billion crowns, of which 84.3 billion crowns came from local budgets. Even non-state schools receive 60-90% of their expenditure from public funds. Total spending per pupil has gone up in real terms by 35% since 1989.

The higher education system now includes management education and training components. During 2004/2005 up to 37% of young people had the chance of achieving a university-type education in public and private universities. During 2005/2006 the portion of young people entering university education will, for the first time, reach 40 %. The percentage of students enrolled in some type of graduate (tercial) school will reach over 50% of the population of the respective age. There is an expectancy that by 2110 up to 45-48% of young population will enter universities. Together with those participating in other forms of specialised tercial education, the percentage will reach 55% of young people. It is expected that, by 2015, 50% of the younger generation will be enrolled in the universities.

Health

There have been significant improvements in life expectancy and infant mortality putting the Czech Republic ahead of all the East European states with the exception of Slovenia and only marginally behind Western Europe. Like in Western countries, circulatory diseases are the most common cause of premature death and cancer rates are rising rapidly. The healthcare system is based on over-generously staffed hospitals and extensive specialist care. The number of doctors per 1,000 of population increased from 3.7 in 1995 to 4.3 in 2003, compared with an EU average of 2.5. The number of hospital beds per 1,000 of population fell from 8.1 in 1990 to 6.5 in 2001, but has subsequently remained at the same level. GPs accounted for just 4,032 of the total of 42,704 physicians in 2003. Since 1992 doctors have been allowed to establish independent practices. The majority of family doctors (and dentists) now work in the private sector.

Following the transition from central planning to a market-based economy, the Czech Republic introduced a number of reforms in the finance, management and organisation of the health sector. However, those efforts have only succeeded in addressing part of the problems, and major issues still remain unsolved. As a result, a heavy debt in the healthcare system presents an ever-greater challenge.

Healthcare expenditure is largely financed through health insurance. It provides generous coverage of health services, in most cases with extremely low co-financing from the patient. The proportion of health-insurance financing of health expenditure is, at 93 percent, very high, even though it has been declining due to the slightly increasing volume of out-of-pocket payments in the health sector. Yet, private out-of-pocket spending levels remain low in the Czech Republic. Major investments in expensive health technology are funded from the state budget.

Key expenditure areas in the health sector are pharmaceutical costs, which have been rising due to several factors: the ageing of the population and the associated increase in the volume of drug use; maintenance of historically extensive hospital infrastructure handed down as a legacy from the pre-independence ear; proliferation of costly medical technology; and steadily growing salaries of medical personnel. All those factors are bound to place an ever greater burden on an already fiscally-stretched health-system.

Hence, a defining feature of the health sector is widespread (and growing) indebtedness. Fuelled by the above factors, expenditure on health care has been consistently surpassing available resources, leaving unpaid bills for services already rendered. The current level of indebtedness in the health sector in the Czech Republic is not high, but it has been rising rapidly.

Labour issues

In line with many of its regional peers, the Czech Republic still suffers from high unemployment (over 8.3% in 2004 if measured as a percentage of the labour force). In addition, there are large regional disparities in unemployment. Regrettably there is also a high incidence of both long-term unemployment, as about one half of Czech unemployed have been searching for a job for over a year while the relevant fraction in the EU-15 economies is below 40%, and youth non-employment: only 30% of Czechs aged 15-24 were employed as of 2003 compared to 40% of the relevant age group in the EU-15 countries.

A total of 32 trade unions are affiliated to the main trade union body - the Czech and Moravian Confederation of Trade Unions (CMKOS), the legal successor to the Communist-era trade union movement. However, numbers have fallen sharply, with only about 25% of the workforce unionised. But the trade unions still exert a strong political influence, not least due to their close links with the left wing of the Social Democratic Party (CSSD).

ANNEX 7: ENVIRONMENT

As a result of entry to the EU in May 1, 2004, the Czech Republic has been steadily achieving environmental quality improvements as well as harmonisation legislation with EU Environmental Directives (subject to Annex V to Article 24 of the Act of Accession 2003 on temporary and transitional measures for the Czech Republic). EU accession will lead to environment compliance investments estimated at around Euro 10 billion. Required annual spending on environmental protection in the Czech Republic is estimated at twice as much as in the current EU member states. Utility companies, particularly in the water and waste water management sector, have been investing substantial amounts of resources into upgrades of existing facilities and expansion of regional coverage. Significant environmental investments will be also required in private industrial enterprises as well as in the public sector.

The main objective of the Czech Republic's State Environmental Policy has been to preserve natural assets and improve environmental quality as well as strike a balance between economic development and environmental protection. The Czech people have high environmental awareness and enjoy increased access to environmental information and decision making process. Despite a slowdown, the Czech Republic has now made progress in the transposition of EC legislation and has effectively overtaken its own legislative timetable in some areas. However, enforcement of legislation in areas such as occupational health and safety and public health is weak. In other areas (e.g. green house gas emissions, solid waste recycling) the Czech Republic's environmental indicators are equal to those of most EU member countries.

Since 2003, the Czech Republic has transposed and implemented Directive 96/61 EC (IPPC) on Integrated Pollution Prevention and Control for new facilities; from 2007 this will also be applied to existing facilities unless an individual transition period is agreed on. Other areas include:

- prepare a new Law on chemical substances and chemical preparations that will be fully compatible with the relevant EC regulations;

- on the basis of analysis of mining laws and related legislation in the individual EU countries, propose amendments to Czech legislation in order to achieve the level of control and administrative procedures comparable with those in the EU countries and reinforce the incorporation of environmental supervision over mining;

At the Regional level an EU PHARE Programme has funded a Twinning Project to assist the Environmental Departments of the 14 Regional Authorities in carrying out the implementation of 46 EC Directives and Council Regulations in 6 basic areas of environmental protection. The project started on March 24, 2003 and ended on October 19, 2004. The main areas addressed include CITES, Chemical substances, waste management, environmental accidents (Seveso II), water protection and air quality.

Important structural changes in environmental quality include significantly declined industrial pollution induced by the closure of outdated and non-competitive industries in the first half of the 1990s. Furthermore, increased manufacturing production has not been accompanied by an increase in pollution. Nevertheless, there are challenges for full harmonisation with EU Directives as well as further environmental quality improvements as follows: improvement of land fills as well as hazardous waste treatment facilities, exploitation of renewable energy, water quality improvement to meet fully with EU drinking standards as well as to protect public health; strengthening of waste water treatment capacities; and flood controls.

The most important international agreements signed by the Czech Republic include the Kyoto Protocol to the UN Framework Convention on Climate Change, whose ratification is being prepared, according to which CR pledges to decrease total emissions of greenhouse gases by 2008 - 2012 by 8% compared to the 1990 level; the Cartagena Protocol on Biological Safety to the Convention on Biological Diversity, intended to ensure protection and safety in handling, using and transferring living modified organisms that are a result of modern biotechnology and that could have a detrimental effect on the protection and use of biological diversity; the Convention on Environmental Impact Assessment in a Transboundry Context (the Espoo Convention); and the Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters (the Aarhus Convention).

The Bank's environmental approach supports the country's EU *acquis* objectives as well as addressing key environmental concerns and focuses on further improving specific environmental management areas through EBRD's projects in line with the EU *acquis* process. Investing in environmental improvements to meet EU standards is an on-going process and the Bank will continue to co-operate with other institutions such as EU ISPA and EIB to enhance environmental *acquis* and improvements.

ANNEX 8: BILATERAL ASSISTANCE

TC OPID	Commitment Name	Fund Short Code	Euro Committed	Euro Disbursed	Fund Approved Date	TC Type	Sector	Team Name
568	Slovak and Czech telecommunications project	AUS	43,080	43,080	18/03/92	Project Implementation	Telecommunications	Telecommunications, Informatics and Media
747	Environmental assessment of D5 motorway	DEN	135,000	135,000	17/08/92	Advisory Services	Construction	Transport
589	Regional Cities Development Programme - water and waste water - Ostrava, Plzen	DEN	29,905	29,905	22/10/92	Project Preparation	Transport, Storage	SEEC Headquarters
589	Regional Cities Development Programme - local government finance framework	ECP	33,231	33,231	20/06/92	Project Preparation	Transport, Storage	SEEC Headquarters
589	Regional Cities Development Programme - Brno clean and waste water sector study	ECP	179,094	179,094	20/06/92	Project Preparation	Transport, Storage	SEEC Headquarters
589	Regional Cities Development Programme - urban transport Brno and Ostrava	ECP	181,148	181,148	20/07/92	Project Preparation	Transport, Storage	SEEC Headquarters
1458	Czech and Moravian Guarantee Development Bank - due diligence	ECP	75,000	75,000	20/10/93	Advisory Services	Finance, Business	Financial Institutions
744	Pre-investment study for upgrading main line rail routes	ECP	393,157	393,157	14/01/94	Project Preparation	Manufacturing	Transport
4532	Assistance in establishing a Securities Commission	ECP	435,336	435,336	15/05/98	Advisory Services	Community/ Social Services	Legal Transition
5739	Czech direct equity fund (framework contract)	ECP	163,689	163,689	02/09/98	Project Preparation	Finance, Business	Financial Institutions
5739	Czech direct equity fund (framework contract)	ECP	70,111	70,111	02/09/98	Project Preparation	Finance, Business	Financial Institutions
12471	Brno Sewerage Network Rehabilitation	ECP	450,000	450,000	22/01/01	Project Implementation	Local Authority Services	Municipal & Environmental Infrastructure
22383	VOPF Valuation Due Diligence	ECP	42,300	42,300	04/10/01	Project Preparation	Finance, Business	Financial Institutions
2802	Sepap Steti a.s. - cost competitiveness investment development	ENE	41,348	41,348	01/09/95	Project Implementation	Agriculture, Forestry, Fishing	Czech/SlovakRepublic HQ
568	Telecommunications technical specifications	FIN	39,657	39,657	12/03/92	Project Implementation	Telecommunications	Telecommunications, Informatics and Media
2802	Sepap Steti a.s. - cost competitiveness investment development	FIN	41,912	41,912	13/09/95	Project Implementation	Agriculture, Forestry, Fishing	Czech/SlovakRepublic HQ
1446	District heating sub-sector study project Czech Republic	GE02	208,492	208,492	10/12/92	Advisory Services	Energy	Power and Energy
716	Environmental training workshop	HOL	43,216	43,216	01/08/93	Training	Community/ Social Services	Environmental Appraisal Unit
732	Prague wholesale market	HOL	114,806	114,806	11/08/93	Project Preparation	Manufacturing	Czech/SlovakRepublic HQ
1448	Power generation and transmission review	ITA	74,427	74,427	01/07/92	Project Preparation	Energy	Power and Energy
732	Prague wholesale market	ITA	68,895	68,895	03/08/93	Project Preparation	Manufacturing	Czech/SlovakRepublic HQ
12795	TurnAround Management Programme - TAM Team Country Coordinator (Andrea Daretti)	ITA	46,400	16,538	11/10/00	Advisory Services	Manufacturing	TAM/BAS Programme
568	Institutional Development Programme	JAP	1,137,629	1,137,629	01/01/92	Project Preparation	Telecommunications	Telecommunications, Informatics and Media
1457	Development of export credit guarantee agency	JAP	137,484	137,484	01/09/94	Advisory Services	Finance, Business	Financial Institutions
2256	Czech Direct Equity Fund (formerly Czech Post-privatisation Fund) - initiation and feasibility	JAP	172,590	172,590	01/04/95	Project Preparation	Finance, Business	Central Europe Front Office
22283	ZEZ - Silko	SPA	23,564	23,564	20/05/03	Advisory Services	Manufacturing	TurnAround Management Group
1455	Development of SPE - export credit insurance	SWE	36,941	36,941	01/02/94	Advisory Services	Finance, Business	Financial Institutions
1448	Power generation and transmission reviews	TAI	18,253	18,253	01/03/92	Project Preparation	Energy	Power and Energy
2207	Czech food holding	UKC	60,724	60,724	06/11/95	Project Preparation	Manufacturing	Agribusiness
2386	Czech food holding (II)	UKC	26,190	26,190	02/03/95	Project Preparation	Manufacturing	Agribusiness
3280	Implementation of Czech food industry holding	UKC	8,058	8,058	08/02/96	Project Implementation	Manufacturing	Agribusiness
7714	Regional - close-out netting legislation	UKE	50,000	50,000	08/11/99	Advisory Services	Finance, Business	Legal Transition
21905	Anti-Corruption workshop	UKE	9,439	9,439	07/03/02	Training	Community/ Social Services	Chief Economist
1448	Power generation and transmission review	USOLD	46,844	46,844	23/03/92	Project Preparation	Energy	Power and Energy
CZECH REPUBLIC TOTAL PROJECTS 34			**4,637,920**	**4,608,058**				

ANNEX 9: ASSESSMENT OF THE CZECH REPUBLIC'S COMMERCIAL LAWS

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for the Czech Republic, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Capital Markets

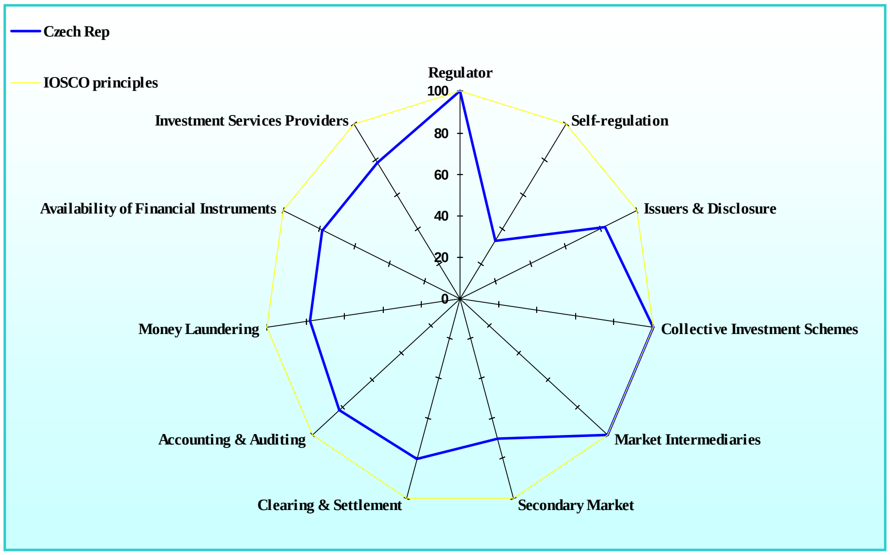
The Czech securities market is regulated by a number of laws and decrees introduced gradually since 1991, and amended on several occasions since then. The most substantial amendments entered into force on 1 May 2004, when the country joined the European Union.

The principal acts regulating the Czech capital markets are the Act on Business Activities on the Capital Market (2004); the Securities Act (1992); the new Act on Bonds (2004); the Securities Commission Act (1998); the Act on Collective Investment (2004) and the Commercial Code (1991).

The Act on Business Activities on the Capital Market is the most important piece, providing comprehensive regulation of all securities markets issues having a "public" nature. It regulates the requirements for setting and managing investment firms, the requirements for listing and trading securities, the requirements of the settlement system, the provisions dealing with investors' protection and grants the Czech Securities Commission (the "CSC") the authority to issue secondary legislation in several areas. Following the enactment of the Act on Business Activities on the Capital Market, several chapters of the Securities Act were abrogated. The Securities Act is now limited to detailing the legal requirements for securities contracts. The recent Act on Collective Investments entirely abrogates the previous Investment Companies and Investment Funds Act and transposes into the Czech legal framework the European provisions concerning undertakings for the collective investment of transferable securities (UCITS). Finally the Commercial Code contains legal provisions concerning company laws and details several commercial contracts.

Supervision of the securities market was exercised by the Ministry of Finance until 1998 when the CSC was established. The CSC's role and functions are detailed in the Securities Commission Act. The CSC has enforcement powers in specific areas related to securities issuance and trading. The enforcement of provisions contained in the Commercial Code remains mainly with the commercial courts, the CSC has certain supervisory powers in the area of take-over bids and in some other areas (e.g. mergers of stock companies. Since the enactment of the Act on Business Activities on the Capital Market, the CSC has new specific regulatory powers.

Quality of securities market legislation – Czech Republic (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004.

According to the EBRD Securities Markets Legislation Assessment conducted in 2004, the country was found to be in "medium compliance" with the Objectives and Principles of Securities Regulation published by the International Organization of Securities Commissions (IOSCO) – see above chart - showing major weaknesses in Self-Regulatory Organisations (SROs) legislation, and in prudential requirements in the areas of clearance and settlement and the secondary market. In particular, the assessment revealed some weaknesses in the legislation concerning reduction of the risk of the non-completion of transactions, and surveillance of the market participants.
Some of the issues mentioned above have been solved with the May 2004 amendments, but others still remain a priority. In particular, the Central Depository, which is regulated in detail by the new Act on Business Activities on the Capital Market, is still to be created and the financial independence and the supervisory powers of the CSC need to be further strengthened.

Company Law and Corporate Governance

The primary law governing corporate governance is the Commercial Code, enacted in 1991 and amended several times, most recently in May 2005, when new provisions on squeeze-outs of minorities[1] were introduced.

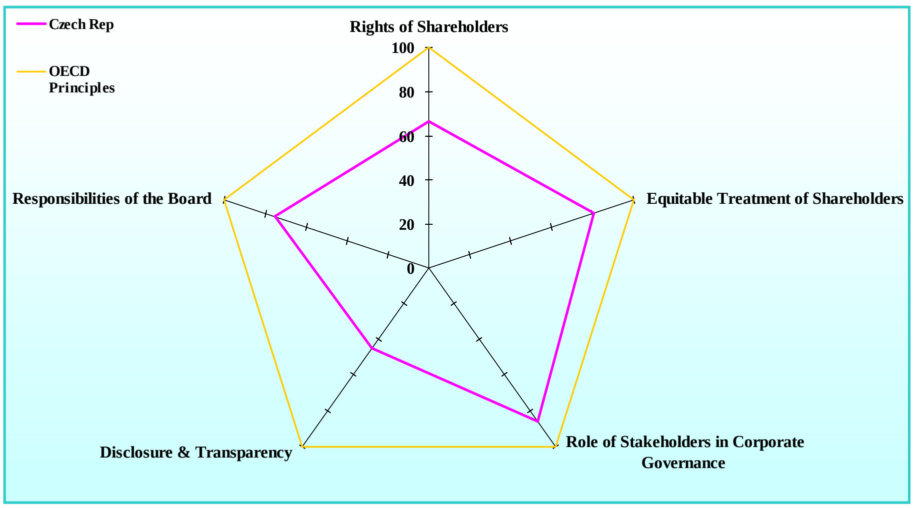
The Commercial Code regulates the establishment and functions of companies in general, rights of shareholders, take-over rules, reporting rules concerning the change of shareholding in a company, merger and acquisition rules, etc. Other provisions on corporate governance are contained in the Securities Act and in the Act on Business Activities on the Capital market, which provides for insider trading rules and disclosure requirements. In addition, in 2004, the Czech Securities Commission finalised a new version of the voluntary Code of Corporate Governance, modelled on the new OECD's

[1] The right for a majority shareholder owning more than 90% of shares to buy off the shares owned by minority shareholders.

Principles of Corporate Governance. Emphasising transparency and accountability, the Code aims to foster sound governance practices in companies in the Czech Republic.

Joint stock companies (JSCs) are the most common form of corporation with a minimum capital requirement of CZK 2 million. They can be organised under a one or two-tier system. Shares are freely transferable. Management of JSCs is entrusted to the board of directors whose members are elected by the general shareholders' meeting or by the supervisory board if the constituent document of the company so provides. However, if a JSC has more than 50 employees, 1/3 of the members in the supervisory board are elected by the employees of the company.

Quality of corporate governance legislation – Czech Republic (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2004

According to the 2004 results of the EBRD's Corporate Governance Sector Assessment Project, under which corporate governance related "laws on the books" were assessed, the Czech Republic was rated as having achieved "medium compliance", on par with many other EU accession countries. As evidenced in the graph above, major weaknesses lay in the "disclosure and transparency" area. A reform priority for the Czech Republic is to strengthen implementation and enforcement of corporate governance legislation in order to transform good institutions into sound corporate practices.

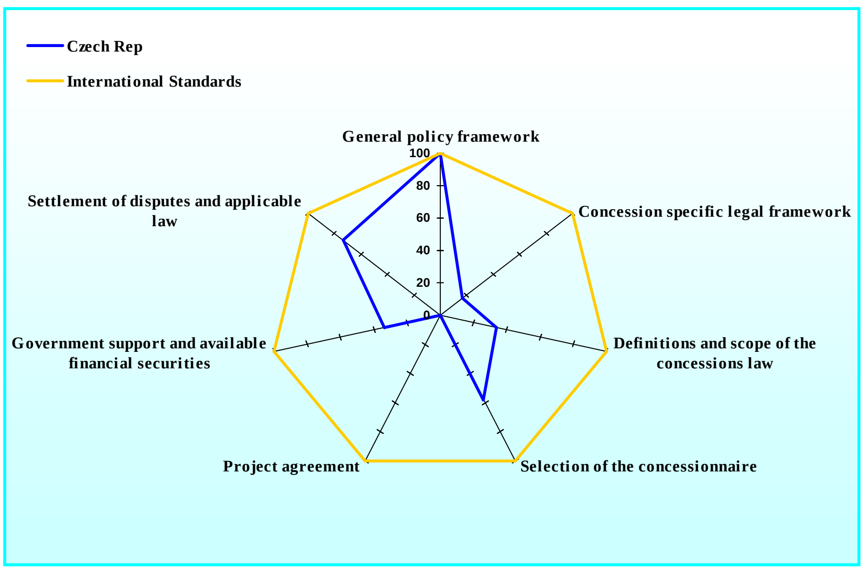
Concessions

The Czech Republic does not currently have a general framework concessions law although a draft Concession Law has been produced and presented to the Government for consideration and is expected to be adopted towards the end of 2005.

The country has been taking a sector-by-sector approach in choosing a suitable private sector participation (PSP) policy and applying it. Several sector-specific acts regulate the right of a private legal entity to utilise public assets in order to provide facilities or services to the public. Among those 34 sector laws are the Water Act, the Energy Act, the Act on Protection and Utilisation of Mineral Resources and the Roads Act. Existing laws provide mainly for a licensing system and, to a limited extent, the granting of concessions. The Water Act and the Act on Water Supply and Sewage cover, among other issues, the permission for water use and discharge of waste water, charges and powers of water authorities and the conditions of conducting business in the water supply and sewage sector. The Roads Act enables private investment in public infrastructure. Under this Act, the Ministry of Transport may transfer some ownership rights of the state in relation to motorways only, by entering into a concession agreement with a private investor for the financing and construction, operation and maintenance of motorways, for a period of at least 25 but not more than 35 years. The natural resources in the territory of the Czech Republic are in the ownership of the state. The Natural Resources Protection and Exploitation Act and the Mining, Explosives and State Mining Authority Act, provide the basic legal framework for carrying on mining and activity involving mining in the Czech Republic.

There is a well spelt out general policy framework for improving the legal environment and promoting PSP in the Czech Republic (Government Resolution on Implementation of General Policy of PSP, adopted in 2004) pursuant to which a PPP Centre was created to deal with public private partnerships (PPPs) on a project level and provide advisory services.

Quality of concession legislation –Czech Republic (2004)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment, 2004.

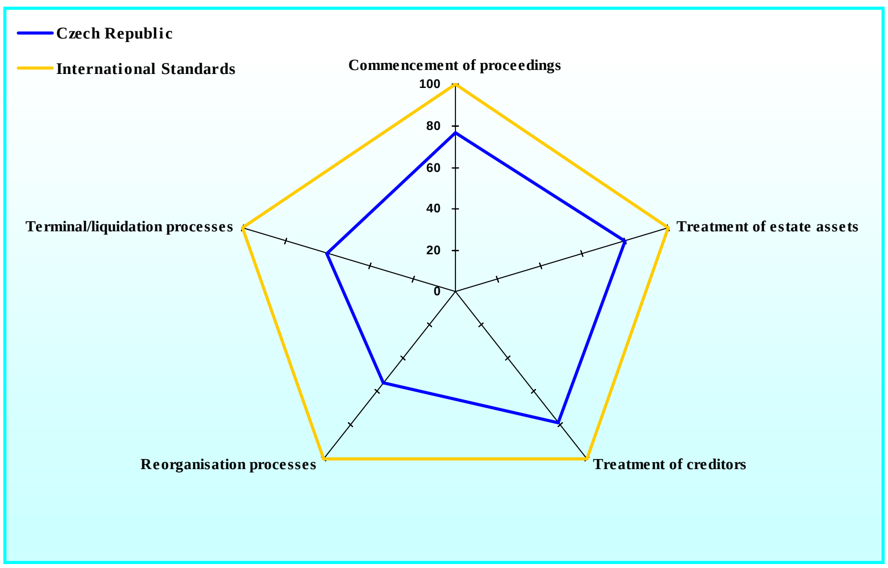
The recent EBRD Assessment of Concession Laws undertaken to evaluate applicable regime throughout the EBRD's 27 countries of operations (the laws on the books only rather than how they work in practice) revealed that Czech laws "partly conform with internationally accepted principles of concessions laws". As can be seen from the above chart, while policy framework as well as rules covering settlement of disputes in concession-related arrangements, for instance, are well developed, most other areas, in particular, project agreement rules, application of current concession rules and availability of financial instruments and state support need to be dramatically improved in order to meet the requirements of modern legal framework facilitating PSP.

The existence of a clear policy along with the creation of a task force as an institutional infrastructure element and the draft Concession Law raise optimism in the future of PPPs in the country.

Insolvency

Bankruptcy and insolvency in the Czech Republic are governed by the Bankruptcy Competition Act of 2000 (as amended) (the "Insolvency Law"). This law scored "medium compliance" when compared with international standards in the EBRD's 2004 Sector Assessment Survey. The graph below displays the data collected in this project and shows the level of compliance of the Insolvency Law with international standards in five core areas:

Compliance of the Czech Republic's Insolvency Law with International Standards
Quality of insolvency legislation – Czech Republic (2004)



Note: The extremity of each axis represents an ideal score, in line with international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment, 2004.

As the above graph reveals, the law has some strengths in certain areas. Specifically, the law is very strong on the requirement of third parties to deliver assets of the insolvent estate to the insolvency administrator. This generally has the effect of enlarging the pool of assets divisible amongst creditors and, therefore, enlarging the recovery for creditors. The law also provides for relatively strict timelines for the hearing of cases and direct notice to known creditors upon the opening of insolvency cases. Both of these elements represent significant strengths.

As the above graph also indicates, however, there is much room for improvement in the Insolvency Law. Specifically, there is a notable absence of detailed criteria to provide evidence that a debtor is insolvent.[2]

[2] The criteria are fairly simple: plurality of creditors and either inability to make good the obligations for longer period or stopping the payments or having larger debts than is the price of enterprise and expected profit together. Detailed criteria could present formal obstacles to what should be essentially a market-driven process.

In addition, the law prohibits the opening of an insolvency case when there are insufficient assets to meet the costs of administration. [3]

In addition to these rather large issues, the Insolvency Law is also deficient in respect of avoidance of pre-bankruptcy transactions (however, it is e.g. possible, since 2000, to appoint a preliminary administrator before decision that debtor is insolvent, in order to ascertain debtor's property situation and to prevent property transfers), imposing sanctions on creditors who fail to lodge claims within time limits (however, claims not lodged in a specified additional period are not taken into account and imposing time limits on reorganisation proceedings.

Although the insolvency law does contain some positive elements (as described above) there is some doubt as to whether any positive attributes in this law can be properly implemented. The EBRD 2004 Legal Indicator Survey on Insolvency which examined the 'effectiveness' (or how the law works in practice) of insolvency regimes revealed that the practical application of the insolvency law by both creditors and debtors is likely to run into serious barriers to access and undue formality. In addition, the results of the survey show that the quality of judges and insolvency administrators, in both creditor and debtor initiated cases, is extremely uneven.

All of these factors, together with the law's deficiencies, militate against the insolvency regime functioning properly as a 'stick' to induce debtors to act in good faith and as a 'carrot' to induce insolvency debtors, with businesses that are fundamentally viable, to try to promote the rescue of such businesses. It is clear that a comprehensive package of reforms (of both the legislative and institution-building variety) is required to remedy this situation. It is therefore unfortunate that recent attempts at modernising the Insolvency Law have met with little success.

In February 2005, the Czech Chamber of Deputies failed to approve long awaited amendments to the Insolvency Law aimed at substantially speeding up and simplifying bankruptcy proceedings and consequently reducing the possibility of corruption and improving access to loans for small- and medium-sized companies. These amendments were intended to act as a 'stop-gap' while more comprehensive legislative reform (initially sponsored by the World Bank in 2003) proceeds. The Cabinet approved a completely new draft Insolvency Act prepared by the Ministry of Justice on 31 August 2005 with a view of presenting it to the Parliament.

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[3] The law provides for this option only if there are not assets, rights etc. that could be sold, or claims that could be recovered, and are, therefore, with the consent of creditors, excluded from the insolvency assets. (Section 44 para 1 letter d) in conclusion with Section 27 para 6 of the BCA). Therefore, there are no significant values that are left dormant.

Secured Transactions

The legal framework for secured transactions in the Czech Republic has improved considerably since 2000. However, it has not yet reached the level of flexibility and transparency that some neighbouring countries have, so there is some scope for improvement, which would, without doubt, benefit the economic players in the country. Principal provisions are found in the Civil Code (Act No 40/1964 Coll., as amended), Civil Procedure Code, and the Law on Bankruptcy and Composition.

The most important change occurred in 2002, when for the first time, Czech law recognised the possibility for parties to create a non-possessory charge over movable assets, by which the debtor provides some movable assets as security to the creditor without having to lose possession of these assets. Non-possessory charges are created in the form of a notarial deed and are registered in a central registry, the Collateral Registry operated by the Czech Chamber of Notaries.

The main problems experienced in practice are:

- The parties can agree to create a non-possessory charge over i) a specifically designated movable item, ii) a charge over a collective asset such as an enterprise or iii) a set of things. There is some uncertainty on the interpretation made of the concept of "collective things" and this makes more sophisticated charges over future assets, fluctuating pool of assets, etc, uncertain, pending the development of clarifying jurisprudence.

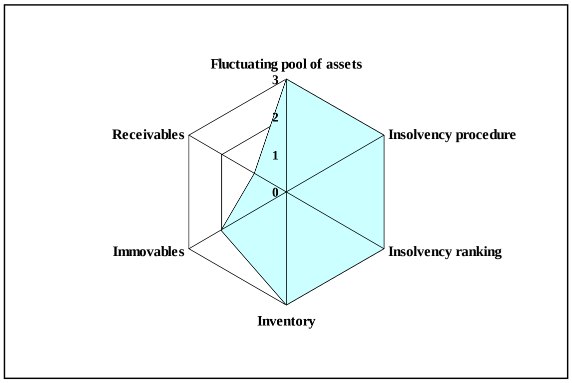
- A charge can secure, up to an agreed amount, debts of a specific kind which will arise between the charge holder and the chargor, during a certain period. Again, this would limit charges over fluctuating pool of debts in practice. It should be noted however that a charge can secure a claim that is to arise in future or a claim that depends on the fulfilment of some conditions.

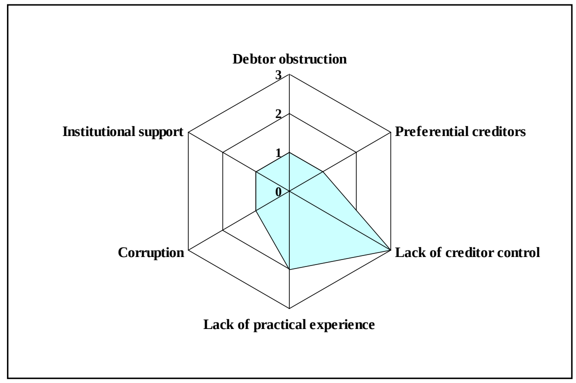
- The Collateral Registry functions in a rather restrictive fashion: in particular, searching the registry can only be done at a notary's office and requires anyone interested to provide either proof of justified interest or written authorisation from the owner.

- Whereas charge enforcement is conducted efficiently (as confirmed by a survey conducted in 2003 by EBRD, see chart below), most often as a public auction led by privately appointed executors, the position in debtor's insolvency is infinitely more complex and inefficient, which causes great uncertainty to creditors.

Obstacles to charge enforcement process – Czech Republic (2003)

Scope | **Process**





Note: The fuller the half moons, the more serious the problems are in each of the respective categories. "Process" factors measure the impact that specific obstacles would have on the enforcement proceedings. "Scope" factors give an indication on how effective enforcement would be when conducted on various types of collateral and in the case of debtor insolvency.

Source: EBRD Legal Indicator Survey 2003.

Telecommunications

The telecommunications sector in the Czech Republic is currently governed by the Act on Electronic Communications 2005 (the "2005 Communications Law") and regulated by the Czech Telecommunication Office (CTO). The CTO was created in 1993 as part of the Ministry of Economy, transferred to the Ministry of Transport and Communications (MTC) in 1996 and constituted as an independent agency in 2000. All residual communications activities were transferred from the MTC to a newly-established Ministry of Informatics (MoI) in 2003. The 2005 Communications Law grants further specific powers and functions to the MoI and the CTO consistent with the European Union (EU) framework for regulation of electronic communications. The 2005 Communications Law replaced legislation from 2000 and aims to facilitate the implementation of the current EU regulatory framework into Czech law in line with their EU membership obligations.

Cesky Telecom, the incumbent former monopolist provider, was 51.1%-owned by the state until April 2005. Following an international tender, the state's 51.1% stake was sold to Telefónica of Spain, with the terms of the privatisation deal reportedly require Telefónica to purchase currently remaining publicly traded equity. It has also been reported that, as part of the privatisation deal, a government-appointed director must sit on the supervisory board of the firm until 2008.

The Czech mobile market is dynamic, with intense competition amongst three strong operators, EuroTel, T-Mobile and Cesky Mobil (Oskar). All three mobile operators possess both GSM and 3G licences (launch of 3G services is planned for 2006). As with other European markets, mobile penetration has passed the 100% mark.

Cesky Mobil (Oskar), EuroTel and T-Mobile are currently designated as dominant (SMP) operator in their respective markets under relevant provisions of previous legislation. In accordance with the 2005 Communications Law, the CTO is required to declare an operator to be an operator with SMP if, on the basis of market analysis, it is seen in a particular market to exert an economic influence alone or with others that allows it to operate to a considerable extent independently of competitors, consumers, or other users. The CTO must complete its analysis before Q2 of 2006 and to review the SMP obligations imposed under the previous legislation before Q3 of 2006.

While full market liberalisation formally occurred in January 2001, delays by the government in implementing critical market liberalising instruments, such as carrier pre-selection and fixed number portability, until 2003 have resulted in Cesky Telecom maintaining a very strong position in the market. Additional delays implementing mobile number portability until 2006 could arguably slow maximisation of competition in the mobile segment. While the 2005 Communications Law appears to have formally addressed many of these issues, practical implementation of these formal legislative and regulatory measures through secondary legislation and pro-active regulatory intervention is now critical if a meaningfully competitive marketplace is to be installed and maintained in the Czech Republic.