

## Czech Business Environment in Comparison with 3 Neighbouring Countries\*

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*A known fact is: capital does not hedge. Capital grows where it is profitable, increases values where it brings gains for investors.*

*The Czech Republic seems to be a very hopeful economy for a capital assessment.*

*What conditions can investors expect? What are advantages of Czech economy? On the contrary, what admonitions do we provide?*

*This article tries to reply to these questions of the basis of a brief Czech economy description in a comparison with territorial close countries – new EU members, as well as the EU average.*

Keywords: *tax rate, labour costs, infrastructure, ICT, bank sector, capital market, public administration.*

### 1. Introduction

The objective of this article is to analyse the situation of business in the Czech environment nowadays. This article is to analyse some chosen problems of business in the Czech environment, particularly in comparison with three neighbouring countries, i.e. Slovak Republic, Poland and Hungary.

The article has been elaborated on the basis of fundamental ideas of economic theory, the systematic literature analysis, the analysis of statistic data, as well as a judgement and determination of the most significant moment in economic development, namely in connection with a creation of a prosperous business environment.

### 2. A basic characteristic of Czech economy

The Czech Republic, with its 10 million citizens and approximately 79 000 km<sup>2</sup> belongs to small economies. However, its market enlarges through integration into joint European area within a frame of the European Union. Nevertheless, we can note that business relations to the East (Russia) began intensifying in the last time repeatedly. The mentioned relations have merged traditional business contacts formerly, and after 1990, they were severed to a great extent.

Former Czechoslovakia – the present Czech Republic and Slovak Republic, has been characterised by one of the highest economic standard in a former Soviet bloc. Even the Czech economy's transformation on the market principles has not brought in light of macroeconomic point of view expressive quakes. Hence it follows, the macroeconomic indicators can be considered as relatively convenient, namely in comparison to countries with analogical historical

\* This paper has been prepared in connection with solving project VEGA No 1/2627/05 "The economic system of self-government after the entrance into the EU".

development as pointed in table 1 (data from 2003):

Table 1

Basic macroeconomic indicators of four countries of central Europe

indicator	Czech Republic	Slovak Republic	Poland	Hungary
GDP at current prices (EUR bn)	75.7	28.2	185.3	73.3
Real GDP change (%)	2.9	4.2	3.7	2.9
Unemployment (%)	8.1	15.6	20	5.5
CPI (%)	0.1	8.5	1.9	4.7
Foreign trade balance	-2.6	-2.2	-5.3	-4.8

*In: Emerging Europe Market Review. No 2 April 2004*

The Czech economy is distinguished – in opinion of the CR-government's vice-chairmen Martin Jahn – by significant advantages, but it has below standard results in comparison with the EU as well.

The Czech Republic has achieved good results in comparison with the EU (25 countries) by these indicators:

- rate of youth in age 20 – 24 with a secondary educational attainment ;

CR	EU
92 %	76.7 %

- companies investment range in per cent of GDP;

CR	EU
22.4 %	16.8 %

- employment of women

CR	EU
56.3 %	55.1 %

- employment of older workers (rate of employees in age group 55 – 66 years)

CR	EU
42.3 %	40.2 %

On the other hand, the Czech Republic has bad results in indicators as:

- labour productivity on 1 employee

CR	EU
62	100 %

- research and development expenditures in per cent of GDP from private and public resources

CR	EU
1.35	1.93

- a part in lifetime education (rate of age group 25-64 years)

CR	EU
6.3 %	9.4 %

(Whether relevant indicators belong in more range into the group signed as “good” or “bad” results, we are leaving for a reader’s consideration.)

### 3. Chance for foreign investors

After the entrance of 10 central and eastern European countries into the EU, more significant possibilities of investments are seen in these countries. It is a chance for investors; however, the countries-investment addressee can be obtained as well.

Showing just the companies with part of foreign capital are in the transformed Czech economy markedly more successful – they have higher labour productivity, more skilled workers have been concentrated in them, and they are very successful in export activities. Nevertheless, great number of these companies belongs to the SME’s (with number of employees to 500 persons), where by 25 % belongs to the so called innovating companies.

However, the most relevant information for investors is the information about a development in relevant economic branches. If we have chosen 4 basic branches, we can see their development in 2002-2004 (2004 is estimated) on the data of annual increases in the table 2.

Table 2

**The chosen branches development in the Czech economy**

branches/year	2002	2003	2004
Industry (%)	-0.4	2.5	2.3
Construction (%)	-8.2	0.3	1.8
Trade, hotels and restaurants, transport	9.6	4.0	5.3
Financial intermediation, business services	0.9	1.4	2,2

*In: Emerging Europe Market Review. No 2 April 2004*

The Czech companies can be divided into two parts: on the one hand – the companies with a shared foreign capital, and on the other hand, pure Czech companies. We can say that the foreign investors have been operated in all branches of Czech economy more or less.

Nevertheless, there can be seen several main different characteristics in a comparison of foreign companies with domestic due to the study of “The strategic audit of the CR”, elaborated by CESES of Charles University ,Prague, in 2004:

Foreign companies in the Czech Republic:

- a labour productivity is higher by 80 % than in domestic companies,
- salaries are higher by 25-30 % than in domestic companies,
- workers are qualitative and skilled,
- an approach to human resources management is worked-out carefully,
- export is their eminency.

Domestic companies in the Czech Republic:

- labour costs on unit added value are higher by 40 % than in foreign companies,

- workers have deficiencies in their qualification,
- inactive opportunities exist in organisation,
- a profit potential is weakened.

### 4. Tax rate in the Czech Republic

Combining the fact of a low level of labour productivity in the Czech Republic and the new-liberal theory on a beneficial impact of a low tax quote for a country’s economic development, we can state that this factor should support entrepreneurs in the Czech Republic, should decrease unemployment and accelerate economic growth.

The former aid of the CR premier Růžena Vintrová has compared the average rate of the total tax quote and GDP per capita by 4 central Europe countries (see in table 3).

Table 3

**A comparison of tax quote and GDP per capita**

	Czech Republic	Slovak Republic	Poland	Hungary
Total tax quote <sup>1</sup>	36.8	36.8	37.7	39.1
GDP per capita <sup>2</sup>	73	51	46	61

<sup>1</sup> *i.e. tax rate including social and health securities in % GDP (average in years 1995-2002)*

<sup>2</sup> *GDP per capita in PPC in 2003, EU (25 countries) is 100 %*

*In: Vintrová, R.: Pád jednoho mýtu. Ekonom No 44/2004, pg 56-59*

By the Czech income tax law, the legal entity income tax is going to decrease stepwise: in 2004 it was 28 %; for 2005 it has been 26 %; from January 1, 2006 will be assessed as 24 % of tax base.

On the contrary, it is necessary to call attention of general trend, which is shown in all developed economies, and that is a transfer of state budget incomes from direct taxes to indirect taxes, i.e. consumer tax (for petrol and oil, tobacco products, alcoholic drinks), and value added tax (the basic rate is 19 %, the scale-down rate is 5 %, some activities are exempted from VAT else, but on the other hand, a great number of items with 5 % of VAT have been shifted into the group of items with 19 % of VAT.

### 5. Labour costs in the Czech Republic

Low labour costs are considered as an advantage in central and eastern European countries. In the Czech Republic, this – still existing advantage – is squared by relatively high level of workers’ skills, e.g. the CEO of PFIZER company in the CR, Richard Paulson, that has been engaged here since 2002, has declared: “The Czechs are hard working, well-educated and inventive people...”\*

And how much can company spare through lower labour costs in total? For example: in 2005, a new car factory TPCA has started its production of small cars

\* Paulson R. in Osobní lékař, No 11/2004, pg 4

Citroen C1, Peugeot 107 and Toyota Aygo in Kolín (approximately 30 km from Prague). The analysts have estimated that a factory location into the Czech Republic failing the west Europe imagines savings as far as 600 USD per car.

Labour costs involve for companies gross wages (before tax and social and health securities), as well as the second part of social and health securities. If it will be assessed by net wage (after tax and social and health securities) to worker in 20 000 CZK (i.e. approximately 930 USD), the total labour costs would be similar in the Czech Republic and in Poland, markedly lower in the Slovak Republic, and on the contrary, markedly higher in Hungary, as it is shown in the table 4.

Table 4

**A comparison of labour costs (in CZK)**

	Czech Republic	Slovak Republic	Poland	Hungary
Net wage monthly	20 000	20 000	20 000	20 000
Gross wage	27 210	24 911	30 305	35 658
Social and health securities as expenditures of employer	9 524	1 403	6 080	12 404
Total labour costs	36 734	26 314	36 385	48 062

Moreover, it is interesting to compare the rates of social and health securities in the analysed countries. Poland is distinguished as considerably lower total level, nevertheless, the burden is divided between employees and employers equally. The other 3 countries are comparable, namely in point of view of total rate, as well as in the layout between employers (a higher rate) and employees (a lower rate), as follows:

Table 5

**Social security contribution (% of gross monthly wage in 2004)**

	Czech Republic	Slovakia	Poland	Hungary
Social security contributions paid by an employee	12.5	13.4	18.7	12.5
Social security contributions paid by an employer	35.0	33.5	20.4	33.5
Total social security contributions burden	47.5	48.6	39.1	46.0

In: *Emerging Europe Market Review. No 2 April 2004*

## 6. Infrastructure of the Czech economy

The Czech Republic has one great strategic advantage: that is its position in the centre of Europe. Moreover, it has relatively developed infrastructures – energetic, traffic and social. For example, if we will compare the traffic infra-

structure by indicators of motorways and expressways length in km, and per 100 m<sup>2</sup> in the analysed 4 countries (see in table No 6), the situation of the Czech Republic is the best uniquely.

Table 6

**Length of motorways and expressways per 100 m<sup>2</sup> (end of the year 2002)**

	Czech Republic	Slovak Republic	Poland	Hungary
Length of motorways and expressways in km	823	312	604	581
Length of motorways and expressways per 100 m <sup>2</sup>	1.041	0.636	0.193	0.624

In: *Emerging Europe Market Review. No 2 April 2004*

In addition, three aspects are important for business environment:

- a quality of economy in point of view ICT development,
- a quality of bank sector and capital market,
- a quality of public administration.

### 6.1. ICT state

A basic traditional indicator of ICT using is number of phone (stationary, as well as mobile). This number achieved 7,2 million (i.e. 0,72 phone per capita) in the year 2000. Furthermore, a volume of using IT in business is important too. The table No 7 argues about a development of chosen indicators in 2000 and 2002:

Table 7

**Chosen ICT indicators in the CR**

indicator	2000	2002	index
business using PC (%)	94.10	96.4	1.024
business using internet (%)	74.58	89.6	1.161
business having self www-pages (%)	40.17	55.9	1.394

In: [www.czso.cz](http://www.czso.cz)

Besides, 29.6 % companies use e-business according to the data from 2002.

Again, if we will compare only a state of mobile phones per 100 inhabitants (see table No 8), we can see the Czech Republic presents the highest value among the 4 analysed countries by the end of the year 2003.

Table 8

**Number of mobile phones per 100 inhabitants**

	Czech Republic	Slovak Republic	Poland	Hungary
Number of mobile phones per 100 inhabitants	93.5	65.5	45.5	78.5

In: *Emerging Europe Market Review. No 2 April 2004*

## 6.2. Bank sector and capital market states

The “Komerční banka”, “Česká spořitelna”, “Československá obchodní banka” (nowadays all these with foreign shareholders) belong to the most stable Czech banks. Stressing e-banking, the new “e-Banka” is developing very dynamically.

Apart from that, many affiliates of significant and well-known European, as well American banks effect in the Czech market.

By September, 30 2004, there have operated 9 banks with Czech capital majority and full 26 banks with foreign capital majority in Czech banking sectors.

Apparently a capital market, the Czech Moody's Investor Service affiliate CRA Rating Agency presents in its special commentary; “Overview and Trends in the Czech Republic Fund Industry”. The start of the collective investment industry in the Czech Republic is sometimes incorrectly related to the market privatization of previously state-owned industries. In 1998, the market stabilised and assets in open-ended unit trusts started to grow at a steady pace. Available figures for the end of 2000 show that open-ended mutual funds now account for 78.4 billion CZK, which represents almost 5% of total household savings. After all the problems and numerous regulatory amendments in the 90's, the Czech Republic collective investment market is finally a fertile and regulated environment, which is well positioned to grow. The market is, however, very concentrated in the hands of a few players. The next step is to create an independent network of distributors. Again, foreign players are kick-starting this process. In addition, significant development will have to occur on the operational and customer service side of the asset management business.

## 6.3. Public administration state

Public administration in the Czech Republic is organized as national and regional. It involves three levels: state – region – municipality.

An entrepreneur has to act with authorities of the state level (company setup, registration, tax obligation, social and health securities), as well with other public authorities (regions, municipalities) where he is going to run a business.

After 1995, several European countries have begun on the OECD recommendation and on the base of the Regulatory Impact Assessment (RIA) with an implementation of “a regulatory reform”. Moreover, the European Union has been innovating procedures in new act verifying impact of regulation on business environment.

Nowadays, the question of an “anti-bureaucratic act” creation is coming in Czech government's agenda.\*

Sorry, public administration effectiveness in connection with absence of competition environment is too low. Lengthy processes – e.g. in new business entity setup – and a great deal relations to institutions and authorities (namely state authorities – as the financial authority, trade authority, authorities of social and health securities) are in evidence.

\* Ekonom 11/2005, str. 52-53

Thus, the foreign SME – entrepreneurs often use for their business start since established companies, which are found with this vision, and then, they are sold to foreign investors.

## 7. Czech government's incentives for investors

The Czech government consider as its priority to create favourable conditions for foreign investors to ensure economic growth. The national agency for investment and support of business environment, the CzechInvest, is attending to foreign investors according to investment incentives law from 2000.

The system of investment incentives involves namely:

- a reduction of legal entity income tax up to 10 years,
- a support of new jobs creation,
- a support of re-qualification,
- a grant of land with infrastructure for attractive price,
- a transfer of land, which is in a state ownership, for attractive price.

## 8. Conclusion

On 11 February 2005 in Washington DC, EU Trade Commissioner Peter Mandelson argues that there remains a fundamental community of values and interest between Europe and the USA.\*\* European and American societies are not identical. Our self images are necessarily different: the United States is after all a remarkably powerful nation. The European Union is a complex and innovative co-operative system of 25 different nation states. He appeals to the 4th WTO Ministerial Conference in Doha (from 9 to 14 November 2001) and he called for the EU and the US to work together in the world – improving the environment for transatlantic business. After the EU-enlargement in 2004, there are new possibilities to use economic and trade policy instruments to address the new global agenda in foreign policy, to make progress in 2005 on the Doha Round, to inject new momentum into our own bilateral relationship both in solving disputes and in generating greater well-being. However, the Czech Republic is not going to stay aside in these processes.

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### Čekų verslo aplinkos palyginimas su trimis kaimyninėmis šalimis

#### Santrauka

Straipsnio tikslas – išanalizuoti dabartinę čekų verslo aplinką lyginant ją su Slovakijos Respublika, Lenkija ir Vengrija. Straipsnis remiasi pagrindinėmis ekonomikos vystymosi teorijomis, mokslinės literatūros ir statistinių duomenų analize bei teiginiais apie galimybę sukurti palankią ir klestinčią verslo aplinką.

Čekijos Respublika, kurioje gyvena 10 milijonų gyventojų, priklauso prie smulkios ekonomikos vystymo šalių. Tačiau, įstojus į

Europos Sąjungą bei efektyviai siekiant bendradarbiavimo su Rusijos verslu jos rinka plečiasi. Šie veiksniai sąlygoja investavimo galimybių augimą. Ypač sėkmingai dirba čekų įmonės, kurios iš dalies remiasi užsienio kapitalu. Tose įmonėse aukštesnis darbo našumas, labiau kvalifikuoti darbuotojai, sėkmingos eksporto operacijos. Ir vis dėlto daugelis tokių įmonių vysto tik smulkų ir vidutinį verslą.

Čekų kompanijas galima suskirstyti į bendras su užsienio investicijomis ir grynai čekiškas. Bendros įmonės apima beveik visas čekų pramonės sritis. Šių įmonių pagrindiniai ypatumai yra šie:

- darbo našumas yra 80 proc. aukštesnis negu vidaus įmonių;
- atlyginimai 25 – 30 proc. didesni;
- darbuotojai yra aukštos kvalifikacijos;
- daug dėmesio skiriama žmogiškųjų išteklių ugdymui;
- eksporto vystymas yra svarbiausias aspektas.

Vietos kompanijų pagrindiniai bruožai:

- darbo kaštai pridėtinės vertės vienetui yra aukštesni 40 proc. negu užsienio kompanijose;
- darbininkai stokoja kvalifikacijos ir įgūdžių;
- pelno potencialas susilpnėjęs.

Čekijos vyriausybės svarbiausias uždavinys – sukurti palankias sąlygas užsienio investuotojams skatinantiems ekonominį augimą. Investicijų skatinimo sistemą sudaro šie veiksniai:

- legalių pajamų mokesčio mažinimas dešimčiai metų;
- naujų darbo vietų kūrimas;
- darbuotojų perkvalifikavimo rėmimas;
- žemės su infrastruktūra pardavimas palankiomis kainomis;
- valstybinės žemės pardavimas palankiomis kainomis.

Raktažodžiai: *mokesčių dydis, darbo kaštai, infrastruktūra, IT, banko sektorius, kapitalo rinka, viešasis administravimas.*

The language of the article is not edited.

Received in March, 2005; accepted in June, 2005.