

Canadian NATO
Parliamentary Association



Association parlementaire
canadienne de l'OTAN

**Report of the Canadian Parliamentary Delegation
respecting its participation at the Visit of the Sub-Committee
on East-West Economic Co-operation and Convergence
(ESCEW)**

Canadian NATO Parliamentary Association (NATO PA)

**Prague, Czech Republic
September 29 - October 1, 2010**

Report

The Canadian NATO Parliamentary Association is pleased to present its report respecting its participation at the visit of the Sub-Committee on East-West Co-operation and Convergence (ESCEW) held in Prague, Czech Republic from September 29 to October 1, 2010. Canada was represented by Mr. Leon Benoit, M.P. and Mr. Anthony Rota, M.P.

THE ECONOMY

The Czech economy is small, and highly dependent on international trade. Its transition to a liberal market economy has been rapid and highly successful. Today its per capita GNP stands at 80% of the EU average. Although the Czech service sector is the country's largest, it also has a strong manufacturing sector which, at 30% of GDP, is outsized by EU standards. The country as a whole enjoys a large trade surplus, although the current account is just slightly in deficit due to foreign investor profit repatriation. The economy is also very closely linked to the German economy which is both a key source of finance and a vital market for Czech goods.

There are, however, persistent structural difficulties that pose a genuine challenge to national policy makers. Above all, public deficits are high and the debt level is rising. Its debt is currently quite low at 35% of GDP. But the dynamics of that debt are worrying economists, and the government now seems intent on addressing the problem. The global recession has clearly exacerbated these problems. Although the Czech financial system was not vulnerable to the first wave of financial shocks that coursed through the global economy, the secondary trade effects have had a severe impact. Last year the Czech economy fell by 4%, and it only returned to growth in the third quarter. Growth has accelerated since then, hitting an annual rate of 2.4% in the second quarter. Unemployment has risen over the past two years but is still lower than the EU average. Although growth has returned, firms are somewhat reluctant to hire again so job growth is not picking up as had been expected.

The Dutch are the leading investors in the Czech Republic. This partly reflects a favourable tax policy there that allows firms from other countries to launch investments and daughter firms based in the Netherlands. Germany is the second largest investor followed by Austria and France.

The Czech Republic's strong reliance on manufacturing exports is increasingly seen as a potential vulnerability. The car industry is particularly important in this regard, but Czech authorities worry that this leaves them vulnerable to sector specific downturns. The Czech economy was given a large boost by German government bonuses extended to those who replaced old cars last year and this helped drag the Czech economy out of recession. The computer manufacturing sector is also important, and there is a sense that this is a somewhat more diversified and robust sector.

The foreign owned sector of the economy has been the most dynamic and profit levels are highest in it. The state sector is a very small share by comparison and public firms enjoy lower profit levels. Foreign owned firms, however, suffered the most in the global

recession given their strong orientation towards export markets. Last year exports fell by 15% and imports by 18%. Europe is the most important trade partner for the Czech Republic followed by Asia. Imports from Asia are growing and Asia's percentage share of both Czech imports and exports are rising. The Czechs enjoy a trade surplus with Europe but are in a significant trade deficit with Asia. Over half of this trade is with China, while Japan and Korea are also significant Asian trading partners. Machinery and electronics for manufacturing constitute a very important share of imports from Asia, although the public is more aware of household appliance imports. Many Asian imports are subsequently included in Czech exports as finished products. Most of these exports, however, head for European rather than Asian markets. That said, Czech exports to Asia are also on the rise and Czech companies believe that Asia will be an ever-more important market in the future. The government is making exports to China, India and Vietnam a particular priority for future growth.

Asia also poses a competitive challenge to the Czech economy and government officials believe that only by pushing the innovative capacity of the national economy will the Czechs be positioned to remain commercially competitive. Currently the Czech economy stands at 27th place in the global competitiveness rankings and is roughly in the middle among European countries. The goal is to foster conditions that will help make Czech firms innovation leaders. Yet, new ways need to be unearthed to finance research and development and to steer young people towards the science and engineering fields. A major university and high school reform to bolster human capital in the country is under development. Although the government is moving toward major spending reductions, the goal is to spare research and development programs from cutting.

The challenges the Czech industry faces were also made evident in a visit the delegation paid to a Bohemian glass plant which continues to flourish but which faces very challenging market conditions. This was a firm that survived decades of state ownership under communism and which has recently been purchased by two investors, saving it from bankruptcy. The global glass market itself has confronted a large shake-out, and firms from Asia are now challenging traditional producers. There have been a range of bankruptcies including firms like Ireland's Waterford.

Czech workers have obviously benefited from the country's relatively low unemployment rate and some workers from Eastern Europe, including Ukraine, have migrated to work in the country. Many of these workers do not enjoy the full range of social protections and were the first to lose their jobs when the economy slowed. Some come through labour agencies and are working in the black and grey markets. Ever fewer Czech workers are engaged in trade union activity and trade unions worry that government policy will make it ever more difficult to organize. Currently, only 16% of Czech workers are unionized, and the level is trending downwards. Last year, there were large trade union demonstrations in Prague and elsewhere and the point was to remind the government not to neglect worker rights and concerns as they sought to address the financial and economic crisis.

The Czech government continues to aspire to adopt the Euro and the economy is well positioned to do so. The economy is highly open and is deeply linked to the Euro area. Unlike Estonia, however, it has not implemented a tight link to the Euro through a

currency board and the Czech Koruna has moved against the Euro. This has accorded it some breathing room during the crisis and helped the country maintain a competitive exchange rate in difficult times.

Although the goal of joining the Euro is broadly shared in Czech society, the recent crisis in Greece and elsewhere has raised questions about the optimum timing. Obviously for a country like Greece, the fact that it could not use the exchange rate to adjust to its domestic crisis exacerbated the downturn. The subsequent economic calamity has revealed certain weaknesses in the rules governing the Euro and Czech officials are watching closely to monitor the changes that are now being adopted to better gauge their own accession strategy.

The economy continues to converge with other Euro members but there are differences. In 2009 and 2010 the convergence process was slowed and developments in the global economy exacerbated the fiscal situation in the Czech Republic. There are also persistent differences in terms of industrial structure with the Czechs maintaining a relatively larger industrial base than most Euro members. The problem is made all the more complex because wages are not highly flexible although this too is changing.

A recent set of stress tests administered on Czech banks revealed that they remain sound. Banking in the Czech Republic has not adopted the complex and sophisticated processes employed in many Western countries, and this actually insulated the financial system from the worst effects of the crisis. Private debt is not a significant problem in the Czech Republic, and households have not taken on foreign currency denominated debt as they have, for example, in Hungary. The real financial problem lies more in the area of public finance and debt service where the Czechs confront structural problems. The pension and healthcare systems need to be reformed if these problems are to be adequately addressed. Currently the country is not meeting the Maastricht criteria on budget deficits, and this alone makes immediate accession to the Euro highly unlikely. The government has not initiated entry into the ERM II process and has not set a date for doing so. In other words, exchange rate convergence with the Euro area has not yet begun. Uncertainties in the Euro area arising out of the Greek crisis has only encouraged Czech caution on this front.

The Czechs will not set a target date until their own budget is fully under control and until the Euro area has worked out its fiscal policy shortcomings. The government recognizes that it will have to manage an inflation differential with the Euro area as part of the accession process; in other words, prices in the Czech Republic will invariably rise as part of a nominal exchange rate adjustment. This is not going to be easy to manage. The sense today is that it is easier to live with a flexible exchange rate than with inflation. A greater degree of convergence in terms of the structure of industry is also desirable. It is important to note that the adjustment for the Czechs to Euro membership will be far greater than it has been for the Estonians. Estonia has long employed a currency board that has meant that the country essentially operates as if it has already adopted the Euro. The Czech Central Bank, like those of Hungary and Poland, runs inflation targeting and flexible exchange rate policies. Over the long run, the Czechs will have to increase productivity to eradicate this natural inflation differential.

DOMESTIC POLITICS IN THE CZECH REPUBLIC

Czech politics have undergone significant changes over the past year. For the first time in years, the governing parties have a significant majority in parliament and are thus positioned to govern in a decisive fashion. This is both an opportunity and a risk because failure to make several key sets of decisions could disillusion voters.

The Czech Republic is firmly anchored in the West and its institutions. It is a respectable and dependable player on the international state. Ostensibly it faces few external challenges; yet, it must learn to better define its own interests and objectives in the international system and within a range of international institutions. For years, domestically weak governments were not well positioned to do this. Internal politics made serious discussions about national objectives difficult, and many key decisions were essentially ceded to bureaucrats. The battles that did take place over missile defence and Kosovo were more about internal matters than genuine foreign policy objectives.

Czech foreign policy has been essentially characterized by continuity and a reasonable degree of consensus. The prospect of "returning to Europe" united the country and provided it with a critical foreign policy mission aimed at joining NATO and the EU. Once this had been accomplished, the question immediately arose, "what next?" It has proved more vexing than some had anticipated.

There is a sense that after six years in the EU and 11 years in NATO, the countries of Central Europe need to do more to press their own vision and interests within those bodies. Central Europe has been a relatively passive consumer of the benefits of membership but has been less successful in identifying positive goals and aims within these organizations. There is today a growing recognition that these countries need to press their interests more intensively within these institutions and more generally. The problem is that the national experience has been to move from total hostility to the West to a total embrace. A more subtle and critical vision is now essential.

There is a general agreement on the need for a multilateral framework for international relations and this helps frame the debate. But a more detailed elaboration of what this all means is needed and there are areas of discord. There has been division, for example, over the degree of integration within the EU - something that came up in the Czech debate over the Lisbon Treaty. There are also clashes between liberal market visions and social market visions of the economy and it seems difficult to find common positions here. Finally there are subtle conflicts between a universalistic impulse and more narrow views of community. This clash becomes evident in discussions about the need to export democratic values. The Czechs need to delve more deeply into what it means to be part of a liberal society and then to predicate its policies on this interior vision of itself. Parliament itself needs to be more fully engaged in discussions about Czech foreign policy. Often it focuses much more on domestic matters and pays international relations scant attention. Public discussions about foreign policy tend to focus more on what it takes to be a good international citizen than what exactly is the Czech national interest. This was evident in the debates about Iraq, Afghanistan and the Lisbon Treaty.

The Visegrad Group could provide an important means for Central European states to develop their own unique positions on these kinds of questions. These countries share a particular vision of Europe and the world, and it would be helpful for them to coordinate those positions informed by that common vision. There are signs that this is beginning to happen. The Visegrad countries are more willing now to prosecute their own set of interests on the international stage and to thus act as a pressure group.

It is also important to stress that Czech parties are hardly uniform in their view of the international system. There is, for example, more scepticism of NATO and NATO operations on the left than there is on the right. Some Social Democratic figures view NATO's Afghan mission as fundamentally flawed and the far left remains opposed even to the concept of NATO membership. At the same time, it was a Social Democratic government in 1999 that led the Czech Republic into NATO and agreed to deploy forces in Kosovo. Much of the discussion remains very politicized, and whether a party is in government or in opposition often dictates their respective views on particular missions. As the Czech democracy matures, this tendency ought to become less apparent.

The Czech government will soon be redrafting the national security strategy and will produce a white paper on defence. Although much of these will reflect a continuity of recent policies, change is also in the cards. The Czech Republic is very fortunate to be surrounded by stable democratic countries, only one of which, Austria, is not in NATO and all of which are in the EU. Relations with all of these countries are excellent. This state of affairs could reinforce a sense of complacency while the risks to Czech security are real, although well beyond its own borders. Bracing Czech society for those kinds of challenges requires strong and focused leadership so that the public can better understand the nature of these security challenges and Czech interests in global stability.

The challenge is made all the more daunting insofar as the Czech government must pen a national strategy in a time of clear fiscal limits. Defence budgets are going to be subject to restrictions, and this requires the government and Czech society at large to establish a clear set of national priorities and identify those elements which it feels are essential, for example, to NATO's New Strategic Concept.

Energy security is another major challenge for the Czechs although there is a sense that NATO can only be helpful in terms of defending the sea lanes of communication. The Czechs are not in a position to exploit renewable technologies at this juncture and so will need both traditional and nuclear based energy sources. This poses some problems with Austria which is very opposed to the construction of new nuclear power plants in Central Europe. The Czech views tend to align more with that of France on this matter. The Czechs have also been investing in new gas pipelines to ensure that they are not entirely reliant on Russia. This has significantly bolstered the country's energy security. The goal, in fact, is to remove the security element from the energy question and to leave these matters up the market.

The Czechs also recognize that they may be over reliant on the automobile market and do want to diversify the country's industrial profile so that it is less reliant on energy intensive industries. Developing a sound foundation in high technologies represents one way to achieve this.

There is no single view of Russia in the Czech Republic and there is no a priori prejudice toward it. There is a degree of historic baggage arising out of Russia's role in the occupation of the country during the Soviet period, but there is also a will to move beyond this. The town of Carpology has become a major attraction for Russians and thousands of well to do Russians are now living in that area. The Czech analysts sometimes say that it is always worthwhile thinking twice before making hard decisions about Russia. Czech attitudes are not only shaped by the events of 1968 but also Russia's role in liberating the country from Nazi Germany. In other words, the legacy is complex and there is always the potential for developing closer ties. This potential was made clear after the recent plane crash in Smolensk which may now be ushering in a new period of closer Polish-Russian ties. Countries like Poland and Russia have long experience with Russia and could help the West deepen links with Russia.

It is also important that ties with Ukraine not be neglected. The immediate outlook for that country is rather negative, particularly in light of decisions taken regarding Russian naval basing in Crimea and the strong anti-NATO position of the government. Western governments should also be reaching out to the Ukrainian people. Czech officials feel that more can be done to help this large important country with great potential.

China is playing an ever more prominent role in the Czech economy. Its investors are looking for new business opportunities in Central Europe and they will likely find them. They have much to offer but they also pose a competitive challenge for the countries of the region. That challenge will grow exponentially once China has developed its capacity to innovate. For the moment, it relies on Western innovation but once this changes, it will emerge as an economically dominant power. This already represents a serious challenge to Western countries and it should be concentrating the minds of our leaders.

THE DEFENCE SECTOR

The financial crisis has also had an outsized impact on the defence sector in the Czech Republic. Falling industrial production in 2009 accounted for the fall in GNP and rising of unemployment. These, in turn contributed to the rising government deficit and public debt, which were further exacerbated by the government's anti-crisis measures. Economic growth will remain the key tool for resolving the public debt problem.

When the Czech Republic acceded to NATO, the standard budgetary allocation for defence spending was supposed to be 2% of GNP. Since 2006, a number of NATO countries have felt compelled to reduce their defence outlays due to the worsening economic climate, and this is also the case for the Czech Republic.

The goal for Czech authorities is to allocate roughly 50% of defence spending on personnel, 30% on operations and 20% on investment in military technology. Czech officials have signed up to the Istanbul commitments and are working to ensure that 50% of its forces are deployable on foreign operations and that ten percent of its forces could be deployed on long term missions. Currently 9.4% of Czech forces are deployed on such missions. Investing becomes particularly difficult in an economic down term and modernization efforts are being slowed by the global economic crisis. The goal is to embark upon major modernization programs for armoured personnel carriers, light multirole vehicle and a 21st century soldier program. The Czechs are also looking to

purchase a tactical air transport vehicle. Developing a viable air defence system after 2015 represents another key challenge for the Czech military. The Czech air forces have leased a set of fighter aircraft on ten year contracts until it makes a final procurement decision. These planes have been used both to protect Czech airspace and to participate in Baltic air defence missions. There are currently serious concerns about how Czech air defence will be conducted after this lease ends in 2015.

Czech authorities are convinced that the key to managing national defence in a time of economic austerity lies in international cooperation. If properly managed, cooperation can be a source of financial savings and deeper allied integration. The Czechs are looking to deepen cooperation in ground surveillance, air command and control systems and in the NATO airborne early warning system. The Czechs are also hosting the Joint CBRN defence center of excellence in the city of Wiskof and a multinational logistics coordination center in Prague. These efforts deepen inter-allied cooperation and offer an important means for sharing costs. The Czechs would also like to see far deeper cooperation and communication between NATO and the EU and believe that European governments cannot afford redundancies arising out of membership in both organizations.

The Czechs are still burdened by a Soviet legacy which bequeathed the country far more military infrastructure than it could ever need or use. The new democracy also inherited an army of 250 thousand soldiers, a huge force that was well beyond that country's needs or capacity to underwrite. Much of the old infrastructure has been privatized, but this process needs to be completed. At the same time, the military has been professionalized and is now, again, in the midst of restructuring and downsizing. Some 3090 people have recently been dismissed, 2100 of who were civilians. This year another 700 civilians will leave the MoD.

ISAF is considered the most important current mission and the Czechs began their participation in it in 2002. Currently more than 500 personnel are engaged in Afghanistan and the Czechs have a PRT in the east of the country. This number will rise to 700 next year. Czech forces are concentrating on reconstruction and stabilization, and developing the Afghan security forces. It is helping the Afghans develop Special Forces, has deployed three transport helicopters to the country and has a surgery team at Kabul International Airport.

Czech forces have also been deployed in Kosovo although Czech units have now been pulled out of Kosovo. This has not been welcome in Alliance circles but Czech officials maintain that the situation in Kosovo is such that it can make a better contribution to peace and security through a non-military presence. The real challenge to security involves matters of corruption and unemployment and the Czech authorities felt that it would be better to increase the military contingent in Afghanistan. Czech forces are also engaged in anti-piracy missions and other multinational force operations. The goal is to create a small and more specialized national military force that can work seamlessly with its allies and make key contributions in specialized areas such as field hospitals and chemical units. The goal is to be able to make these kinds of forces deployable within two days

Defending a 4% share of the overall MoD budget for operations will remain a priority for the government despite the overall budget cuts that the Ministry faces. The Ministry will seek to find savings while minimizing the impact on forces. This will be difficult. There have been several corruption scandals in recent months that have raised questions about the transparency of the procurement process. The government has announced its intention to make the process far more transparent and cost effective.

There is a sense among many Czech elites that the entire anti-missile system discussion in the Czech Republic was mishandled. It had been cast as a NATO matter, but it was, in fact, a bilateral issue between the Czech Republic and the United States. The public was never actively engaged in the discussion and some saw it as a gratuitously anti-Russian system even though it was designed to thwart an Iranian rather than a Russian missile attack. The Obama administration ultimately shelved the proposal.

Respectfully submitted,

The Honourable Senator Jane Cordy
Canadian NATO Parliamentary Association (NATO PA)

Travel Costs

ASSOCIATION	Canadian NATO Parliamentary Association (NATO PA)
ACTIVITY	Visit of the Sub-Committee on East-West Economic Co-operation and Convergence (ESCEW)
DESTINATION	Prague, Czech Republic
DATES	September 29 – October 1, 2010
DELEGATION	
SENATE	
HOUSE OF COMMONS	Mr. Leon Benoit, M.P. and Mr. Anthony Rota, M.P.
STAFF	
TRANSPORTATION	\$15,007.98
ACCOMMODATION	\$1,890.41
HOSPITALITY	\$0.00
PER DIEMS	\$1,017.08
OFFICIAL GIFTS	\$0.00
MISCELLANEOUS / REGISTRATION FEES	\$0.00
TOTAL	\$17,915.47