



Brussels, 29.5.2013  
COM(2013) 353 final

Recommendation for a

**COUNCIL RECOMMENDATION**

**on the Czech Republic's 2013 national reform programme**

**and delivering a Council opinion on the Czech Republic's convergence programme for 2012-2016**

{SWD(2013) 353 final}

Recommendation for a

## **COUNCIL RECOMMENDATION**

**on the Czech Republic's 2013 national reform programme**

**and delivering a Council opinion on the Czech Republic's convergence programme for 2012-2016**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies<sup>1</sup>, and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission<sup>2</sup>,

Having regard to the resolutions of the European Parliament<sup>3</sup>,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

- (1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.
- (2) On 13 July 2010, on the basis of the Commission's proposals, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States<sup>4</sup>, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.
- (3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

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<sup>1</sup> OJ L 209, 2.8.1997, p. 1.

<sup>2</sup> COM(2013) 353 final.

<sup>3</sup> P7\_TA(2013)0052 and P7\_TA(2013)0053.

<sup>4</sup> Council Decision 2013/208/EU of 22 April 2013.

- (4) On 6 July 2012, the Council adopted a recommendation on the Czech Republic's national reform programme for 2012 and delivered its opinion on the Czech Republic's updated convergence programme for 2011-2015.
- (5) On 28 November 2012, the Commission adopted the Annual Growth Survey<sup>5</sup>, marking the start of the 2013 European Semester for economic policy coordination. Also on 28 November 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the second Alert Mechanism Report<sup>6</sup>, in which it did not identify the Czech Republic as one of the Member States for which an in-depth review would be carried out.
- (6) On 14 March 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.
- (7) On 26 April 2013, the Czech Republic submitted its 2013 convergence programme covering the period 2013-2016 and, on 17 April 2013, its 2013 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (8) Based on the assessment of the 2013 convergence programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the Czech Republic has reduced the headline deficit by 1.4% of GDP from 2009 to 2012 due to substantial consolidation efforts and that, based on current expectations, it is on track to correct the excessive deficit. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible. According to the convergence programme, real GDP growth is expected to be at 0% and 1.2% in 2013 and 2014, respectively, compared to -0.4% and 1.6 % in 2013 and 2014 respectively in the Commission 2013 spring forecast. The objective of the budgetary strategy outlined in the programme is to keep the general government deficit below the 3% of GDP reference value. The general government deficit target of 2.9% of GDP in 2013 is in line with the deadline for correcting the excessive deficit set out in the Council recommendation of 2 December 2009. The Commission 2013 spring forecast projects the government deficit at 2.9% and 3% of GDP in 2013 and 2014, respectively. There is a risk of worse-than-expected budgetary outcome in 2013 stemming from additional corrections in EU funds reimbursements. On the positive side, one-off revenues related to the planned auction of new telecom frequency bands could result in a better-than-expected budgetary outcome in 2013. The convergence programme confirms the previous medium-term objective of a deficit of 1% of GDP, which adequately reflects the requirements of the Stability and Growth Pact. The (recalculated) structural budget deficit is projected to increase by 0.3%, 0.2% and 0.5% of GDP in 2014, 2015 and 2016 respectively; therefore no adjustment towards the medium-term objective is foreseen in the programme, which is not in line with the Stability and Growth Pact. The rate of growth of government expenditure complies with the expenditure benchmark of the Stability and Growth Pact in 2014 but deviates by 0.3% and 0.5% of GDP in 2015 and 2016 respectively. According to the convergence programme, the

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<sup>5</sup> COM(2012) 750 final.

<sup>6</sup> COM(2012) 751 final.

debt-to-GDP ratio is forecast to continue to increase over the programme period, albeit at a slowing pace, and to reach 51.9% of GDP in 2016.

- (9) Swift and durable recovery is hindered in the Czech Republic by repeated cuts in public investment expenditure. Safeguarding growth-enhancing expenditure with a high multiplicative effect, including projects co-financed by EU funds, would not only help buttress recovery but could also contribute to tackling the long-term challenges. Substantial growth effects could follow from prioritising expenditure on measures aiming at increasing employment, research and innovation, education, childcare facilities and infrastructure projects. At the same time, ensuring legality, regularity and efficiency of such spending is key.
- (10) Limited progress was made in 2012 on tax reform. While the real estate transfer tax was increased, no steps were taken to raise the very low level of recurrent property taxes. Plans to introduce a CO<sub>2</sub> tax and abolish exemptions from excise duties on natural gas for heating have been dropped. The implicit tax rate on energy is below the EU average and vehicle circulation taxes remain very low. Structural challenges also remain in taxation of labour, in particular affecting low-income earners and part-time workers. Only marginal steps were taken to reduce discrepancies in the tax treatment of employees and the self-employed. The Czech Republic also has room to further improve the efficiency of its tax administration. As regards personal and company income taxes, the government is planning to establish a Single Collection Point in 2015, which could effectively streamline the tax administration and help reduce the complexity of the current system. However, a drawback of the reform is that the tax bases for personal income tax, health and social contributions will not be harmonised, thereby leaving a large part of the potential benefits of the reform unexploited.
- (11) The Czech Republic has a sustainability gap of 5.0% of GDP, which is above the EU average. This gap largely reflects the projected long-term cost of ageing, which is driven by the expected increases in pension expenditure and in health and long-term care spending. An important source of the unsustainable increase in pension expenditure lies in the slow rate at which the statutory retirement age is being raised, in particular for men. Ensuring that the statutory retirement age increases more rapidly compared to current legislation and linking it to life expectancy would significantly strengthen the sustainability of the system. Moreover, an indexation formula based on prices, when implemented over the long run, would generate substantial savings and at the same time preserve the purchasing power of pensioners.
- (12) Contrary to the 2012 country-specific recommendation, the government introduced a pre-retirement scheme in 2013, which offers the possibility of drawing a pension up to five years before reaching the statutory retirement age. The pre-retirement pensions are going to be paid from the (third) pension savings pillar. However, the pillar enjoys a substantial state subsidy through direct co-payments and tax deductibility of contributions. Irrespective of whether the eligibility criteria for gaining access to the scheme will be effectively met by only a limited number of persons, as the government expects, the measure allows beneficiaries to use the previously accrued public subsidy for a purpose that goes against policies to promote longer working lives.
- (13) The expected increase in health and long-term care spending also provides a substantial contribution to the cost of ageing and the large sustainability gap. Reforms aimed at improving the efficiency of the health system via cost containment and more market-oriented solutions have been implemented in recent years in the Czech

Republic. However, problems still exist. Compared to other Member States, the Czech healthcare system tends to be excessively centred on hospital care, which gives rise to inefficiencies. There is scope to improve the provision of care in the most clinically appropriate and cost-effective way, for example by moving to day-of-surgery admission and reducing inappropriate lengths of stay in acute care hospitals.

- (14) Recent OECD projections show that full convergence of the female and male employment rates would halt the projected decline of the total labour force and increase GDP per capita by as much as 16.5 % by 2030. The government has proposed a draft Act on 22 May 2013 to introduce private 'child groups' led by professional nannies, accompanied by tax subsidies for care providers and participating families. This is a step in the right direction but is only a partial response to the issue. Despite a continued shortage of childcare facilities, in particular for under three year olds, there are no plans to increase budgetary support to public pre-school childcare facilities. The employability and labour market participation of disadvantaged people also remains a problem: there is scope for increasing the efficiency and effectiveness of public employment services.
- (15) The 2012 country-specific recommendation on public administration specifically mentioned the need to increase the efficiency of public administration and step up the fight against corruption. However, only limited progress has been made in adopting the priority legal acts under the Czech anti-corruption strategy for 2011-12. A new anti-corruption strategy for 2013-14, adopted by the government in January 2013, needs to be followed up by the urgent adoption of outstanding priority acts, such as the Public Servants Act. This new legislation will need to adequately separate political appointees from non-political staff, guarantee independence of state officials and create a well-functioning career system to reduce high staff turnover. The Czech Republic has made substantial progress in implementing the Public Procurement Act, which came into force in April 2012. However, difficulties in implementing the Act have been reported by local authorities. As regards the implementation of EU funds, most of the measures included in the action plan to strengthen the management and control system were implemented by the end of 2012. However, the Czech authorities will need to ensure continuous monitoring of the action plan.
- (16) At the level of compulsory education, Czech pupils attain broadly average results in international comparisons. In mathematics and science, however, the education outcomes have worsened rapidly over time. The Czech authorities have responded with a set of measures which entails the development of minimum education standards, which are to be used for nationwide testing of pupils. However, a more integrated system should be developed, ensuring that pupils, teachers and schools that underperform in the tests receive systematic support would further raise the level of ambition of the reform. The main challenge facing the Czech higher education system is to ensure that the rising number of students is equipped with the skills needed to succeed in the labour market. A reform of the Higher Education Act is being discussed to introduce differentiated funding arrangements and enhance accreditation. These are relevant and ambitious proposals, although their actual impact will depend on the final design of the reform. The authorities also plan to adopt revised evaluation standards for funding of research institutions. Increasing the share of quality indicators, including enhancing the collaboration with the business sector, would help the Czech research and innovation system reach a higher level of excellence.
- (17) The Czech Republic is amongst the EU Member States with the highest number of regulated professions. A public consultation on the review of the regulatory

framework for professions was conducted in 2012 and results are to be presented in 2013. This is an important step in order to reduce or eliminate barriers to those professions for which regulation is not proven necessary or considered excessive (including the length of mandatory traineeships) and for which an easier access could unlock further employment and growth. Despite improvements in recent years, the Czech Republic has still one of the highest energy intensity in the EU, in particular in the buildings and energy sector.

- (18) In the context of the European Semester, the Commission has carried out a comprehensive analysis of the Czech Republic's economic policy. It has assessed the convergence programme and national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in the Czech Republic but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (7) below.
- (19) In the light of this assessment, the Council has examined the Czech Republic's convergence programme, and its opinion<sup>7</sup> is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that the Czech Republic should take action within the period 2013-2014 to:

1. Implement as envisaged the budget for the year 2013 so as to correct the excessive deficit in 2013 in a sustainable manner and achieve the structural adjustment effort specified in the Council recommendations under the EDP. For the year 2014 and beyond, reinforce and rigorously implement the budgetary strategy, supported by sufficiently specified measures, to ensure an adequate fiscal effort to make sufficient progress towards the medium-term objective. Prioritise growth-enhancing expenditure including committing on time remaining projects co-financed with EU funds under the current financial framework.
2. Reduce the high level of taxation on labour by shifting taxation to areas less detrimental to growth, such as recurrent taxes on housing and vehicle circulation taxes. Further reduce discrepancies in the tax treatment of employees and the self-employed. Improve tax compliance and reduce compliance costs by establishing the Single Collection Point and harmonising the tax bases for personal income tax and social and health contributions.
3. Speed up the increase of the statutory retirement age compared to current legislation, introduce a clear link between the statutory retirement age and life expectancy, and revise the indexation mechanism. Accompany the increase in retirement age with measures promoting employability of older workers and reduce early exit pathways. In particular, remove the public subsidy for the pre-retirement scheme. Take measures to significantly improve cost-effectiveness of healthcare expenditure, in particular for hospital care.
4. Take measures to strengthen the efficiency and effectiveness of the public employment service. Increase significantly the availability of inclusive childcare facilities with a focus on children up to three years old, and the participation of Roma children, notably by adopting and implementing the law on private childcare facilities and strengthening the capacities of public childcare facilities.

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<sup>7</sup> Under Article 9(2) of Council Regulation (EC) No 1466/97.

5. Ensure implementation of the anti-corruption strategy for 2013-2014. Adopt a Public Servants Act that should ensure a stable, efficient and professional state administration service. Improve the management of EU funds in view of the 2014-2020 programming period. Strengthen the capacity for implementation of public tenders at local and regional level.
6. Establish a comprehensive evaluation framework in compulsory education and take targeted measures to support schools that rank low in educational outcomes. Adopt measures to enhance accreditation and funding of higher education. Increase the share of performance-based funding of research institutions.
7. Drawing on the on-going review, proceed with a reform of regulated professions, by reducing or eliminating entry barriers and reserves of activities where they are unjustified. Take further measures to improve energy efficiency in the buildings and industry sectors.

Done at Brussels,

*For the Council  
The President*