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Recommendation for a

COUNCIL RECOMMENDATION

on the Czech Republic's 2014 national reform programme

and delivering a Council opinion on the Czech Republic's 2014 convergence programme

{SWD(2014) 404 final}

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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[1], and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy 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, the Council, on the basis of the Commission's proposals, 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, 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

1 OJ L 209, 2.8.1997, p. 1.
2 COM(2014) 404 final.
3 P7_TA(2014)0128 and P7_TA(2014)0129.

commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on the Czech Republic's 2013 national reform programme and delivered its opinion on the Czech Republic's updated convergence programme for 2012-2016.

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[4], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[5], 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 20 December 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 16 April 2014, the Czech Republic submitted its 2014 national reform programme and on 28 April 2014 its 2014 convergence programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(8) The objective of the budgetary strategy outlined in the 2014 Convergence Programme is to keep the general government deficit below the 3% of GDP Treaty reference value over the programme period. The programme mentions the medium-term objective of -1% of GDP, which reflects the requirements of the Stability and Growth Pact. While the budgetary strategy is in line with the Stability and Growth Pact in2014, the required adjustment in structural terms is not expected to be met in 2015 as the recalculated structural balance is projected to deteriorate by 0.6 pp. In addition, government expenditure is expected to grow at a pace not consistent with the expenditure benchmark. The recalculated structural balance is foreseen to deviate from the required adjustment path also in 2016 and 2017 with the recalculated structural balance projected at -1.6% and -1.9% of GDP respectively. Overall, a risk of deviation from the adjustment path towards the medium-term objective is to be expected as of 2015. According to the programme, the debt ratio, which is below the 60% of GDP reference value, is projected to fall temporarily by 1.1 pp to 45% of GDP in 2014 and to increase to 46% of GDP in 2015. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The Czech economy is expected to grow by 1.7% in 2014 and 2% in 2015 according to the programme compared to 2% and 2.4% envisaged by the Commission 2014 spring forecast. The main risks to the budgetary outlook stem from high uncertainty about the future development of public investment and from a potential one-off expenditure related to the planned lease contract for fighter jets with an expected deficit-increasing impact of 0.5% of GDP in 2015. According to the Commission forecast there is a risk of significant deviation from the medium-term objective in 2015. The difference with the programme scenario lies in different assumptions on policies and discretionary measures in 2015. Based on its assessment of the programme and the

[4] COM(2013) 800 final.
[5] COM(2013) 790 final.

Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the deficit has been sustainably brought below 3% of GDP in 2013, in line with the Council recommendation, and that while the medium-term objective is expected to be reached in 2014, there is a risk of significant deviation from it as of 2015.

(9) The Czech Republic has emerged from a two-year long recession and is now faced with the challenge of achieving sustained high-growth, in a context of rapid population ageing. Public investment has been on a steep declining path in recent years and investment in infrastructure has particularly suffered. The growth model of the Czech economy before the crisis relied on large inflows of foreign capital and a strong export orientation. As room for catching-up based on the accumulation of production factors (including foreign capital) appears limited, redirecting the economy towards domestic drivers of growth would open up new avenues to productivity gains. Essential elements of this process include supporting education, training and innovation and strengthening institutions.

(10) The government has recently approved the Treaty on Stability, Coordination and Governance, although its ratification by Parliament is still pending. Work on a comprehensive reform of the fiscal framework began in 2011 but its adoption and implementation is still uncertain. The adoption of the relevant legislation ensuring compliance with Council Directive 2011/85/EU on budgetary frameworks has also been delayed..

(11) In the field of taxation, the key challenges for the Czech Republic are to make revenue collection more efficient and achieve a more growth-friendly tax structure. The Czech Republic took some measures to improve tax compliance, in particular in the area of indirect taxation, but the overall cost of compliance is still too high. In this context, the tax bases (income taxes, health and security contributions) have not yet been harmonised and the establishment of a single collection point foreseen in 2015 was cancelled. The Czech government however announced its intention to address the issue of the harmonisation of the tax bases. The 2013 recommendations regarding the taxation structure have not been followed up. Labour taxation remains high, especially for low-income earners, including part-time workers, notably due to the elevated social security contributions. Some potential exists for a shift away from labour taxation to other areas, such as environmental and recurrent housing taxes, which are both relatively low. Significant discrepancies remain in the tax and social contributions treatment of employees and the self-employed, which lead to the narrowing of the tax base and create incentives for bogus self-employment with unfair consequences for those employed under a regular employment contract.

(12) The Czech Republic faces medium sustainability risks in the long term largely due to projected increases in pensions and healthcare expenditure. According to the current legislation, the statutory retirement age is planned to increase over the long-run but too slowly in the medium term. The government plans to introduce a revision mechanism aligning the retirement age to changes in life expectancy but this is only a partial response to the sustainability gap challenge. Furthermore, the temporarily lower indexation of pensions will be terminated in 2015, a year earlier than planned, and the standard pension indexation mechanism (prices plus a third of the rise in real wages) has not been reviewed. Limited progress has been made in promoting the employability of older workers. No progress has been made in improving the cost-effectiveness of public spending on healthcare. The in-patient sector shows excess

capacity pointing to room for possible improvements in cost-effectiveness and governance.

(13) Some initial steps have been made to improve the capacity and quality of the public employment service. These go in the right direction but their impact needs to be evaluated. Active labour market policies remain underfunded and do not effectively target women with young children, young people and older workers. Despite the relatively high overall employment rate, these groups remain under-represented in the labour market. A limited access to affordable childcare facilities and services and a comparatively low take-up of part-time work hampers women's participation in the labour market. The gender pay gap in 2012 was still one of the largest in the EU.

(14) The quality and labour market relevance of the Czech education system are a cause for concern. Some measures were taken to improve the evaluation framework in the compulsory education, but the follow up with schools and pupils with weaker outcomes remains a challenge. The attractiveness of the teaching professions is also an issue, which the government intends to address. The low participation of Roma children in mainstream inclusive early childhood education and in primary education remains a challenge for their integration. The higher education reform has been delayed and no progress has been made on enhancing accreditation and funding in higher education. Only minor changes were introduced as regards the funding of research institutions. It remains crucial to create the right incentives for public researchers to strive for excellence, address societal challenges, and cooperate with the business sector.

(15) The process of de-regulating the high number of regulated professions has started, but at a slow pace not producing rapid benefits from increased competition in the service sector. The Czech Republic has taken some initial measures to increase energy efficiency, especially through public funding incentives in support of the buildings sector. The potential for energy savings remains substantial and more ambitious measures would also contribute to reducing energy dependency.

(16) The quality and efficiency of public administration continue to represent a challenge with negative economic repercussions. The long-awaited Civil Service Act has not been adopted yet; its adoption is a key priority for the government. Progress in the fight against corruption has been limited; major pieces of legislation from the 2013-14 anti-corruption strategy have not been adopted. A clear longer-term vision on how to address in a durable way this issue of great importance for economic and societal development has not yet been formulated. The implementation of public tenders at local and regional level is marked by unnecessary delays. The new public procurement rules step backward by removing some of the transparency safeguards. Limited progress has been made on improving the implementation of EU funds. Further effort is needed as shown by the high error rates reported by the audit authority for several programmes at the end of 2013.

(17) 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 the 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.

(18) In the light of this assessment, the Council has examined the Czech Republic's convergence programme, and its opinion[6] is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that the Czech Republic take action within the period 2014-2015 to:

1. Following the correction of the excessive deficit, preserve a sound fiscal position in 2014. Significantly strengthen the budgetary strategy in 2015 to ensure that the medium-term objective is achieved and remain at the medium-term objective thereafter. Prioritise growth-enhancing expenditure to support the recovery and improve growth prospects. Adopt and implement measures to strengthen the fiscal framework, and in particular establish an independent fiscal institution to monitor fiscal policies, introduce fiscal rules for local and regional governments and improve co-ordination between all layers of government.

2. Improve tax compliance with particular focus on VAT and reduce the costs of collecting and paying taxes by simplifying the tax system and harmonising the tax bases for personal income tax and social and health contributions. Reduce the high level of taxation on labour, particularly for low-income earners. Shift taxation to areas less detrimental to growth, such as recurrent taxes on housing and environmental taxes. Further reduce discrepancies in the tax treatment of employees and the self-employed.

3. Ensure the long-term sustainability of the public pension scheme, in particular by accelerating the increase of the statutory retirement age and by linking it more clearly to changes in life expectancy. Promote the employability of older workers and review the pension indexation mechanism. Take measures to improve significantly the cost-effectiveness and governance of the healthcare sector, in particular for hospital care.

4. Strengthen the efficiency and effectiveness of the public employment service, in particular by setting up a performance measurement system. Reach out to non-registered youth and provide individualised services. Increase considerably the availability of affordable and quality childcare facilities and services, with a focus on children up to three years old.

5. Ensure that the accreditation, governance and financing of higher education contribute to improving its quality and labour market relevance. Accelerate the development and introduction of a new methodology for evaluating research and allocating funding in view of increasing the share of performance-based funding of research institutions. In compulsory education, make the teaching profession more attractive, implement a comprehensive evaluation framework and support schools and pupils with poor outcomes. Increase the inclusiveness of education, notably by promoting the participation of socially disadvantaged and Roma children in particular in early childhood education.

6. Accelerate the reform of regulated professions, focusing on the removal of unjustified and disproportionate requirements. Step up the efforts to improve energy efficiency in the economy.

7. In 2014 adopt and implement a Civil Service Act that will ensure a stable, efficient and professional state administration service. Speed up and substantially reinforce

[6] Under Article 9(2) of Council Regulation (EC) No 1466/97.

the fight against corruption by implementing the remaining legislative measures provided for in the anti-corruption strategy for 2013-2014 and by developing plans for the next period. Further improve the management of EU funds by simplifying implementing structures, improving capacity and tackling conflicts of interest. Increase transparency of public procurement and improve the implementation of public tenders by providing appropriate guidance and supervision.

Done at Brussels,

For the Council
The President