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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of the Czech Republic

and delivering a Council opinion

on the updated Convergence Programme of the Czech Republic, 2011-2014

{SEC(2011) 712 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(3) thereof,

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

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 European Commission's proposal to launch a new strategy for jobs and growth, 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 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[3], which together form the “integrated guidelines”. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ C, p. .
[3] Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 29 April 2011, the Czech Republic submitted its 2011 National Reform Programme and on 5 May its 2011 Convergence Programme update covering the period 2011-2014. In order to take into account the interlinkages, the two programmes have been assessed at the same time.

(6) The global financial crisis, channelled through the Czech economy's high trade openness, took a heavy toll on GDP growth and unemployment in the Czech Republic. Real GDP declined by 4.1% in 2009, as a result of the fall in exports and in domestic investment. The unemployment rate increased significantly from 4.4% in 2008 to 7.3% in 2010, and the employment rate fell by 2 percentage points between 2008 and 2010. However, the high degree of exposure to international trade and a fast recovery in the Czech Republic's main trading partners have also facilitated a quick rebound in the real GDP growth rate in 2010 to 2.3% and will continue to support a moderate recovery.

(7) Based on the assessment of the updated Convergence Programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic assumptions underpinning the programme are plausible in the first two years of the programme and too favourable thereafter. The programme is based on a lower growth projection for 2012 compared with the Commission services 2011 Spring forecast, mainly on account of a further sustained reduction in real government consumption expenditure, which is not taken up in the Commission services' no-policy-change forecast for 2012. The programme foresees a reduction of the general government deficit below 3% of GDP in 2013 and further to 1.9% of GDP in 2014. The planned consolidation is mainly based on expenditure restraint. The proposed measures are broadly sufficient to reach the target by 2013, as recommended by the Council, but there are risks to the actual budgetary outcome of measures as presented in the programme. Moreover, the attainment of the targets for the outer years of the programme seems to rely largely on favourable cyclical conditions and further efficiency gains in public administration, which may become increasingly difficult to materialise. The achievement of the medium-term budgetary objective is foreseen beyond the horizon of the programme. The average annual fiscal effort over the period 2011-2013 is below 1% of GDP recommended by the Council under the EDP procedure of 2 December 2009.

(8) The Programme set out a clear objective to bring the deficit in public finances below 3% of GDP by 2013. The challenge will be to ensure that measures underlying the

path for the deficit reduction in 2011-13, as well as in subsequent years, do not compromise long-term growth, especially by safeguarding expenditure on education and public R&D, and that they provide an adequate buffer for increases in expenditure entailed by demographic developments.

(9) The budgetary consolidation strategy includes measures that affect VAT revenue: the lower VAT rate is planned to rise in 2012 and 2013, while the higher rate is to decrease in 2013. The government also intends to increase the number of firms liable to VAT from 2013. According to the Programme, these changes should result in an increase in tax receipts of 0.7% of GDP in 2012 and further by 0.1% of GDP in 2013. In addition, there seems to be further scope for boosting revenue from indirect taxes, which stood at 11.8% of GDP in 2010, compared to the EU average of 13.4%, and thereby possibly shift taxes away from labour. Furthermore, the difference between actual VAT revenue and the theoretical VAT liability is estimated to be significantly above the EU average, substantiating the need for measures improving tax compliance.

(10) Given that the budgetary impact of ageing is projected to be well above the EU average, the reform of the pension system is an important issue. The government has put forward two sets of proposals. The first package is expected to receive Parliamentary approval by September 2011 and targets the public Pay-As-You-Go pillar, which has been in deficit since 2009. It includes, among other measures, an increase in the statutory retirement age, which will be unified at 67 years in 2041 for men and women. This set of parametric reforms goes some way towards addressing the fiscal sustainability problem; it may, however, not be sufficient to address the challenges created by population ageing. The second package of measures, not yet formally approved by the government, would consist in the introduction of a voluntary second private pillar in 2013, with the aim to increase diversification in retirement incomes and support their future adequacy by promoting the development of private savings. However, the suggested form of the pillar creates few incentives to join the scheme and may actually add to the long-term pressures highlighted above. The operating costs of such pension funds also need to be carefully analysed and kept as low as possible to ensure the effectiveness of the system.

(11) The labour market is perceived as moderately flexible and had not shown evidence of major dysfunctions before the global financial crisis. Yet, some structural weaknesses are evident. A key challenge concerns the severe difficulties that women with children face when re-integrating into the labour market after maternity leave. The issue is significant also because of its wider economic repercussions: longer spells out of work, a high gender employment gap, and the highest gender pay gap among all Member States. Early return to work remains difficult despite the government's effort to give parents greater choice in determining the length of parental leave. The problem can be attributed partly to the low willingness of firms to provide part-time employment contracts, often used by employees with small children in other Member States, and partly to limited availability of affordable child-care facilities, especially for children below the age of three.

(12) While the overall unemployment rate remains firmly below the EU average, long-term unemployment is on the rise, particularly among the 20-29 years old. The low-educated as well as other low-wage earners face considerable difficulties in finding employment. High long-term unemployment is consistent with under-funded and

relatively low-scale active labour market policies and a low share of participants in regular activation measures.

(13) Inefficiencies in public administration, which weigh on the business environment, could be addressed by comprehensively implementing existing strategies. The government has launched a 'better regulation' agenda in 2007 and an anti-corruption strategy for the years 2011-2012. They announce measures that are important to improve the quality of the Czech legal and regulatory framework, which ranks below the EU average according to international surveys, and strengthen the confidence of businesses. A challenge is to stabilise the public administration, as frequent and far-reaching reorganisations impede its efficiency. For doing so, it would be important to adopt the Public Servant Act, which has been repeatedly postponed. The government has recently adopted measures to increase the transparency of public procurement. However, one element of the regulatory framework, namely the specific type of company shares that permit a fully anonymous transfer of wealth, remains prone to risks and therefore deserves attention.

(14) The crisis is expected to have negativly impacted on potential growth. Improving human capital is important, despite the high ratio of young people enrolled in universities, and is hindered by insufficient quality of training, as illustrated by the low ranking of Czech tertiary education institutes in international surveys. Furthermore, spending per student, in comparable prices, is in the lower quarter of the EU countries and is especially limited for primary education. The National Reform Programme outlines measures for all stages of education. A complex reform of tertiary education has been in preparation for several years. Ensuring quality and efficient tertiary education is important for competitiveness and innovation capacity.

(15) The Commission has assessed the Convergence Programme and National Reform Programme of the Czech Republic[4]. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in the Czech Republic but also their conformity 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. In this light, the Commission considers that the focus on fiscal consolidation should be kept, while protecting growth-enhancing expenditure. The long-term sustainability of public finances depends, to a large extent, on the capacity to implement now the necessary pension reform. Raising labour market participation, in particular of women, and job opportunities for the long-term unemployed, are essential. Further steps to improve the quality of public services and the regulatory framework, as well as the quality of tertiary education, are crucial for competitiveness.

(16) In light of this assessment, also taking into account the Council Recommendation under Article 126(7) Treaty on the Functioning of the European Union of 2 December 2009, the Council has examined the 2011 update of the Convergence Programme of the Czech Republic and its opinion[5] is reflected in particular in its recommendations under (1) and (2) below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of the Czech Republic,

4 SEC(2011) 712.

5 Foreseen in Article 9(3) of Council Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that the Czech Republic should take action within the period 2011-2012 to:

(1) Implement the planned consolidation in 2011 and take countervailing measures of a permanent nature in case of any revenue shortfalls or expenditure slippages. Adopt fiscal measures as planned in the programme for 2012 and underpin the target for 2013 by more specific measures. Avoid cutting expenditure on growth-enhancing items and exploit the available space for increases in indirect tax revenue, improve tax compliance, and reduce tax evasion.

(2) Introduce a comprehensive pension reform in order to improve the long-term sustainability of public finances and to ensure the future adequacy of pensions. Efforts should focus, first, on further changes to the public pillar, including a more rapid increase in the statutory retirement age than planned, underpinned by measures promoting the employment of older workers; and, second, on the development of private savings. In this context, ensure that the envisaged funded scheme attracts broad participation and is designed to keep administrative costs transparent and low.

(3) Enhance participation in the labour market by reducing the barriers for parents with young children to re-enter the labour market through increased availability and access to affordable childcare facilities. Increase the attractiveness and availability of more flexible forms of working arrangements, such as part-time jobs.

(4) Strengthen the capacity of the public employment service to increase the quality and effectiveness of training, job search assistance and individualised services, linking funding of programmes to results. In consultation with stakeholders, introduce tailor-made training programmes, for older workers, young people, low skilled and other vulnerable groups.

(5) Take the necessary measures to improve the quality of public services in areas essential for the business environment. In this context speed up the implementation of the anti-corruption strategy in line with the identified targets, adopt the Public Servants Act to promote stability and effectiveness of the public administration, and revise the Commercial Code to abolish anonymous shareholding.

(6) Establish a transparent system of quality evaluation of academic institutions and link it to its funding in order to improve the performance of tertiary education.

Done at Brussels,

For the Council
The President