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**COMMISSION STAFF WORKING DOCUMENT**

**Assessment of the 2014 national reform programme and convergence programme for  
CZECH REPUBLIC**

*Accompanying the document*

**Recommendation for a COUNCIL RECOMMENDATION**

**on Czech Republic's 2014 national reform programme and delivering a Council opinion  
on Czech Republic's 2014 convergence programme**

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## EXECUTIVE SUMMARY

**The Czech Republic's economic recovery is gaining ground.** According to the Commission 2014 spring forecast, GDP growth is expected to reach 2% this year after two years of recession. The unemployment rate, which fell moderately to 6.8% at the end of last year, is forecast to decrease further reaching 6.6% in 2015. Youth unemployment has also slightly decreased recently and remains below the EU average. In the first half of this year, the export-oriented sectors are expected to lead the way out of the prolonged recession with domestic demand progressively taking over as the main growth driver thereafter. Inflation is projected to remain at very low levels this year because of a large cut in regulated electricity prices and to increase only moderately in 2015.

**Overall, the Czech Republic has made limited progress in addressing the 2013 country-specific recommendations.** Key reforms largely stalled in the second half of 2013, given the political context. Some progress was made towards improving the fiscal position, tax compliance and the quality of compulsory education and research institutions. Limited progress was made in most other areas, notably in terms of enhancing the performance of the public employment service and ensuring the availability of childcare services, in implementing the anti-corruption strategy, strengthening the implementation of public tenders, improving the management of EU funds, de-regulating the service sector and on increasing energy efficiency. Some country-specific recommendations remain unaddressed. Specifically, no progress has been made in reducing the high level of taxes on labour and in buttressing the long-term sustainability of public finances. The Public Service Act and the reform of higher education have also yet to be adopted.

**The key challenge for the Czech Republic is to end a protracted period of subdued growth and to reignite the stalled income convergence process.** To this end, domestic drivers of growth need to be strengthened while ensuring that public finances are firmly placed on a sustainable trajectory. Measures with high growth potential in the short term include prioritising public investment in infrastructure, while ensuring efficient absorption of EU funds, and improving public administration. Rapidly activating untapped potential supplies of labour, notably by groups facing barriers to enter the labour market, and reaping benefits from the quickly expanding R&D base would also raise income and strengthen domestic demand. These challenges are rightly recognised by the policy plans submitted by the Czech Republic. The updates of the national reform programme and of the convergence programme contain relevant and ambitious measures. Overall, delivering sustainable growth in the long term requires reforms in following areas:

- **Public finances:** Despite a significant improvement in the headline general government deficit in 2013, the Czech Republic's budgetary strategy from 2015 onwards does not comply with the Stability and Growth Pact. Moreover, significant cuts in public investment over the past four years undermine the country's growth potential. The key challenge for the Czech taxation system is to ensure that it is more supportive of growth and to improve the efficiency of tax collection. Furthermore, the high pension and health care costs associated with the Czech Republic's ageing population pose a risk to the long-term sustainability of its public finances that need to be addressed with particular attention.
- **Education:** The weak points of compulsory education include the evaluation framework and the strong impact of socio-economic background on performance. For higher education, in an environment of rapidly rising enrolment rates and limited budgetary resources, the main challenge remains to achieve quality learning outcomes and to improve labour-market relevance of graduates' skills.

- **Innovation:** Important steps have been taken recently to develop research infrastructure and support innovative firms. However, the performance of domestic drivers of knowledge-based growth — in both public and private institutions — remains weak. Particularly worrying is the extremely low participation of business in co-funding public research.
- **Energy efficiency and access to regulated professions:** Despite a slowly decreasing trend, the energy intensity of the Czech economy remains very high. There is significant potential for energy efficiency improvements which would also increase energy independence and promote efficient allocation of resources. The Czech Republic reports one of the highest levels of regulated professions in the EU and the regulation of professional services is very strict. The pace of opening up of regulated professions has been slow so far with little impact on the service sector.
- **Public administration:** In international surveys, corruption is perceived as an important obstacle for business. An unstable and inefficient public administration has negative repercussions for the country's growth and competitiveness and for the absorption of EU funds.
- **Labour market:** Despite the comparatively high overall employment rate, some groups remain significantly underrepresented in the labour market and struggle to find jobs. This concerns particularly women with small children, youth, older people, low-skilled and disabled persons. For women, the impact on employment of motherhood is one of the largest in the EU, which is largely due to limited access to affordable childcare and limited take-up of part-time work. The scope and effectiveness of services provided by labour offices could be improved, as the rates of activation of registered unemployed remain one of the lowest in the EU.

## 1. INTRODUCTION

In May 2013, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies for the Czech Republic. On the basis of these recommendations, the Council of the European Union adopted seven CSRs in the form of a Council Recommendation in July 2013. These CSRs concerned public finances, the tax system, the pension system, healthcare, the labour market, the performance of public administration, education, regulated professions and energy efficiency. This staff working document (SWD) assesses the state of implementation of these recommendations in the Czech Republic.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2013 (AGS)<sup>1</sup> and the third annual Alert Mechanism Report (AMR),<sup>2</sup> which were published in November 2013. The AGS sets out the Commission's proposals for building the necessary common understanding about the priorities for action at national and EU level in 2013. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising the public administration. The AMR serves as an initial screening device to determine whether macroeconomic imbalances exist or risk emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a

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<sup>1</sup> COM(2013) 800 final.

<sup>2</sup> COM (2013) 790 final.

complete and durable rebalancing is achieved, 16 Member States were selected for a review of developments in the accumulation and unwinding of imbalances. These in-depth reviews were published on 5 March 2014, along with a Commission Communication.<sup>3</sup> The Czech Republic was not subject to the in-depth review in 2014.

Against the background of the 2013 Council Recommendation, the AGS and the AMR, the Czech Republic presented its national reform programme (NRP) and its convergence programme on 16 and 28 April 2014 respectively. These programmes provide detailed information on progress made since July 2013 and on the government's future plans. The information included in these programmes provides the basis for the assessment made in this staff working document.

The programmes submitted underwent an open consultation process. Preparation of the national reform programme involved several consultations with representatives of the Czech parliament, social partners, regional authorities, academia and other stakeholders. Before adoption by the government, both programmes were submitted to and discussed in the committees of the Czech parliament.

## 2. ECONOMIC SITUATION AND OUTLOOK

### Economic situation

**The recovery is gaining some ground in the Czech economy, following two years of negative growth.** The recession in 2012 and 2013 took a toll on domestic demand. While private consumption expenditure was negatively affected by decreases in real disposable income of households, gross capital formation slowed down due to recurrent cuts in public investment and increased risk aversion on the part of businesses. Overall, GDP decreased by 0.9% in 2013. The unemployment rate stabilised at around 7%. In November 2013, the Czech National Bank loosened its monetary policy stance by weakening the koruna, and has signalled its intention to maintain this policy at least throughout 2014.

### Economic outlook

**The recovery is expected to strengthen in 2014, sustained by the improving global economy.** However, the income gap vis-à-vis the EU average is projected to remain broadly unchanged in 2014-15. Export-oriented sectors (including industry) are likely to be the main drivers of growth in 2014, while rebalancing towards domestic drivers should follow in 2015, along with strengthening confidence in both the corporate and household sectors. The labour market deterioration is expected to have bottomed out in 2013 and the unemployment rate is projected to gradually decrease. Despite the central bank's foreign exchange interventions, inflation is likely to remain subdued in 2014 due to the diminishing impact of past increases in indirect taxes and to a large drop in regulated electricity prices. Stronger domestic demand is expected to stoke up inflation in 2015.

**The macroeconomic outlook underlying the convergence programme and national reform programme is plausible.** Both strategic documents share the same economic outlook. According to the convergence programme, real GDP growth is expected to reach 1.7% in 2014 and 2.0% in 2015, compared to 2.0% projected for 2014 and 2.4% projected for 2015 in

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<sup>3</sup> Aside from the 16 Member States identified in the AMR, Ireland was also covered by an in-depth review, following the Council's conclusion that it should be fully integrated into the regular surveillance framework after successfully completing its financial assistance programme.

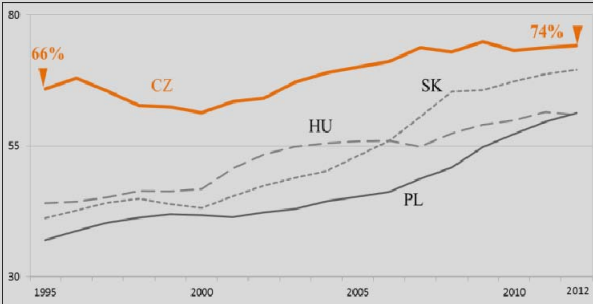
the Commission 2014 spring forecast. The macroeconomic scenario presented in the two programmes does not include estimates of the macroeconomic impact of structural reforms.

**Box 1: Stalled convergence**

**In the decade before the 2008 crisis, the Czech Republic enjoyed the longest period of uninterrupted growth in its history** and was praised for its success in attracting foreign direct investment (FDI) and for its favourable labour-market outturns. Compared to some other central and eastern European (CEE) countries, convergence of the Czech economy to the EU-15 was, however, somewhat slower (see Figure 1). Moreover, in the post-2008 period, the economy has been in the doldrums longer than other countries in the region and the process of catching up with the EU average is projected to broadly stagnate in 2014-15. This overall unimpressive economic performance raises questions about the country’s growth prospects in the medium term.

**Drivers of growth in the Czech economy and other CEE countries were broadly similar despite their different starting positions back in the 1990s.** The inflow of foreign direct investment was the most distinctive factor shaping growth in the majority of CEE countries, and was an appropriate choice for countries that needed to recapitalise and move up the technological ladder. However, room for catching up based on the accumulation of production factors (including foreign capital) was more limited in the Czech economy compared to other CEE countries because of the higher level of development it had reached in the 1990s. Therefore, other essential prerequisites for growth, such as quality institutions, innovation and economic policies, gained relative importance. Despite favourable labour market developments, relatively strong real GDP growth and the absence of sizeable macroeconomic imbalances in the pre-crisis period, progress on structural reforms in these areas has been limited (see sections 3.3-3.5 of this document). As a consequence, real convergence was slow, in particular when measured by net national disposable income per capita, a proxy of material living standards (see Figure 2). Looking ahead, the Czech working-age population is projected to shrink by 6% by 2020 and to continue falling thereafter, which is likely to be an additional drag on growth. This heightens the importance of progressing with the reform agenda in order to restart convergence.

**Figure 1: GDP per capita relative to EU-15**



**Figure 2: Convergence in living standards**



Source: Eurostat. Figure 1 shows GDP per capita in comparable prices (PPS) relative to the EU-15 average. Figure 2 shows the change in net national disposable income per capita in comparable prices (PPS) relative to the EU-15 between 1995 and 2012.

### 3. CHALLENGES AND ASSESSMENT OF THE POLICY AGENDA

#### 3.1. Fiscal policy and taxation

##### *Budgetary developments and debt dynamics*

**The objective of the convergence programme is to keep the general government deficit below the 3% of GDP reference value in 2014-2017 and to pursue a neutral fiscal policy after 2015.** The programme mentions the medium-term budgetary objective (MTO), which is set at a structural deficit of 1% of GDP. The MTO reflects the objectives of the Stability and Growth Pact. According to the programme and based on the recalculated structural balance<sup>4</sup>, the MTO will be achieved in 2014 but the structural balance is projected to deteriorate thereafter so that achievement of the MTO is not foreseen within the programme period.

**The headline general government deficit reached 1.5% of GDP in 2013, which is a significantly better outcome compared to the 2.8% of GDP target envisaged in the 2013 programme.** A combination of several factors accounted for this improvement. A fall in public investment of 12% against a projected increase of 4% was the dominant factor on the expenditure side. Furthermore, savings were achieved in interest expenditure and in social transfers. On the revenue side, higher-than-projected revenue was recorded in taxes on production, social contributions as well as in property income (reflecting strong performance of some state-controlled companies). The final budgetary outcome was also influenced by discretionary measures amounting to approximately 1% of GDP (see Box 2). Overall, the 2013 budget was implemented in line with the 2013 country-specific recommendation, but the sizeable retrenchment of public investment goes against the recommendation to prioritise growth-enhancing expenditure.

**The programme envisages an increase in the headline general government deficit to 1.8% of GDP in 2014.** This is a significantly lower target compared to the 2.9% of GDP foreseen in the 2013 programme. The difference compared to the target included in last year's programme can be explained mainly by the base effect, i.e. lower-than-expected deficit in 2013. Expenditure-to-GDP ratio is projected to remain broadly stable. The main factor driving expenditure growth in 2014 is the projected surge in public investment by almost 30%, because of a significant increase in EU-funded investment projects towards the end of the 2007-2013 programming period. The impact on the deficit is however limited to national co-financing (0.2% of GDP according to the programme). The revenue-to-GDP ratio is expected to decrease by 0.3 pp to 40.6% which is driven by the deficit-increasing effect of discretionary measures as well as by the fact that the main revenue categories such as VAT, PIT and the social security contributions will be affected by the expected subdued growth in private consumption and in the compensation of employees. The fiscal projections in the programme also include a one-off revenue from the sale of newly released frequency ranges amounting to 0.2% of GDP. The Commission 2014 spring forecast projects a slightly higher deficit of 1.9% of GDP, which is mainly due to a higher expected government consumption as both the public sector wage bill and the intermediate consumption are forecast to grow more dynamically than envisaged in the programme. The recalculated structural balance is projected to deteriorate by 0.9 pp to -1 % of GDP, which is similar to the -1.1% of GDP projected in the Commission Forecast.

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<sup>4</sup> Cyclically adjusted balance net of one-offs and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology

**The programme envisages an increase of the headline general government deficit to 2.3% of GDP in 2015 and a gradual decline to 1.7% of GDP in 2017.** These headline targets are significantly lower than those foreseen in the previous year's programme. This can be explained by the above mentioned base effect from 2013 and, to a lesser extent, by the differences in the planned discretionary measures. In 2015 specifically, the authorities plan to cancel the previously adopted tax reform and introduce other measures instead, notably changes to the personal income tax, a second reduced VAT rate and higher indexation of pensions (see Box 2 for more details). The overall effect of the planned discretionary measures will be deficit-increasing and amounts to approximately 0.2% of GDP according to the programme. The Commission 2014 spring forecast projects a headline general government deficit of 2.4% of GDP in 2015 but there are significant differences in the composition of revenue and expenditure as the Commission Forecast does not include the new discretionary measures announced in the programme. The envisaged improvement of the general government headline deficit in the later years of the programme reflects for most part the expected improvement in macroeconomic conditions. Both the revenue and the expenditure ratios are projected to fall but there are no specific discretionary measures underpinning these trends. The recalculated structural balance is expected to deteriorate by 0.6 pp to -1.6% of GDP in 2015, stabilise at -1.6% of GDP in 2016 and deteriorate further to -1.9% of GDP in 2017. The Commission 2014 spring forecast expects the structural deficit to reach 1.9% of GDP in 2015.



### Box 2: Main budgetary measures

Revenue	Expenditure
<b>2013</b>	
<ul style="list-style-type: none"> <li>• Increase in the both VAT rates and in excise duties (+0.4% of GDP)</li> <li>• Changes in personal income tax and health insurance contributions (+0.2% of GDP)</li> <li>• Increase in the property transfer tax and other revenue (+0.1% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Lower indexation of pensions (-0.2% of GDP)</li> <li>• Reduction in subsidies for renewable energy (-0.1% of GDP)</li> </ul>
<b>2014</b>	
<ul style="list-style-type: none"> <li>• Increase in excise duties on tobacco (+0.1% of GDP)</li> <li>• Expiry of special tax on photovoltaic power plants (-0.2% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Changes in sickness benefit payment system (+0.1% of GDP)</li> </ul>
<b>2015</b>	
<ul style="list-style-type: none"> <li>• Changes in personal income tax (-0.1% of GDP)</li> <li>• Introduction of a second reduced VAT rate (-0.1% of GDP)</li> <li>• Increase in excise duties on tobacco (+0.1% of GDP)</li> <li>• Changes in social security contributions (+0.2% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Higher indexation of pensions (+0.1% of GDP)</li> <li>• Increase in social transfers (+0.1% of GDP)</li> <li>• Increase in the public sector wage bill (+0.1% of GDP)</li> </ul>
<b>2016</b>	
<ul style="list-style-type: none"> <li>• N.a.</li> </ul>	<ul style="list-style-type: none"> <li>• Increase in the public sector wage bill (+0.1% of GDP)</li> </ul>
<b>2017</b>	
<ul style="list-style-type: none"> <li>• N.a.</li> </ul>	<ul style="list-style-type: none"> <li>• N.a.</li> </ul>
<p>Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

**There are several risks to the budgetary outlook as presented by the programme.** Based on the experience from the past four years when public investment was repeatedly much lower than expected, there is high uncertainty about future development of public investment. This concerns mainly the domestic public investment which should increase moderately by

about 3% per year according to the programme. A more dynamic rebound in domestic public investment can however not be excluded as certain public entities may have postponed their investment projects and thus built up reserves for a future increase in their investment activity. On the other hand, the EU-funded investment may not increase as much as projected because the programme scenario is based on a rather optimistic assumption about the absorption capacity. This in turn would imply lower national co-financing. Secondly, the forecast does not include a one-off expenditure related to a possible renewal of a lease contract for fighter jets. According to the programme, the contract is likely to be concluded in 2015 with an estimated potential deficit-increasing impact of 0.5% of GDP.

**The Czech Republic corrected the excessive deficit in 2013 in line with the Council recommendation but the projected fiscal effort from 2015 onwards does not comply with the Pact.** The headline general government deficit was firmly below the 3% of GDP threshold in 2013 and the Commission 2014 spring forecast confirms the durability of the correction of the excessive deficit. The annual average structural effort in the period 2010-2013 amounted to 1.4% of GDP while the annual adjusted average structural effort was 1.7% of GDP. Both values are significantly above the minimum annual average fiscal effort of 1% of GDP required by the Council recommendation. The recalculated structural balance is expected to reach -1% of GDP in 2014 implying that the Czech Republic should reach its MTO this year. According to the information provided in the programme, the growth rate of government expenditure, net of discretionary revenue measures will not exceed the reference medium-term rate of potential GDP growth (1.6%) in 2014. The deterioration of the recalculated structural balance by 0.6 pp in 2015 indicates a risk of significant deviation from the MTO. The growth rate of government expenditure is projected to exceed the reference medium-term rate of potential GDP growth (1.6%) by 0.3 pp in 2015 pointing to a risk of deviation. The most important factor causing the difference between the two indicators is the difference between the apparent revenue elasticity and the standard one. As the former is lower than the latter by almost 0.3 pp, the cyclical adjustment overestimates the cyclical component of revenues and implies a larger deterioration of the structural balance in 2015 than would otherwise be the case. Based on the Commission 2014 spring forecast, both indicators suggest a risk of significant deviation. The difference with the programme scenario lies in different assumptions on policies and discretionary measures in 2015, as explained above. In conclusion, based on the assessment of the programme and the Commission forecast, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, a risk of significant deviation from the MTO is to be expected in 2015. Furthermore, the recalculated structural balance is expected to deviate from the MTO also in 2016 and 2017 as the recalculated structural balance is projected to remain unchanged in 2016 and deteriorate by 0.3 pp in 2017 against the required annual structural adjustment of 0.5% of GDP.

**The debt-to-GDP ratio is projected to fall temporarily by 1.1 pp to 44.9% of GDP in 2014 and to increase to 46% of GDP in 2015.** Since the debt ratio is below the reference rate of 60% of GDP, the debt reduction benchmark is not applicable. The programme expects the debt-to-GDP ratio to increase to 47.1% of GDP in 2016 and stabilise at the same level in 2017. The contribution of the primary balance is projected to increase in 2015 and fall thereafter while the contribution of interest expenditure remains stable. The improvement in the ratio in 2014 is mainly due to discrepancies between the cash and accrual approach expected in the programme scenario. The interest risk and the currency risk seem broadly contained, given the relatively low share of short-term and variable debt and of foreign-denominated debt. The full implementation of the convergence programme would put debt on an increasing path by 2030. The debt-to-GDP ratio would be above the 60% of GDP reference value in 2030.

### **Box 3: Excessive deficit procedure for the Czech Republic**

On 2 December 2009, the Council decided that an excessive deficit existed in the Czech Republic. The most recent Council Recommendation under Article 126(7) TFEU was adopted on the same date. The Council recommended that the Czech Republic's authorities should put an end to the present excessive deficit situation by 2013. In particular, the Czech Republic was recommended to implement the deficit-reducing measures in 2010 as planned in the draft budget law for 2010; to ensure an average annual fiscal effort of 1 % of GDP over the period 2010-13; and to specify the measures necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than expected at the time. In addition, in order to limit risks to the adjustment, the Czech Republic was recommended to rigorously enforce its medium-term budgetary framework and to improve monitoring of budget execution throughout the year to avoid expenditure overruns compared to budget and multiannual plans. Furthermore, the Council invited the Czech authorities to implement reforms with a view to raising potential GDP growth and reforms conducive to enhancing the quality of public finances, in particular reforms improving the efficiency and effectiveness of public spending. In addition, the Council invited the Czech authorities to continue with the necessary pension and healthcare reforms.

The year following the correction of the excessive deficit, the Czech Republic will be subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO.

An overview of the current state of excessive deficit procedures is available on: [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/deficit/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm).

#### *Fiscal framework*

**The implementation of the current fiscal framework has been rather weak and stronger rules are necessary.** The main features of the current fiscal framework include an expenditure rule for central government and multiannual fiscal planning. Nominal expenditure ceilings are set on a rolling tri-annual basis and can be adjusted only in specifically defined cases which are enumerated in the Budgetary Rules Act. However, enforcement of the expenditure ceilings has been weak, and they have been revised upwards several times. Levels other than the central government are insufficiently integrated in the expenditure rule as local and regional government budgets are not part of the medium-term budgetary targeting. In addition, coordination between the different layers of government has been insufficient. There are no strict rules concerning local and regional government debt.

**Work on a comprehensive reform of the fiscal framework began in 2011 but its adoption and implementation is still uncertain.** In 2012, the government approved a constitutional act on fiscal responsibility introducing major changes to the current fiscal framework. One year later, it approved an implementing act on fiscal responsibility rules. However, parliament has not adopted these proposals yet and the form in which they will be adopted is unclear. Adoption of the relevant legislation ensuring compliance with Council Directive 2011/85/EU on budgetary frameworks has also been delayed. In particular, the requirement to ensure independent monitoring of compliance with numerical fiscal rules has not been fulfilled. As for the requirements of the Directive adopted so far, cash-based fiscal data are made available on a monthly basis for the six state funds, and improvements have been made in the area of forecasting. The government has recently approved the Treaty on Stability, Coordination and Governance, which is an important political step, though its ratification by the parliament

remains pending. The Czech government is also prepared to create the necessary conditions for adopting the euro.

### ***Long-term sustainability***

#### **The Czech Republic appears to face medium fiscal sustainability risks in the long-term.**

These are primarily related to the projected ageing costs contributing with 4.0 pp. of GDP over the very long run, in particular due to the pension and health components. The pension expenditure contribution to the long-term sustainability gap amounts to 2.2% of GDP over 2016-60 (i.e. some 1.4 pp higher than the EU average). The increase in the ratio of pension expenditure to GDP in 2010-60 is projected to be 2.7 pp<sup>5</sup> (i.e. 1.1 pp higher than the EU average). The long-term sustainability gap<sup>6</sup>, showing the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at 5.3% of GDP. Risks would be higher in the event of reverting to the higher structural primary balance deficits observed in the past, such as the average for the period 2004-2013. It is therefore appropriate for Czech Republic to continue to implement measures that reduce government debt and further contain age-related expenditure<sup>7</sup> growth to contribute to the sustainability of public finances in the medium and long term. The medium-term sustainability gap<sup>8</sup>, showing the adjustment effort up to 2020 required to bring debt ratios to 60% of GDP in 2030, is at 0.6% of GDP which implies a medium risk. This is primarily a result of the structural primary balance in 2015 and the ageing costs that are only partially mitigated by the debt level.

**In 2013, the Czech Republic received a CSR concerning the long-term sustainability of pensions.** The Czech Republic was invited to take steps to increase the effective retirement age by aligning the statutory retirement age to changes in life expectancy, review the indexation mechanism, promote the employability of older workers and remove the public subsidy for the pre-retirement scheme. The analysis in this staff working document leads to the conclusion that there has been no progress on measures taken to address this recommendation.

**The standard pension indexation mechanism has not been revised and the temporarily lower indexation of pensions introduced in 2013 will be terminated in 2015, a year earlier than planned.** The standard indexation mechanism which was in place until 2012 links pension indexation to increases in aggregate consumer price index plus a third of the real wage growth. The 2014 national reform programme announces plans to go back to this indexation mechanism as a rule as of 2015 while at the same time a discretionary increase of 1.8% is proposed for 2015 in order to preserve purchasing power of pensioners. This implies a negative budgetary impact in the short term and does not address the sustainability challenge that prompted the country-specific recommendation. The standard indexation mechanism, while not excessively generous in EU comparison, does not sufficiently limit pension expenditure in the long term. Substantial savings would have to be found in other parts of the budget if this indexation formula is preserved. Even though the employment rate of people

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<sup>5</sup> Data on the contribution of pension expenditure to long-term sustainability and the increase in the ratio of pension expenditure to GDP, based on the *Fiscal Sustainability Report 2012*, the *Ageing Report 2012* and updates to Commission forecasts.

<sup>6</sup> See Table V in the Annex. The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing.

<sup>7</sup> Ageing costs comprise long-term projections of public age-related expenditure on pension, health care, long term care, education and unemployment benefits. See the 2012 Ageing Report for details.

<sup>8</sup> See Table V in the Annex. The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance to be introduced until 2020, and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population.

over 55 is rising, limited progress has been made in promoting the employability of older workers. Most measures taken in this area focus on stimulating labour demand, public information campaigns and learning centres for seniors, and do not address workers' motivation to invest in keeping their labour-market skills up-to-date. The national reform programme 2014 reports measures with a potential to increase the employability of older workers in a form of a social insurance and income tax allowance for people above 50 and working pensioners respectively.

**Going forward, the authorities plan to introduce a revision mechanism aligning the retirement age to changes in life expectancy.** This mechanism would address part of the country-specific recommendation and could help to shield the pension system from unexpected changes in life expectancy. It is, however, only a partial response to the sustainability challenge because it does not address the current size of the sustainability gap. Other risks related to the financial balance of the pension system (such as the proportion of the working age population) are outside its scope. Furthermore, according to the 2014 national reform programme, the retirement age would not change automatically based on the review's findings which lowers the credibility of the measure. No further changes to the pension system are planned in the short term. Elimination of the public subsidy for the pre-retirement scheme, also called for in the country-specific recommendation, is not expected. However, the scheme has been used relatively little so far and so does not pose immediate fiscal risks.

**The government has recently announced plans to abolish the fully funded statutory pillar but no details are provided in the national reform programme.** The pillar was created in 2013 and has attracted less than 2% of the labour force so far, partly because participation is conditional on topping up the present level of contributions with a further 2% of salary, which may be more difficult for some workers under the current economic circumstances. The fully funded statutory pillar has also suffered from a lack of strong and lasting commitment across the political spectrum, which seems to be an important precondition for a long-term pension reform.

**In 2013, the Czech Republic received a CSR concerning the cost-effectiveness of public spending on healthcare, in particular in hospitals. There has been no progress on this recommendation.** Projected long-term health spending is a matter of concern and poses a risk to long-term sustainability. The contribution of healthcare expenditure to the long-term sustainability gap amounts to 1.1% of GDP over 2016-60 (i.e. some 0.2 pp higher than the EU average). The increase in the ratio of healthcare expenditure to GDP in 2010-60 is projected to be 1.7% pp<sup>9</sup> (i.e. 0.5 pp higher than the EU average).<sup>10</sup>

**The sources of inefficiencies in the in-patient sector are manifold and stem largely from poor governance of the healthcare system.** Public procurement suffers from the absence of a pooled purchasing approach and irregular practices are reported, in particular for medical devices. There are various reported public-hospital cases<sup>11</sup> where prices for medical devices such as radiotherapy equipment by far exceeded the market price. More generally, capital

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<sup>9</sup> Data on the contribution of healthcare to long-term sustainability and the increase in the ratio of healthcare expenditure to GDP, based on the *Fiscal Sustainability Report 2012*, the *Ageing Report 2012* and updates to Commission forecasts.

<sup>10</sup> Both the average number of acute-care beds (5 beds per 1 000 inhabitants vs. 3.6 in the EU on average) and average acute-care length of stay (6.8 days vs. 6.1 in the EU on average) are high compared to the EU average. A record-low proportion of day cases in the total number of discharges (2 % vs. an EU average of 26 %)<sup>10</sup> is also reported. These findings raise concerns about the incentive structure and cost-effectiveness in the in-patient sector.

<sup>11</sup> *Study on Corruption in the Healthcare Sector*, HOME/2011/ISEC/PR/047-A2, October 2013.

investment planning also seems to be inefficient and not systematic. These are also signs of insufficient supervision over insurance funds and healthcare providers. The contract policy between facilities and insurance funds lacks transparency. Furthermore, hospital management faces a limited risk of default or wage cuts, which gives rise to moral hazard. In addition, many facilities do not meet reporting standards and information to secure better cost and quality control is therefore insufficient, which does not allow the diagnosis-related group (DRG) funding model to work properly.

**The existing in-patient care infrastructure shows excess capacity, while out-patient care remains over-utilised.** Plans to transform acute hospital-bed capacity into long-term care beds and to improve integrated care practices have not been implemented. Necessary care coordination has been insufficient. Furthermore, the in-patient acute-care bed-occupancy rate has been decreasing in the last decade. Related to this, there is a risk that current high care-utilisation rates in the out-patient sector will increase further if no measures are taken to streamline unnecessary consultations and especially referrals to specialist care. The envisaged abolishment of most of the regulatory fees in the outpatient sector only aggravates the absence of care coordination mechanisms and increases overconsumption. The 2014 national reform programme seeks to introduce measures with a potential to improve the cost-effectiveness of healthcare expenditure. There are plans to cut the overhead costs of the insurance funds and to foster price competition for healthcare providers by promoting the transparency of the contract policy between insurance funds and facilities. The envisaged more cost-based allocation of public health contributions among insurance funds intends to create level playing field. Finally, there are plans to strengthen the supervision over both the public health contributions system and insurance funds. However, a comprehensive action plan comprising well-designed incentive structures, that could address the lagging cost-effectiveness of the system and its weak governance, is missing.

### *Tax system*

**The key challenge for the Czech taxation system is to make it more supportive of growth, simpler and more predictable, and to make tax collection more efficient and user-friendly at the same time.** The overall level of taxation in the Czech Republic is relatively low in comparison to the rest of the EU, but labour taxation remains high, notably due to the elevated social-security contributions. Especially low-income earners face a high tax burden. There is still some potential to shift away from labour taxation to other kinds of tax, such as environmental and recurrent housing taxes, which are both relatively low. Structural problems also remain within the labour taxation area, where large differences persist in the tax treatment of employees and the self-employed. Furthermore, the tax system is very complex, which puts a significant burden on taxpayers. Finally, there is scope for further improvements in tax compliance, in particular in the area of indirect taxes and taxes paid by the self-employed.

**In 2013, the Czech Republic received a CSR concerning taxation.** In particular, the Czech Republic was invited to reduce the high level of labour taxation by shifting tax 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, and improve tax compliance and compliance costs by setting up the single collection point and harmonising the tax bases for personal income tax and social and health contributions. The analysis in this staff working document leads to the conclusion that there has been limited progress on measures taken to address this recommendation and that tax-related challenges remain relevant.

**No progress has been made in reducing the high level of labour taxation.** Labour taxation increased in 2013 as a result of temporary consolidation measures affecting both the personal income tax and social security contributions. In 2011, the Czech Republic adopted a comprehensive tax reform which was to enter into force as of 2015 and would reduce the total tax burden on labour. However, recent plans to abolish the reform before its entry into force imply that overall labour taxation is likely to remain high in the foreseeable future. In the 2014 national reform programme, the government announced plans for a new revenue-neutral labour-tax reform, which is planned to be introduced in 2016 and includes changes in both the tax base and the tax rates and introduction of a permanent second tax bracket for high-income earners.

**As concerns the structure of labour taxation, there is a need for lowering the tax burden on low-income earners.** The unemployment rate among low-skilled people is four times higher than the national average and the tax wedge on low-income earners is above the simple EU average<sup>12</sup>. Given low earners' unsatisfactory employment situation, a reduced tax burden (including through lower social-security contributions for employers) could contribute to improving their labour-market prospects. The 2014 national reform programme reports plans to temporarily lower the social security contributions for disadvantaged groups such as older workers, women with young children or the long-term unemployed, but specific proposals are not yet available.

**Significant discrepancies in the tax treatment of employees and the self-employed remain.** Some changes in the taxation of the self-employed were introduced in 2013, but the overall effect is expected to be limited as these measures do not sufficiently address the main problems. According to a recently published study,<sup>13</sup> the self-employed pay on average 27% less in taxes than employees. The two main explanations of this discrepancy are large flat-rate deductions for expenses and a low tax base, and these have been in place for several years now and remain unchanged. Another but related problem is bogus self-employment and widespread under-reporting of taxable income. The convergence programme includes plans for introducing a cap on flat-rate expenses deductions in the category eligible for 60% deduction as of 2016. A review comparing taxation of the self-employed with that of employees is being conducted which could lead to further changes in this area. At the same time, the national reform programme announces plans to harmonise the tax bases for income taxes, health and social security contributions which according to the Czech authorities should further reduce the discrepancies in the tax treatment. Concrete details are however not yet available.

**The recurrent tax on housing and the vehicle circulation tax remain unchanged.** The recurrent property tax is the one of lowest in the EU and represents only 0.2 % of GDP in revenue. In addition, the debt bias in housing taxation<sup>14</sup> remains relatively high. Although the Czech Republic increased the real-estate transfer tax in 2013, no changes have been made to the recurrent property tax and no measures are currently planned in this area. Similarly, no changes have been made to the vehicle circulation tax. The Czech Republic is only slightly below the EU average as concerns the contribution of environmental taxation to GDP. While transport fuel taxes are among the highest (6th highest in the EU), the implicit tax rate on

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<sup>12</sup> At 39.3% (2012), the tax wedge on low-income earners (67% of average wage) is above the simple EU average of 37.7%. At 50% of the average wage, it is also above the EU average (36.2%, EU average: 34.1%). Source: DG ECFIN Tax and Benefits Indicators Database

<sup>13</sup> See Dusek, Kaliskova, Munich (2013): '*Kdo a kolik odvádí do společné kasy? Zdanění příjmů ze zaměstnání a podnikání v českém systému*', IDEA.

<sup>14</sup> The tax deductibility of mortgage interest payments favours the use of debt. This type of tax relief contributes to increasing both housing prices and debt leverage.

energy remains below the EU average and earlier plans for introducing a carbon tax have been dropped. There is therefore some scope for an increase in green taxes, in particular in the area of pollution and resource taxation,<sup>15</sup> not only from the public revenue perspective but also in terms of environmental goals.

**The Czech Republic put in place several measures to improve tax compliance, in particular in the area of VAT.** According to a recently published study,<sup>16</sup> the VAT compliance gap in the Czech Republic was around 23 % on average between 2000 and 2011, the 8th highest in the EU. On top of the measures implemented from 1 January 2013,<sup>17</sup> the Czech authorities introduced compulsory electronic VAT returns in 2014 and amended the act on fuels (in force since October 2013), introducing a compulsory deposit for fuel distributors. While the overall effectiveness of these measures has yet to be evaluated, recent tax collection statistics suggest a positive impact on indirect tax receipts. The 2014 national reform programme envisages further measures (i.g. digitalisation of tax collection, a lower limit for cash payments, potential broadening of the reverse charge mechanism) to improve tax compliance. Moreover, the administrative cooperation with other Member States' revenue authorities can be further improved to tackle cross-border VAT fraud. The Czech Republic tends to reply late to requests for information coming from other Member States and makes limited use of multilateral controls in the field of VAT.<sup>18</sup>

**Limited progress was achieved in the area of tax administration.** The Czech Republic further strengthened electronic systems for submitting tax returns, but administrative costs per net revenue collection are still at one of the highest levels in the EU, and the country ranks second highest in terms of the time needed to comply (in particular for labour and consumption taxes)<sup>19</sup>. A Single Collection Point (SCP) for income taxes, health and security contributions and customs planned for 2015 was abolished. The 2014 national reform programme mentions the authorities' intention to retain some features of the SCP concept and present a new proposal aiming at simplifying the tax collection, including the above-mentioned harmonisation of tax bases. In this context, the planned introduction of a second reduced VAT rate for medicines, books and baby food as of 2015 goes against the idea of simplifying the tax system as it introduces additional complexity.

### 3.2. Financial sector

**Having weathered the period of economic decline since 2008 remarkably well, the banking sector remains well-capitalised, with a comparatively high average return on assets.** The key financial soundness indicators and stress tests conducted by the Czech National Bank confirm the resilience of the Czech banking sector against deterioration of the real economy and external risks. In the third quarter of 2013, the share of non-performing loans amounted to 5.2 %, the capital adequacy ratio was well above 16 % and the return on equity reached almost 18 %, the second highest in the EU. The loans-to-deposit ratio of slightly above 73 % suggests that the credit supply is unlikely to be considered a major factor in access to financing. In 2013, the Czech Republic did not receive a CSR in this area.

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<sup>15</sup> 5th lowest in the EU in 2012.

<sup>16</sup> See TAXUD (2013): *Study to quantify and analyse the VAT gap in the EU-27 Member States*.

<sup>17</sup> A new concept of 'unreliable taxpayer', a requirement to use verified bank accounts for all business transactions, and an obligation for newly-registered VAT payers to submit tax returns on a monthly basis.

<sup>18</sup> European Commission (2014) Commission Staff Working Document accompanying the Report on the application of Council Regulation (EU) No 904/2010 concerning administrative cooperation and combating fraud in the field of VAT

<sup>19</sup> The PricewaterhouseCoopers *Paying Taxes 2013 report* (p. 98) and the *World Bank Doing Business Report 2014* state that it takes 413 hours to comply with tax requirements in the Czech Republic, compared to the OECD average of 173 hours.



**The SME access-to-finance index for the Czech Republic has shown a continuous, albeit small, improvement between 2007 and 2012.**<sup>20</sup> However, this masks two opposite developments. While access to debt financing provided by banks is perceived to have increased substantially between 2007 and 2012 and is seen as comparatively easy and affordable, access to equity financing is considered to have worsened considerably. As a consequence, the SME access-to-finance index ranks the Czech Republic as the Member State with the least accessible equity financing and the country suffers from a lack of early-stage financing programmes for SMEs through the equity channel. The official projects of a seed/venture capital fund financed through EU funds have been stalled and will be revisited in the 2014-20 programming period. The act on investment companies and investment funds<sup>21</sup>, effective since 2014, may lead to greater involvement of private investors in funding SMEs at different stages of their development.

### **3.3. Labour market<sup>22</sup>, education and social policies**

**Using the potential of the labour force better and improving the quality, equity and labour-market relevance of education could support the Czech economy's growth prospects in the medium and long term.** The overall labour market situation in the Czech Republic has proved to be relatively strong, with the unemployment rate at 7 % in 2013. Nevertheless, relatively low unemployment rates exist in parallel with under-used labour potential, a situation that points to a number of structural challenges. The high employment impact of motherhood, caused by limited access to affordable childcare facilities, adversely affects women's career progress. The participation rate of disadvantaged people, notably of young people, older workers, the low-skilled and long-term unemployed, remains low, in part due to ineffective public employment services. Moreover, there are concerns about the quality, equity and labour-market relevance of the education system at all levels. Roma people in particular still face obstacles to social inclusion and labour-market access.

**In 2013, the Czech Republic received CSRs concerning labour-market and education policies.** In particular, the Czech Republic was invited to take additional steps to strengthen the efficiency and effectiveness of the public-employment service, significantly increase the availability of inclusive childcare facilities with a focus on children up to three years old, and increase the participation of Roma children, set up a comprehensive evaluation framework in compulsory education and put in place targeted measures to support schools that rank low in educational outcomes, and adopt measures that enhance accreditation and funding for higher education. The analysis in this staff working document leads to the conclusion that the Czech Republic has made limited progress on measures taken to address these recommendations.

#### ***Labour market***

**Despite the relatively high overall employment rate, there are specific groups that remain under-represented in the labour market or struggle to find jobs.** This concerns primarily women with children up to three years of age, young people, older people, the low-skilled and people with disabilities. The particular reasons for their high unemployment levels differ. For women, data show that the impact of motherhood on employment was one of the most significant in the EU in 2012, which is due to limited access to affordable childcare facilities and comparatively low take-up of part-time work. Access to childcare facilities remains among the lowest in Europe: only 5 % of children up to three years of age

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<sup>20</sup> European Commission (DG ENTR), SME Access-to-Finance Index

<sup>21</sup> No 240/2013 Coll.

<sup>22</sup> For further details, see the 2014 Joint Employment Report, COM(2013)801, which includes a scoreboard of key employment and social indicators.

are cared for in formal childcare, compared to 30 % in the EU.<sup>23</sup> The long spells out of work and difficulty in returning to work adversely affect women's career progress, as evidenced by the large gender-employment gap and pay gap (both 4<sup>th</sup> largest in the EU<sup>24</sup>). Women are also generally disadvantaged in employment due to labour market discrimination; vertical and horizontal gender segregation<sup>25</sup> is still present in different sectors of the labour market.<sup>26</sup> As regards youth and elderly workers, their respective unemployment rates are below the EU average, but both groups also show below-average participation rates. Young people's participation rate is low largely due to rapidly increasing enrolment in education or training<sup>27</sup>. The youth unemployment rate stabilised in 2013 at the level of 18.9, however the NEET (Not in Education, Employment or Training) rate has been growing (by 0.8 pp between 2011 and 2013), and some regions still experienced persistent challenge of high youth unemployment. The draft Youth Guarantee Implementation Plan (YGIP) presented by the Czech authorities remains very general and offers limited information. Older workers tend to leave the labour market relatively early due to the still low pensionable age. The participation rates of low-skilled and other disadvantaged groups, in particular the Roma, remain low in part due to a lack of targeted public employment services<sup>28</sup> as well as due to social barriers.

**Limited progress has been made in increasing the availability of inclusive childcare facilities.** The draft law on child groups was approved by the government in January 2014. The law creates less demanding conditions for establishing private child groups as compared to those for public childcare facilities, and introduces tax incentives to provide and to take up this form of care. This measure is a relevant step in the right direction, but its effectiveness will depend on the level of incentives included in the final version of the law.<sup>29</sup> Monitoring the quality of service will be essential to tackling the educational element of this form of pre-school education and might influence the effective use of those facilities. No progress has been made as regards public childcare services. The future of the few remaining public nurseries is uncertain as they are expected to be taken over by professional private child-minders recognised under the Trade Licensing Act.

**The 2014 national reform programme presents several relevant measures for 2014 and 2015 that should further improve the availability of childcare services.** The authorities plan to provide municipalities with additional resources, partly co-financed by EU funds, to enable them to build additional childcare facilities. With a view to mitigating the differences between children entering compulsory education, it is planned that the last year of pre-school

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<sup>23</sup> Eurostat Labour Force Survey data (2012). Data for children older than three are higher, but still below the EU average.

<sup>24</sup> The unadjusted gender pay gap; Eurostat 2012 data.

<sup>25</sup> Horizontal segregation is understood as under- (or over-) representation of a certain group in occupations or sectors not ordered by any criterion, whereas vertical segregation is understood as under- (or over-) representation of a clearly identifiable group of workers in occupations or sectors ordered on the basis of specific attributes.

<sup>26</sup> The index on gender segregation in economic sectors was at 21.2% in 2011 and decreased to 21% in 2012. The EU-28 average was 18.7% in 2012.

<sup>27</sup> The youth participation rate decreased from 46% in 1998 to 30% in 2011, while it stayed broadly unchanged in the EU-15 (fluctuating around 46 %). Over the same period, the proportion of students in the 15-24 age group increased from 46% in 1998 (equal for both men and women), to 62% for men and 69% for women in 2011 (50% for men and 52% for women in the EU-15). Taking into account changes in the size of the population, the increase in the number of students closely tracks the number of young workers who left the labour market.

<sup>28</sup> While low-skilled workers constitute a relatively small part of the labour force (less than 10%), they face a high risk of unemployment and their employment rate is much lower than the EU average, at 21.1% in 2012 (EU average: 44.5%).

<sup>29</sup> This is the lesson from the ongoing European Social Fund project which initially aimed to create 7 500 places in corporate childcare facilities, but by January 2014 contracted less than 700 places, largely due to low demand on the part of employers.

education will be made compulsory, which is also a step towards improving the inclusiveness of pre-school education.<sup>30</sup> While the outlines of these measures are yet to be specified in detail, if implemented with an adequate level of ambition they have the potential to improve the participation rate of women with young children in the labour market.

**Limited progress has been made in response to the recommendation to strengthen the efficiency and effectiveness of the public-employment service.** Most importantly, the public employment service (PES) offices were reinforced with some 1 000 workers in 2013-14. The majority of posts were earmarked for counselling the unemployed, assisting employers, and tackling undeclared work. Some initial steps have also been taken to improve the quality of services provided by the PES, and these go in the right direction. However, the PES suffers from a lack of long-term strategic direction. For instance, a flagship project on payment cards that help to efficiently disburse social benefits was prematurely ended and a new IT system caused major delays in disbursing social benefits in 2013 before it was removed because of flaws in the tendering process. The difficulties in setting up an efficient data processing system for the PES might hamper the proper design of active labour market policies (ALMPs).

**ALMPs remain under-funded and do not adequately target those furthest away from the labour market.** Rates of activation of registered unemployed people remain one of the lowest in the EU. Most importantly, the scope and effectiveness of individualised and targeted services provided by labour offices is not adequate. Those most difficult to employ do not receive relevant educational and counselling assistance. The monitoring of PES performance is not evidence-based and deficient. However, some work has been carried out to improve ALMPs. One positive development was the increased number of people who were re-trained in 2013. Further measures were introduced in the follow-up to the 2012 reform of the PES, but they are not expected to bring tangible results before 2015. In particular, European Social Fund projects started in 2013 aim to create a coherent methodology for improving the work with labour-office clients, establish an efficient system of human resource management and improve the current system of training staff, strengthen advisory and consultancy services to foreigners, and strengthen cooperation with employers with a focus on monitoring vacancies and employers' needs. A task force is planned, and will tackle the remaining weaknesses, including work to develop ways to more effectively monitor and implement activation programmes.

### ***Education***

**The quality, equity and labour-market relevance of the Czech education system is a matter of concern in view of the need to strengthen the essential drivers of growth.** According to the latest PISA (Programme for international student assessment) results, the Czech Republic has achieved significant progress in decreasing the proportion of low-achievers compared to the previous test round. The results of the 2012 PISA survey confirm that the performance of Czech pupils is strongly linked to their socio-economic background and to participation in early-childhood education. The 2014 national reform programme refers to the on-going work in view of amending the Education Act towards inclusive education with individual support for children with specific needs to enable their integration into mainstream education. The teacher population is ageing rapidly and the profession is not attractive salary-wise.<sup>31</sup> The early school leaving rate remained very low in 2013,<sup>32</sup> with

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<sup>30</sup> According to *Roma Education in Comparative Perspective* (Brüggemann, 2012), only 28% of Roma children aged 3-6 attended formal childcare in 2011, compared with the national average of 74% (Eurostat).

<sup>31</sup> OECD *Education at a Glance*, 2013.

<sup>32</sup> See the overview table in Section 4 for more information on the EU-2020 target for early school leaving.

Roma pupils accounting for a high proportion of early school leavers. In higher education,<sup>33</sup> the main challenge remains to ensure the quality and labour-market relevance of graduates' skills, in view of the rapidly rising enrolment rates and limited resources. Public expenditure on education is below the EU average and its recent increase (from 4.5 % of GDP in 2008 to 4.8 % in 2012) is almost fully accounted for by higher R&D grants.

**Some progress has been made on the 2013 recommendation to establish a comprehensive evaluation framework in compulsory education and to put in place targeted measures to support schools that rank low in educational outcomes.** The considerable autonomy of schools coupled with unequal performance between and within schools makes improvement-oriented evaluation and feedback particularly relevant. Some measures have been put in place to set up the evaluation framework. For instance, the authorities introduced a modified state curriculum for primary education, notably amending mathematics courses and introducing a second foreign language, and are developing minimal education standards to provide more specific guidance (and an assessment base) for schools. Also, a new career system for pedagogical staff is being developed, and should establish a link between performance and salaries. The effectiveness of this measure to attract and retain talented young people in the profession is, however, conditional on increasing the overall amount of financing available for salaries and on measures to improve the quality of teachers' initial training, including the development of practical teaching skills. The 2014 national reform programme envisages introduction of a career system which is intended to attract talented professionals through i.a. financial incentives but concrete measures and their fiscal impact are not specified.

**The assessment and follow-up phases of the evaluation framework in compulsory education remain a weak point.** The nation-wide computer-based testing of pupils was tested twice. The 2014 national reform programme confirms the usage of the testing for external evaluation purposes, although only a sample testing instead of an annual nation-wide one is foreseen for the time being. The testing could help identify problems and provide useful feedback but, crucially, its effectiveness will depend firstly on the level of support offered to underperforming schools and teachers, and secondly on the intensity of its usage. The support provided to low-performing schools and teachers is expected to take the form of recommendations issued by the Czech Schools Inspectorate. Additional resources (financial or human) are not envisaged. Moreover, the impact of these recommendations will also depend on governance issues, notably regarding responsibilities and capacities of headmasters and municipalities (which are founding bodies of schools).<sup>34</sup>

**No progress has been made on strengthening accreditation and funding in higher education.** Political instability delayed the adoption of the revised Act on Higher Education. The 2014 national reform programme announces the submission of amendments to the Act to the government by September 2014. It is not clear at this stage what the final content of the amendments will be. In their previous version, regarding accreditation, the reform proposal planned to decrease the reliance on ex-ante criteria (such as the number of professors) and move towards surveillance based on internal quality-assurance systems. They also envisaged multi-annual contracts with public higher-education institutions (HEIs) and differentiated funding according to the profile of study programmes. If these elements remain in the amendments to be adopted and if the reform is effectively implemented, it would allow HEIs to focus on their strengths (e.g. offering quality profession-oriented bachelor programmes or

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<sup>33</sup> See the overview table in Section 4 for more information on the EU-2020 target for higher education.

<sup>34</sup> Recommendations to this effect can be found in the 2014 report of the Czech Schools Inspectorate '*Posouzení systému evaluace a monitoringu v České republice*'.

more academic master degrees or research programmes). This would contribute to improving the quality and labour market relevance of higher education and help reduce the high proportion of students going on to take master's degrees. Setting the level of financial incentives so as to induce the targeted distribution of study programmes across the envisaged profiles will be a key factor in the reform's effectiveness. It is not clear to what extent the amendments will solve governance issues within universities. Funding of HEIs' education activities has only marginally increased in 2014 in nominal terms, and the same is expected for 2015, implying a decrease in funding as a percentage of GDP.

### *Social policies*

**Poverty and social exclusion indicators for the Czech Republic are among the lowest in the EU.** The key challenge is to tackle social exclusion among the Roma population, which continues to face obstacles to effective participation in the labour market, social services and mainstream education.<sup>35</sup> Problems in the most deprived areas have escalated, provoking clashes between the Roma and parts of the neighbouring majority population. Funding earmarked for supporting Roma inclusion has been decreasing. In 2013, the Czech Republic did not receive a CSR in this area.

**Some steps have been taken to fight social exclusion among Roma and to integrate groups with a high incidence of poverty or social exclusion.**<sup>36</sup> Ensuring the adequate participation of Roma children in mainstream early-childhood and primary education is a key tool in preventing their future social exclusion<sup>37</sup>. The proportion of Roma children in practical schools (schools with adapted educational programmes for children with mild mental disability) has so far decreased only marginally, but new assessment and diagnostic tools are being developed to avoid placing socially-disadvantaged children in such schools, and regular monitoring of the proportion of Roma pupils in schools was introduced in 2013. The Equal Opportunities Action Plan, which was adopted in 2012 and aims to improve equality in the education of Roma children, is being implemented, albeit at a slow pace. A specific Roma integration strategy for 2014 and beyond is currently being drafted.

**In the Czech Republic, an above-average incidence of poverty or social exclusion is reported for the unemployed, single-parent families with at least one child, and households with three or more children.** In January 2014, the government approved a comprehensive 2014-20 Strategy on Social Inclusion, following a strategy on preventing and tackling homelessness (up to 2020) from October 2013. These strategies represent a step in the right direction as they provide a complex approach to fighting poverty, combining access to housing, social services, access to health services and other elements. However, social housing remains deficient and steps taken in this area are not yet satisfactory.

### **3.4. Structural measures promoting growth and competitiveness**

**Over the past decade, the Czech Republic has started to lag behind in terms of the quality of several key growth enablers.** The performance of its R&D sector and the quality of the business environment and transport infrastructure is suboptimal and foundations for sustainable and green growth remain relatively weak. According to the 2014 Innovation

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<sup>35</sup> The number of socially-excluded Roma is estimated at about 80 000-100 000, which represents around a third of all Roma living in the Czech Republic. Among the countries with significant Roma minorities, the Czech Republic has one of the highest number of reported instances of discrimination against Roma: 74% of Roma say they have been discriminated against while looking for a job and 41% experienced discrimination at work; only 24% of Roma are in employment. See: *Fundamental Rights Agency Roma Pilot survey 2011*.

<sup>36</sup> See the overview table in Section 4 for more information on the EU-2020 target for poverty.

<sup>37</sup> 23% of Roma children up to the age of 15 attend special schools/classes only for Roma, one of the highest proportion in the EU. Source: *FRA Roma Pilot survey 2011*.

Union Scoreboard, the Czech Republic has a status of a ‘moderate innovator’ which is not fully line with its strong innovation potential. Productivity growth is further hindered by a number of intertwined challenges, ranging from weak performance of the scientific research and its rare spill-overs to the private sector, complex regulation and relatively weak competition in the service sector,<sup>38</sup> high compliance costs for businesses, high energy intensity and low energy efficiency of the industry-based economy, to the poor quality of rail and road transport infrastructure.

**In 2013, the Czech Republic received CSRs concerning the funding of research institutions, regulated professions and energy efficiency.** The analysis in this staff working document leads to the conclusion that the Czech Republic has made some progress on the funding of research institutions and limited progress in the areas of regulated professions and energy efficiency.

**Box 4: Potential impact of structural reforms on growth – a benchmarking exercise**

Structural reforms are crucial for boosting growth. It is therefore important to know the potential benefits of these reforms. Benefits of structural reforms can be assessed with the help of economic models. The Commission uses its QUEST model to determine how structural reforms in a given Member State would affect growth if the Member State narrowed its gap vis-à-vis the average of the three best EU performers on key indicators such as the degree of competition in the economy or labour market participation. Improvements on these indicators could raise GDP by about 5.3% in a 10-year period. Some reforms could have an effect even within a relatively short time horizon. The model simulations corroborate the analysis of Section 3.4, according to which the largest gains would likely stem from increased competition, e.g. through reducing entry barriers for regulated professions and improving the business environment. The simulation also supports the analysis in Sections 3.1 and 3.3 and shows that gains could be achieved through increasing labour market participation of women and older workers.

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<sup>38</sup> OECD Indicators of Product Market Regulation (PMR), which measure the degree to which policies promote or inhibit competition in areas of the product market where competition is viable, indicate that regulation in professional services is stricter than the average for the EU countries represented in the OECD. This is the case for all professional services included in the PMR (accountants, lawyers, architects and engineers). For retail trade, the Czech Republic applies relatively strict conditions on licences needed to engage in commercial activity, and maintains an above-average degree of price control. Most network services have been deregulated, but there is still only limited competition in the electricity market (with a high degree of public ownership and of vertical integration) and in the postal, rail and airline markets (with a high degree of public ownership).

**Table: Structural indicators, targets, and potential GDP effects<sup>39</sup>**

Reform areas		CZ	Average 3 best EU performers	GDP % relative to baseline	
				5 years	10 years
Market competition	Final goods sector markups (price-cost margin)	0.20	0.13	1.8	2.4
Market regulation	Entry costs	8.40	0.13	0.0	0.1
Tax reform	Implicit consumption tax rate	21.4	28.6	0.2	0.3
Skill enhancing reforms*	Share of high-skilled	5.7	10.7	0.0	0.1
	Share of low-skilled	7.5	7.5	0.0	0.0
Labour market reforms	Female non-participation rate (25-54ys):			0.5	0.9
	- low-skilled	33.8	26.4		
	- medium-skilled	17.2	10.5		
	- high-skilled	20.5	4.3		
	Low-skilled male non-participation rate (25-54ys)	22.6	7.7	0.0	0.0
	Elderly non-participation rate (55-64ys):			0.5	1.0
	- low-skilled	28.9	13.4		
	- medium-skilled	12.0	4.8		
	- high-skilled	3.6	3.3		
	ALMP (% of GDP over unemployment share)	5.3	37.4	0.2	0.2
Benefit replacement rate**	57.2	52.6	0.1	0.2	
Total				3.5	5.3

Source: Commission services. Note: Simulations assume that all Member States undertake reforms which close their structural gaps by half. The table shows the contribution of each reform to total GDP after five and ten years. If the country is above the benchmark for a given indicator, we do not simulate the impact of reform measures in that area; however, the Member State in question can still benefit from measures taken by other Member States.<sup>40</sup> \*The long-run effect of increasing the share of high-skilled labour in the population could be 1.1% of GDP and of decreasing the share of low-skilled labour could be 0.1%. \*\* EU average is set as the benchmark.

### **Research and innovation**

**The Czech economy shows significant weaknesses in terms of how domestic drivers of knowledge-based growth perform.** One of the current big challenges is therefore to accelerate the emergence of domestic innovation leaders in the national innovation system, which has so far been dominated by a few large foreign affiliates. Foreign affiliates are estimated to account for 60% of all business expenditure on R&D. This is closely linked to the need to upgrade the science sector, with a view to radically improving the quality and relevance of its science and technology output.<sup>41</sup> Equally worrying is the lack of genuine science-business cooperation and knowledge transfer, as evidenced by the extremely low level of co-funding provided for public research by businesses. Accelerating the modernisation of national research systems is a priority area in the 2014 Annual Growth Survey.

**Some progress was made in increasing the proportion of funding allocated on the basis of the quality and relevance of output.** A revised methodology for evaluating research in

<sup>39</sup> Final goods sector mark-ups is the difference between the selling price of a good/service and its cost. Entry cost refers to the cost of starting a business in the intermediate sector. The implicit consumption tax rate is a proxy for shifting taxation away from labour to indirect taxes. The benefit replacement rate is the % of a worker's pre-unemployment income that is paid out by the unemployment scheme. For a detailed explanation of indicators see Annex.

<sup>40</sup> For a detailed explanation of the transmission mechanisms of the reform scenarios see: European Commission (2013), "The growth impact of structural reforms", Chapter 2 in QREA No. 4. December 2013. Brussels; [http://ec.europa.eu/economy\\_finance/publications/qr\\_euro\\_area/2013/pdf/qrea4\\_section\\_2\\_en.pdf](http://ec.europa.eu/economy_finance/publications/qr_euro_area/2013/pdf/qrea4_section_2_en.pdf)

<sup>41</sup> Only 5.6% of all Czech scientific publications score amongst the 10% most-cited publications worldwide (EU average: 11%; the Czech Republic ranks 20th). Similarly, the number of patents produced remains very low by international standards, reaching only 0.84 (Patent Cooperation Treaty) patents per billion purchasing power standard (EU average: 1.98; the Czech Republic ranks 18th).

2013-15 was adopted in 2013, but the changes are minor, the evaluation itself suffers delays, and it is still only a short-term solution. Its results might come too late to influence the budget allocation in 2015. For the longer term, the development of a new methodology expected to influence budget allocation starting in 2017 has not started yet. It remains crucial to ensure that this new methodology offers the right incentives to public researchers to strive for excellence, address societal challenges, and cooperate with the business sector.

**Several steps have been taken to develop research infrastructure, support innovative firms and, more recently, establish long-term partnerships between the science community and the business sector.** In April 2013, the national research, development and innovation (RDI) policy for 2009-15 was updated to evaluate progress achieved in reforming the research system, and to improve the supply of skills, knowledge transfer and the innovative capacity of the business sector. The Technology Agency of the Czech Republic, created in 2012 to support applied research and science-business cooperation (notably through its competence centres), continues to unfold a rich portfolio of support programmes to implement the RDI priorities revised by the government in 2012.<sup>42</sup> These efforts are being largely supported by EU funds allocated to R&D, which reached 0.3% of GDP in 2012 and have become one of the main sources of R&D funding in the Czech Republic<sup>43</sup>. As a result, the level of public funding injected into the national innovation system is currently quite high by EU standards. In 2012, the sum of national and EU funding of R&D amounted to 1.01% of GDP) and business expenditure on R&D is gradually catching up. However, these initiatives and efforts are not yet translating into a visible improvement of the quality and relevance of scientific output which would support the emergence and development of more domestic innovation leaders. This weak performance is attributed to misaligned incentives embodied in the current approach to evaluating public research and allocating funding. The complexity of Czech research and innovation policy may also play a role.<sup>44</sup> Another important milestone is the recent extension of the R&D tax incentives, which will cover research activities outsourced by businesses to public research institutions as of January 2014. This is a step towards fostering cooperation between academia and the business sector.

### ***Business environment***

**The business environment in the Czech Republic ranks low in international comparisons,<sup>45</sup> in particular in the areas of the costs of paying taxes and perceived corruption.** At the same time, some progress has been made on simplifying start-ups and on enforcing contracts. As pointed out in Section 3.1, the time businesses need to comply with tax returns is still excessively high, despite a recent decrease. The customs duties are also time-consuming. The country has significant potential to improve its performance in terms of time taken to process imports and exports resulting in a reduction of business costs and trade

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<sup>42</sup> In 2014, it is launching two new programmes to support the verification of R&D results in terms of their practical application and their subsequent commercial use (GAMA) and to fund joint international projects with third countries (DELTA).

<sup>43</sup> However, Czech participants in the 7<sup>th</sup> Framework Programme for Research and Technological Development still receive a share of the total EC funding (0.67%) which is markedly lower than the share of the Czech Republic in total EU expenditures on R&D (1.07%)

<sup>44</sup> Czech innovation policy is defined by a set of intertwined strategic documents, governed by three government bodies, and implemented through a wide set of support actions, ranging from applied research programmes run by the Technology Agency, R&D tax incentives, project-based funding, competitive-based institutional funding, and operational programmes under EU funds.

<sup>45</sup> According to the World Bank's *Doing Business Report 2014*, the Czech Republic ranks 75th out of 189 countries when it comes to how easy it is to do business. In addition, the OECD Indicators of Product Market Regulation (PMR) show excessive complexity of regulatory procedures, in particular regarding the issuance of licences and permits, and an above-average administrative burden imposed on start-ups.



facilitation<sup>46</sup>. Many surveys, studies and international comparative indicators also show a high perception of corruption as negatively affecting businesses operating in the Czech Republic (see Section 3.5). Perceived corruption seems to be affected by a lack of transparency regarding the ownership of firms. The new citizens' code effective from 2014 introduces a new form of ownership (trust) with limited transparency about the users and beneficiaries of revenues from property, including shares. This step seems to go against the changes in anonymous shareholding adopted in May 2013. The Czech Republic also scores poorly on protecting investors (22nd place in the EU-27), and there is scope for improvement in how easy it is to obtain construction permits.<sup>47</sup>

**Although recent data show that a relatively long time is needed to start up a business,<sup>48</sup> some progress has been achieved in this regard.** Two important reforms entered into force in 2014, and are expected to improve the Czech Republic's ranking. A new act on commercial corporations abolishes the minimum capital requirements for a limited liability company and an act on public registers of legal and natural persons enables faster registration of entities in the Commercial Registry and related registries. On the negative side, contract enforcement remains cumbersome and costly in EU comparison.<sup>49</sup> However, in 2014 the Czech Republic introduced measures aimed at simplifying and speeding up the proceedings for executing and enforcing judgments. By 2013, the time to complete insolvency proceedings had fallen by 4.4 years compared with 2008, while the recovery rate of creditors in the Czech Republic more than tripled over the past six years.

**The Czech Republic has made limited progress on the recommendation to reform the regulated professions.** The country reports one of the highest levels of regulated professions in the EU and the regulation of professional services is stricter than the EU average. This is the case for all professions (accountants, lawyers, architects) and engineers covered by the OECD Indicators of Product Market Regulation (PMR). In 2012, the Czech authorities announced a comprehensive reform of the regulatory framework to reduce the number of regulated professions. While around 50 professions have been opened up through non-legislative measures since then, the number of regulated professions remains high (around 340 in April 2014). The sluggish pace of implementing the reform does not allow for a substantial impact on the service sector. No systemic assessment of the necessity and adequacy of the remaining regulated professions has been conducted yet, and the same holds true for the definition of the economic and qualitative aspects of the deregulation process. While the 2014 national reform programme foresees neither of those, it plans to reduce the number of regulated professions, or mitigate entry barriers, by 25%, taking as a reference point the number 345 in October 2013.

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<sup>46</sup> World Bank. (2013). *Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises*. Washington, DC: World Bank Group.

<sup>47</sup> For construction permits, the Czech Republic ranks 15th in the EU-27, with a very high number of procedures (33 vs. 14 in the EU on average), though with relatively little time needed to obtain one (120 vs. 174 days in the EU on average).

<sup>48</sup> According to the World Bank's *Doing Business Report 2014*, it takes 20 days to start up a business in the Czech Republic, while according to European Commission data the time needed is 15 days — [http://ec.europa.eu/enterprise/policies/sme/business-environment/start-up-procedures/progress-2012/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/business-environment/start-up-procedures/progress-2012/index_en.htm).

<sup>49</sup> According to the World Bank's *Doing Business Report 2014*, the Czech Republic ranks 22nd in the EU-27 with a slightly below-average number of procedures (27 vs. 32), but with a relatively high number of days needed (611 vs. 566) and very high claiming costs (33 vs. 22%).

## *Energy, climate and resource efficiency*

**As only limited progress has been achieved to improve energy efficiency in the buildings and industry sectors, the potential for energy savings remains substantial.**<sup>50</sup> Despite following a slow declining trend, the energy intensity<sup>51</sup> of the Czech economy remains very high amounting to approximately 250%<sup>52</sup> of the EU average and the fourth highest in the EU. While the energy intensity in transport is increasing with no known policy approaches to slow down or stop this trend, the energy intensity of industry has improved since 2001 but was still among the highest in the EU in 2011. However, the observed decrease in the energy intensity is caused at large by restructuring and only to a small part by better energy efficiency of production processes within industrial sectors. The challenges regarding energy efficiency are partly due to non-existence of a dedicated administrative body concentrating expertise in the field and, possibly, also to neglecting benefits of energy efficiency improvements and their positive impact on industry's competitiveness. The Czech authorities do not foresee the introduction of effective binding energy efficiency measures such as binding targets for energy service providers or energy taxes. In addition, measures such as improvement of the legal and fiscal framework for the provision of specific investment schemes and energy performance contracting are not currently contemplated and incentivising of private investment in energy efficiency is limited.

**On the positive side, several measures have been put in place to promote energy efficiency, in particular in the buildings sector and in production, transfer and consumption of energy.** Some funding to promote energy efficiency has been provided from EU Funds to co-finance several programmes (i.g. Eko-energie). Besides that, the national budget has been supporting several domestic programmes. The “New Green Savings” programme was approved in November 2013 offering grants for a total amount of approx. EUR 1.1 billion, highly dependent on the sale of emissions allowances. Overall, public resources earmarked for energy efficiency improvements appear to be insufficient in light of the uncertainty related to revenues from sale of the emission allowances. Given these limitations, the macroeconomic impact of energy efficiency measures presented in the 2014 national reform programme seems overstated. The complete and timely transposition and effective implementation of the Energy Efficiency Directive (due in June 2014) would provide additional tools to promote energy efficiency. In 2013, the Czech Republic notified its national indicative energy target and the 3rd National Energy Efficiency Action Plan is currently being examined by the Commission to assess the progress.

**Regarding renewable energy, all operational support for new renewables installations in the electricity sector has been stopped except for small hydroelectricity.** Moreover, the special levy on private producers have been extended further aggravating the situation of investors in the sector and leading to more limited investments. Although the original level of support for private activity in this area may have been excessive for a certain period, these de facto retroactive changes to the support scheme for renewables have been highly detrimental to market confidence and practically stopped all further developments. Moreover, based on the recent legal provisions in force since 2014, the support for all newly installed renewable energy sources of electricity has been abolished. As regards the necessity to expand and renew the electricity grid both on a transmission and a distribution level there have been insufficient efforts to reduce lead times, which remain unacceptably long.

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<sup>50</sup> According to the national notifications required under the Energy Efficiency Directive.

<sup>51</sup> Energy efficiency is commonly measured by energy intensity, i.e. amount of energy needed to produce one unit of GDP. However, it is acknowledged that this measure has limitations as energy consumption is influenced also by other factors than only the efficiency of its use.

<sup>52</sup> 356 kgoe/1000 € compared to EU average of 143 kgoe/1000 € in 2012, Eurostat.

**Low air quality, insufficient water management and frequent floods give rise to significant economic, health and environmental costs.** Although the national reform programme 2014 recognises that the quality of the environment is an important aspect of citizens' well-being, the measures listed are basically those already announced and awaited from the past. The Czech Republic is among the Member States that suffer most from the impacts of bad air quality.<sup>53</sup> The country also still has to meet the basic obligations stemming from the EU *acquis* in the area of water management, as well as to ensure that the investments made in water infrastructure over recent years are economically viable. Moreover, the Czech Republic has suffered from several severe floods in the last decade,<sup>54</sup> which created significant costs<sup>55</sup> and disrupted the national economy. However, it failed to reduce the risk of floods through nature-friendly and cost-effective measures.

**The performance of the waste management system is not improving as fast as it needs to.** The performance of municipal waste treatment in the Czech Republic is under the EU average, with low recycling and high landfill rates.<sup>56</sup> No relevant national strategies have been formulated to divert waste from landfills. The recycling rates are not directly addressed in the Waste Act and the target of 50 % of recycled material by 2020 will be hard to meet unless significant efforts are made. Furthermore, greenhouse gas emissions (GGE) from waste have been growing. Still, the national GGE target remains within reach. As mentioned in Section 3.1, there are options for an increase in environmental taxes, notably in the area of pollution and resource taxation, which would help reach both public-revenue and environmental goals.

### ***Transport***

**The relatively underdeveloped transport infrastructure and obsolete vehicle fleet<sup>57</sup> continue to be detrimental to the environment and economic growth.** Insufficient investment in the maintenance and reconstruction of the transport network has led to deficiencies in safety and capacity, as well as to a higher environmental burden. Progress in modernising the transport system has been rather limited so far, partially due to low efficiency and effectiveness of some of the infrastructure projects. The rail network is in rather poor technical condition, which makes it a less attractive alternative to road transport.<sup>58</sup> Although certain railway connections have been opened to private operators, competition is still low<sup>59</sup> owing to some persisting obstacles. These include limited public tendering of public-service contracts, technical and safety regulations and operational barriers<sup>60</sup> which reflect i.a. lack of a fully independent regulator and also the price structure opacity of the incumbent. The opaque structure creates risks of cross-subsidisation and predatory pricing. The 2014 national reform programme recognises the weaknesses of the transport system and rightly identifies

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<sup>53</sup> The Czech Republic's current non-compliance with EU standards on air quality limits is responsible for over 1 500 premature deaths nationally.

<sup>54</sup> 12 in the 2002-13 reference period.

<sup>55</sup> EUR 4.1 million for the six floods for which data were available.

<sup>56</sup> Around 60% of municipal waste generated in the Czech Republic is still landfilled, while the current rate of recycling stands at 16% for municipal waste. Source: *Municipal waste management in the Czech Republic*, (Eurostat data for 2012).

<sup>57</sup> The density of highways per 1000 people in the Czech Republic is around half of the EU average (ESTAT, 2011); about 54% of the passenger cars in the country is over 10 years old, as compared to, for example, around 36% in Germany (UNECE, 2012).

<sup>58</sup> Use of rail passenger transport has been steadily decreasing — from 8 million passenger-km in 1995 to 6.7 million passenger-km in 2011, a 16% decrease (ITF, 2011).

<sup>59</sup> The market share of all but the principal railway undertakings in passenger rail transport is at 3% (RMMS, 2012).

<sup>60</sup> e.g. the incumbent is allowed to charge commissions of up to 25% of new entrants' ticket sales for running the nationwide ticketing systems; OECD Economic survey 2014

the challenges. The government adopted two strategic documents in 2013: the Transport Policy for 2014-20<sup>61</sup> that identifies the main challenges of the sector and proposes measures to tackle them, and the Transport Sector Strategies - 2nd Phase that sets priority projects in transport infrastructure. However, the latter document has been criticised for not being consistent enough with the challenges identified and has not been approved by the Commission, which requested its further development.

### 3.5. Modernisation of public administration

**The quality and efficiency of the public administration is still a challenge, with negative repercussions on the growth performance of the Czech economy.** According to the 2014 EU Anti-Corruption Report,<sup>62</sup> 71 % of Czech businesses consider that corruption is a major obstacle to doing business, and 69 % point to patronage and nepotism as obstacles. These are one of the highest figures in the EU. The World Economic Forum analysis concludes that the perception of public-fund diversion is also one of the highest in the EU.<sup>63</sup> Lobbying is not regulated, and the procedures for financing political parties and election campaigns are not sufficiently transparent. Prosecution of corruption in the private sector is almost non-existent.<sup>64</sup> Inefficient and unstable public administration under continuous political influence has a negative impact on the country's competitiveness, as well as on the implementation of EU funding.

**In 2013, the Czech Republic received a CSR concerning public administration.** In particular, the Czech Republic was invited to implement the anti-corruption strategy, adopt the Public Servants Acts, improve the management of EU funds and strengthen the capacity for the implementation of public tenders. The analysis in this document leads to the conclusion that the Czech Republic has made limited progress on measures taken to address these recommendations.

**Progress in the fight against corruption has been limited.** In the 2013 country-specific recommendation, the Czech authorities were asked to ensure implementation of the anti-corruption strategy for 2013-14, but so far this has been hampered by the absence of clear political commitment and ownership. The strategy itself provides a detailed assessment of corruption and covers a wide range of policies and measures, but in a rather fragmented way without a clear longer-term vision. Implementation of the major reforms, which were already included in the previous strategy (2011-12) and were moved to the current one, has been significantly delayed, and key legislation has not been adopted. The key reform areas include transparency of ownership of firms, independence of the state prosecution, conflicts of interest, freedom of information, creation of specialised courts, regulation of lobbying, the Public Service Act, financing of political parties, extension of powers of the Supreme Audit Office, protection of whistle-blowers, and a reform of parliamentary immunity.

**A Public Service Act ensuring a stable, efficient and professional state administration service has not been adopted.** In 2013, the draft of a new law on the civil service was adopted by the government and sent to parliament, but due to political circumstances as well as its low quality, the proposal was finally dropped. A new draft Public Service Act was prepared instead, building on the existing law which was adopted back in 2002 but never entered into force in its entirety. The draft is currently under discussion in parliament. Some crucial aspects are still unclear, namely those related to remuneration, demarcation lines

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<sup>61</sup> Ministry of Transport (2013), *The Transport Policy of the Czech Republic for 2014–20 with the Prospect of 2050*.

<sup>62</sup> The *EU Anti-Corruption Report 2014*, COM(2014) 38 final.

<sup>63</sup> World Economic Forum, *Global Competitiveness Reports* (2012-13; 2013-14).

<sup>64</sup> Only eight cases in 2010-12. *The EU Anti-Corruption Report 2014*, COM(2014) 38 final.

between political and administrative posts, and a transparent recruitment and career system. The provisions ensuring the independence of regulatory and similar bodies deserve scrutiny. Institutional capacity and efficient public administration are two of the key pre-requisites for drawing EU funds in the new programming period 2014-20. The government has stated that the adoption of the Public Service Act is one of its key priorities and plans the entry into force for 1 January 2015.

**Limited progress has been made on improving the implementation of EU funds, in line with the 2013 recommendation.** The measures of the action plan of 2012 to strengthen the management and control system of the implementation structure for the European Regional Development Fund (ERDF) and the Cohesion Fund (CF) continued to be implemented in 2013. Nevertheless, corrections had to be applied for some programmes in 2013, because of expenditure incurred before the action plan. Moreover, the error rates (again concerning expenditure before 2013), reported by the audit authority for several programmes at the end of 2013, are rather high. This might result in stopped payments for some programmes in 2014 and the need to apply further corrections. The main sources of irregularities continued to be deficiencies in public procurement procedures. Moreover, several programmes suffered or will suffer substantial de-commitments due to a non-fulfilment of n+3/n+2 rules at the end of 2013 (one of the highest in the EU) which lead to a net loss of funds for the Czech Republic. Problems continue to appear in the management of the funds, because of a weak public administration in general, insufficient separation between political and non-political staff and related conflicts of interest, complex implementation structures and lengthy public procurement procedures.

**Limited progress has been made on measures taken to address the need to strengthen the capacity for implementing public tenders at local and regional level.** In April 2012, a substantially amended Public Procurement Act introduced additional transparency safeguards through stricter rules for publishing tenders and public contracts to mitigate corruption-related risks. Nevertheless, implementation of the new rules has proven rather difficult, in particular due to the still-inadequate administrative capacity and lack of guidance or training for staff responsible for applying the rules. The administrative capacity of the Office for the Protection of Competition (UOHS), in charge of supervising implementation of the public procurement rules, is still insufficient despite recent reinforcement. This leads to unnecessary delays in the implementation of projects, including those co-funded by the EU. A further strengthening of the UOHS's administrative capacity and provision of better guidance would speed up and smooth the public procurement process.

**New public procurement rules in force since 2014 are a step backwards, as they may reduce transparency.** In late 2013, an amendment to the 2012 Act was adopted, increasing the financial thresholds above which public contracts are subject to public procurement rules. Apart from failing to provide the necessary stability and continuity in public procurement, the new amendment appears to go against the changes adopted in 2012 by removing some of the transparency safeguards and loosening the public procurement rules. In this context, transposition of the new public procurement directives due in April 2016 and preparation for the transition to e-procurement are an ideal opportunity for a strategic, systemic and in-depth review of the Czech public procurement system.

#### 4. CONCLUSIONS

**The growth performance of the Czech economy in recent years has been subdued and a transition towards domestic drivers of growth will be required going forward.** The current growth model of the Czech economy has been one of rapid accumulation of production factors, especially capital, and of strong export orientation. The build-up of fixed capital was supported by high inflows of foreign capital, attracted by cheap but relatively skilled labour and the proximity to the economic core of the EU. However, room for catching up based on the accumulation of production factors (including foreign capital) is limited, and redirecting the economy towards domestic drivers of growth is therefore needed. The crucial elements of this process include boosting education and training, strengthening institutions, supporting innovation, and unleashing the full potential of the labour supply, while ensuring long-term fiscal and financial stability. All of these issues were addressed in the 2013 country-specific recommendations.

**The analysis in this staff working document leads to the conclusion that the Czech Republic has made limited progress in addressing the 2013 country-specific recommendations.** Some progress has been made in the area of public finances. The excessive deficit was sustainably corrected in 2013 and the MTO is expected to be reached in 2014 but the projected fiscal effort from 2015 onwards does not comply with the Stability and Growth Pact. In the area of taxation, the Czech Republic implemented some measures to improve tax administration and tax collection, however many issues remain unaddressed. The government has announced several reforms in the area of taxation but these have not been sufficiently detailed at this stage. No progress has been made on improving the long-term sustainability of public finances and on increasing the cost-effectiveness of healthcare expenditure. On labour market issues, the Czech Republic put in place some measures to improve the effectiveness and efficiency of the public employment service as well as to increase the availability of inclusive childcare facilities, but more work is necessary to address the remaining labour-market challenges. Progress in the area of education has been limited, as the Czech authorities partially addressed the quality of compulsory education but failed to adopt a reform of tertiary education. Concerning research and development policies, several steps have been taken to develop research infrastructure, support innovative firms and, more recently, establish long-term partnerships between the science community and the business sector. The quality of the public administration is still a pressing challenge as progress in the fight against corruption has been only limited and the key reform of the public service has not been adopted. Limited progress has been made with regard to the reform of regulated professions, the number of which remains high. Finally, the Czech Republic has made limited progress on energy efficiency by implementing several programmes financed from public sources and aimed mainly at improving the energy efficiency of buildings. A national 2020 energy efficiency target was set at the end of 2013.

**Challenges identified in last year's staff working document and reiterated in the Annual Growth Survey thus remain valid.** The policy plans submitted by the Czech Republic address these challenges, and there is broad coherence between the updates of 2014 national reform programme and the 2014 convergence programme. The national reform programme confirms the Czech Republic's commitment to addressing shortcomings in the areas of labour market, education, business environment, public administration including fight against corruption, transport, energy efficiency and climate change and R&D and innovation. The convergence programme shows the Czech Republic's commitment to complying with the recommendations of the Excessive Deficit Procedure, in line with the Stability and Growth Pact.

## OVERVIEW TABLE

2013 commitments	Summary assessment <sup>65</sup>
Country-specific recommendations (CSRs)	
<p><b>CSR 1:</b> 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, in order 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 by EU funds under the current financial framework.</p>	<p>The Czech Republic has made some progress in addressing CSR 1:</p> <ul style="list-style-type: none"> <li>• The recommendation on the correction of the excessive deficit was fully addressed. The excessive deficit has been sustainably brought below the 3% of GDP threshold in line with the Council recommendation.</li> <li>• Some progress in budgetary strategy for 2014 and beyond. The MTO was reached in 2014 but a deviation from it is expected in 2015 and beyond according to the convergence programme.</li> <li>• Limited progress in prioritising growth enhancing expenditure including committing on time remaining projects co-financed by EU funds. Public investment dropped by 12% in 2013. A significant increase is planned for 2014 but this depends crucially on the expected realisation of the remaining EU-funded projects. The de-commitment of EU Funds was one of the highest in the EU in 2013.</li> </ul>
<p><b>CSR 2:</b> 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.</p>	<p>The Czech Republic has made limited progress in addressing CSR 2:</p> <ul style="list-style-type: none"> <li>• No progress in reducing the high level of taxation on labour. No changes have been made to labour taxation in the past year. The reform planned for 2015 will be significantly modified.</li> <li>• No progress in increasing the recurrent tax on housing and vehicle circulation taxes. No changes have been implemented in these two areas. No reforms have been announced.</li> <li>• Limited progress in reducing discrepancies between employees and the self-employed. No changes have been implemented in the past year, except for the rather minor</li> </ul>

<sup>65</sup> The following categories are used to assess progress in implementing the 2013 country-specific recommendations:

No progress: The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures.

Limited progress: The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk.

Some progress: The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases.

Substantial progress: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR.

Fully addressed: The Member State has adopted and implemented measures that address the CSR appropriately.

	<p>measures in force since the beginning of 2013. Some measures are announced for 2015 and 2016.</p> <ul style="list-style-type: none"> <li>• Some progress in improving tax compliance. Measures were put in place mainly in the area of VAT compliance and a new act on fuels was adopted in October 2013.</li> <li>• Limited progress in reducing compliance costs. Electronic tax submission has been strengthened, but tax bases have not been harmonised and the single collection point will not be implemented in 2015 as originally planned.</li> </ul>
<p><b>CSR 3:</b> Increase the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy, and review 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.</p>	<p>The Czech Republic has made no progress in addressing CSR 3:</p> <ul style="list-style-type: none"> <li>• No progress in increasing the effective retirement age. The planned path for the pensionable age remained unchanged, rising slowly, in particular for men. The indexation mechanism has not been reviewed.</li> <li>• Limited progress in accompanying the increase in retirement age with measures promoting the employability of older workers. Some measures have been taken but for the most part they do not address the motivation of workers to invest in keeping their labour-market skills up-to-date.</li> <li>• No progress in removing the public subsidy for the pre-retirement scheme. Elimination of the subsidy is not expected.</li> <li>• No progress in improving the cost-effectiveness of healthcare expenditure. Plans to streamline hospital-bed capacity and to improve integrated care practices have not been implemented.</li> </ul>
<p><b>CSR 4:</b> Take additional efforts 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 provision of childcare services and strengthening the capacities of both public and private childcare services.</p>	<p>The Czech Republic has made limited progress in addressing CSR 4:</p> <ul style="list-style-type: none"> <li>• Limited progress in taking additional steps to strengthen the efficiency and effectiveness of PES. The PES was reinforced, but it suffers from a lack of a long-term strategic direction.</li> <li>• Limited progress in significantly increasing the availability of inclusive childcare facilities with a focus on children up to three years old, and on increasing the participation of Roma children. A draft law on child groups was approved by the government but its effectiveness will depend on the level of incentives included in the final version.</li> </ul>
<p><b>CSR 5:</b> Ensure implementation of the anti-corruption strategy for 2013-14. Adopt a Public Servants Act that should ensure a stable, efficient and professional state administration service. Improve the management of EU</p>	<p>The Czech Republic has made limited progress in addressing CSR 5:</p> <ul style="list-style-type: none"> <li>• Limited progress in implementing the anti-corruption strategy. Minor anti-corruption</li> </ul>



<p>funds in view of the 2014-20 programming period. Strengthen the capacity for implementation of public tenders at local and regional level.</p>	<p>measures have been put in place but the main reforms outlined in the strategy have not been implemented.</p> <ul style="list-style-type: none"> <li>• No progress in adopting the Public Servants Act. Its adoption has been significantly delayed and is now under discussion in parliament.</li> <li>• Limited progress in improving the management of EU funds. The measures included in the 2012 action plan continued to be implemented in 2013.</li> <li>• Limited progress in strengthening the capacity for implementing public tenders. Administrative capacity of some public bodies has been strengthened but it remains insufficient and guidance and training for staff responsible for applying the public procurement rules is insufficient.</li> </ul>
<p><b>CSR 6:</b> 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.</p>	<p>The Czech Republic has made limited progress in addressing CSR 6:</p> <ul style="list-style-type: none"> <li>• Some progress in setting up a comprehensive evaluation framework in compulsory education. Some measures have been put in place.</li> <li>• No progress in adopting measures to improve accreditation and funding of higher education. Political instability delayed the adoption of the revised Act on Higher Education that had been announced for 2013.</li> <li>• Some progress in increasing the proportion of performance-based funding of research institutions. A revised methodology for evaluating research in 2013-15 was adopted in 2013 but the changes are minor and the evaluation itself has been delayed.</li> </ul>
<p><b>CSR 7:</b> Drawing on the ongoing 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.</p>	<p>The Czech Republic has made limited progress in addressing CSR 7:</p> <ul style="list-style-type: none"> <li>• Limited progress in introducing a reform of regulated professions. Only around 40 professions were opened up in 2013 and the number of regulated professions remains high.</li> <li>• Limited progress in improving energy efficiency. An indicative national energy efficiency target was set and national energy efficiency measures announced in 2013. The measures are non-binding and depend heavily on public funding.</li> </ul>
<p><b>Europe 2020 (national targets and progress)</b></p>	
<p><b>Policy field target</b></p>	<p><b>Progress achieved</b></p>
<p>Employment rate target: 75 % by 2020</p>	<p>The employment rate continues to rise and reached 72.5% in 2013. The increase is mainly due to the rising employment rate of older workers, which is</p>

	related to the ongoing increase in the pensionable age.
R&D target (public expenditure only): 1 %  R&D intensity (overall) in 2013: 1.88 % of GDP	The rapid increase of R&D intensity since 2010 is due to an increase of both public and private R&D expenditure. The additional funding comes mainly from foreign affiliates and from EU funds. The new government is considering setting an R&D intensity target. With regard to recent trends, an ambitious but at the same time reasonable national target would be in the range of 2.5 % to 3 % of GDP in 2020.
Greenhouse gas (GHG) emissions national target: +9 % (compared to 2005 emissions, Emissions Trading Scheme (ETS) emissions not covered by this national target)	The non-ETS greenhouse gas emissions dropped by 7 % between 2005 and 2012. According to the latest national projections and taking into account existing measures, it is expected that the target will be achieved.
2020 Renewable energy target: 13 %  Share of renewable energy in all modes of transport: 10 %	The share of renewable energy in the overall basket increased by an average of around 0.5 pp per year in 2004-11, and reached 9.4 % in 2011 (Eurostat, March 2014). The increase is even steeper for the share of renewables in all modes of transport, which increased by an average of around 0.7 pp per year between 2005 and 2012, and peaked at 5.6 % in 2012 (Eurostat data). If these trends continue, it will be possible for the Czech Republic to reach the 2020 targets.
National indicative Energy efficiency target for 2020: savings of final energy consumption of 47.84 PJ (13.29 TWh)	The Czech Republic notified the Commission of its target in April 2013 and submitted a report on national measures to meet the target and to comply with Article 7 of the EED. The target is to reach a level of 39.6 Mtoe in primary consumption and 25.3 Mtoe in final energy consumption by 2020. The 3rd National Energy Efficiency Action Plan is currently being examined by the Commission to assess the progress.
Early school leaving target: 5.5 %	The proportion of early leavers from education and training (percentage of the population aged 18-24 with at most lower secondary education and not in further education or training) decreased from 5.5 % in 2012 to 5.4 % in 2013, effectively below the target. The high proportion of Roma among early leavers (72 %) needs to be closely monitored.
Tertiary education target: 32 %	The increase continued, from 25.6 % in 2012 to 26.7 % in 2013. Based on current tendencies and demographic trends, the national figure is likely to be met. Efforts to improve quality and labour market relevance are needed.
Target on the reduction of population at risk of poverty or social exclusion in number of persons: Maintaining the number of persons at risk of poverty or social exclusion at the level of 2008 (15.3 % of the total population) with efforts to reduce it by 30 000.	The number of people at risk of poverty or social exclusion has marginally increased and reached 1 580 ths. in 2013. This is marginally above the target value for 2020 (which itself is not very ambitious).

## ANNEX

## Standard tables

Table I. Macroeconomic indicators

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015
<b>Core indicators</b>								
GDP growth rate	1.9	4.1	2.8	1.8	-1.0	-0.9	2.0	2.4
Output gap <sup>1</sup>	-1.7	0.7	2.6	-0.5	-1.9	-3.3	-2.4	-1.3
HICP (annual % change)	6.5	2.0	2.6	2.1	3.5	1.4	0.8	1.8
Domestic demand (annual % change) <sup>2</sup>	1.7	3.4	2.1	-0.1	-2.8	-0.7	1.0	2.0
Unemployment rate (% of labour force) <sup>3</sup>	6.6	7.9	6.2	6.7	7.0	7.0	6.7	6.6
Gross fixed capital formation (% of GDP)	29.4	26.9	25.7	24.1	23.1	22.1	22.1	22.1
Gross national saving (% of GDP)	26.2	23.6	23.2	21.0	20.7	21.1	21.7	21.9
<b>General Government (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-3.8</b>	<b>-5.0</b>	<b>-3.2</b>	<b>-3.2</b>	<b>-4.2</b>	<b>-1.5</b>	<b>-1.9</b>	<b>-2.4</b>
<b>Gross debt</b>	<b>14.5</b>	<b>27.4</b>	<b>31.6</b>	<b>41.4</b>	<b>46.2</b>	<b>46.0</b>	<b>44.4</b>	<b>45.8</b>
<b>Net financial assets</b>	<b>36.9</b>	<b>14.0</b>	<b>6.5</b>	<b>-5.8</b>	<b>-11.6</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	38.5	40.2	39.4	40.0	40.3	40.9	40.6	40.2
Total expenditure	42.2	45.2	42.5	43.2	44.5	42.4	42.5	42.6
<i>of which: Interest</i>	1.0	1.1	1.2	1.4	1.5	1.4	1.4	1.3
<b>Corporations (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-2.5</b>	<b>-0.2</b>	<b>-0.5</b>	<b>0.3</b>	<b>-0.6</b>	<b>1.3</b>	<b>2.6</b>	<b>3.8</b>
<b>Net financial assets; non-financial corporations</b>	<b>-119.6</b>	<b>-99.8</b>	<b>-95.0</b>	<b>-93.7</b>	<b>-89.7</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; financial corporations</b>	<b>4.0</b>	<b>-2.2</b>	<b>-3.8</b>	<b>-2.4</b>	<b>-2.8</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	21.1	18.4	16.9	15.8	15.5	15.2	14.8	14.6
Gross operating surplus	26.5	27.9	29.4	28.7	27.8	28.2	29.0	29.6
<b>Households and NPISH (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>2.4</b>	<b>1.3</b>	<b>1.1</b>	<b>1.3</b>	<b>3.5</b>	<b>1.2</b>	<b>1.6</b>	<b>1.7</b>
<b>Net financial assets</b>	<b>72.8</b>	<b>68.1</b>	<b>59.5</b>	<b>66.0</b>	<b>68.8</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	31.5	31.5	31.6	32.4	32.9	32.3	31.9	31.9
Net property income	4.9	3.7	3.6	3.5	3.2	3.0	2.7	2.5
Current transfers received	16.5	16.9	17.5	18.6	19.2	19.0	18.9	18.8
Gross saving	6.5	5.3	5.8	5.5	6.0	4.8	4.8	4.6
<b>Rest of the world (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-3.9</b>	<b>-3.9</b>	<b>-2.5</b>	<b>-1.6</b>	<b>-1.4</b>	<b>1.1</b>	<b>2.4</b>	<b>3.1</b>
<b>Net financial assets</b>	<b>6.4</b>	<b>20.1</b>	<b>33.3</b>	<b>36.9</b>	<b>36.1</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	-2.6	-0.1	3.1	4.1	5.6	6.4	7.5	7.9
Net primary income from the rest of the world	-1.2	-3.8	-6.2	-6.7	-7.4	-6.6	-6.9	-7.0
Net capital transactions	0.0	0.3	1.2	1.9	1.2	2.3	2.8	3.3
Tradable sector	55.1	54.6	52.6	51.4	51.9	51.8	n.a	n.a
Non tradable sector	35.8	36.2	37.7	38.7	37.8	37.4	n.a	n.a
<i>of which: Building and construction sector</i>	6.8	6.0	6.3	6.1	5.6	5.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	70.8	91.9	113.3	120.4	117.7	113.6	107.4	106.5
Terms of trade goods and services (index, 2000=100)	99.9	101.3	97.8	95.4	94.9	96.2	96.4	96.5
Market performance of exports (index, 2000=100)	77.7	92.9	108.1	117.2	121.7	120.7	121.4	122.0
<b>Notes:</b>								
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
<sup>2</sup> The indicator on domestic demand includes stocks.								
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.								
<b>Source:</b>								
<i>Commission 2014 spring forecast (COM); Convergence programme (CP).</i>								

**Table II. Comparison of macroeconomic developments and forecasts**

	2013		2014		2015		2016	2017
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	-0.9	-0.9	2.0	1.7	2.4	2.0	2.1	2.5
Private consumption (% change)	0.1	0.1	0.7	0.6	1.9	1.5	1.6	1.9
Gross fixed capital formation (% change)	-3.5	-3.5	2.3	2.7	2.6	2.0	2.1	3.1
Exports of goods and services (% change)	0.2	0.2	5.0	3.8	6.2	4.2	4.4	4.9
Imports of goods and services (% change)	0.6	0.6	4.0	3.4	6.0	3.8	4.1	4.7
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	-0.4	-0.4	1.2	1.0	1.8	1.3	1.5	1.9
- Change in inventories	-0.2	-0.2	-0.2	0.2	0.0	0.1	0.0	0.0
- Net exports	-0.3	-0.3	1.0	0.5	0.6	0.6	0.6	0.6
Output gap <sup>1</sup>	-3.3	-3.0	-2.4	-2.3	-1.3	-1.5	-0.7	0.4
Employment (% change)	0.9	0.9	0.2	0.3	0.4	0.2	0.2	0.2
Unemployment rate (%)	7.0	7.0	6.7	6.8	6.6	6.6	6.4	6.0
Labour productivity (% change)	-1.8	-1.8	1.8	1.4	2.0	1.9	1.8	2.3
HICP inflation (%)	1.4	1.4	0.8	1.0	1.8	2.3	2.1	2.0
GDP deflator (% change)	1.9	1.9	1.3	1.8	1.7	1.7	1.0	1.3
Comp. of employees (per head, % change)	-1.9	-1.9	2.1	1.2	2.4	3.5	3.3	3.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.1	1.1	2.4	1.2	3.1	1.2	1.0	0.8
<u>Note:</u>								
<sup>1</sup> In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<u>Source:</u>								
Commission 2014 spring forecast (COM); Convergence programme (CP).								

**Table III. Composition of the budgetary adjustment**

(% of GDP)	2013	2014		2015		2016	2017	Change: 2013-2017
	COM	COM	CP	COM <sup>1</sup>	CP	CP	CP	CP
<b>Revenue</b>	<b>40.9</b>	<b>40.6</b>	<b>40.6</b>	<b>40.2</b>	<b>39.9</b>	<b>39.5</b>	<b>39.3</b>	<b>-1.6</b>
<i>of which:</i>								
- Taxes on production and imports	12.4	12.2	11.9	12.1	11.6	11.5	11.3	-1.1
- Current taxes on income, wealth, etc.	7.3	7.3	7.3	6.9	7.2	7.2	7.2	-0.1
- Social contributions	15.6	15.4	15.3	15.2	15.3	15.4	15.5	-0.1
- Other (residual)	5.5	5.7	6.1	6.0	5.8	5.4	5.3	-0.2
<b>Expenditure</b>	<b>42.4</b>	<b>42.5</b>	<b>42.4</b>	<b>42.6</b>	<b>42.2</b>	<b>41.5</b>	<b>41.0</b>	<b>-1.4</b>
<i>of which:</i>								
- Primary expenditure	41.0	41.1	41.0	41.3	40.8	40.1	39.7	-1.3
<i>of which:</i>								
Compensation of employees	7.6	7.5	7.4	7.4	7.3	7.3	7.1	-0.5
Intermediate consumption	5.6	5.5	5.4	5.4	5.3	5.3	5.3	-0.3
Social payments	20.0	19.9	20.1	19.8	20.1	20.0	19.7	-0.3
Subsidies	2.0	2.0	2.0	2.0	2.0	1.9	1.9	-0.1
Gross fixed capital formation	2.8	3.2	3.5	3.6	3.3	3.0	2.9	0.1
Other (residual)	3.0	2.9	2.6	3.1	2.8	2.7	2.7	-0.3
- Interest expenditure	1.4	1.4	1.4	1.3	1.4	1.4	1.3	-0.1
<b>General government balance (GGB)</b>	<b>-1.5</b>	<b>-1.9</b>	<b>-1.8</b>	<b>-2.4</b>	<b>-2.3</b>	<b>-2.0</b>	<b>-1.7</b>	<b>-0.2</b>
<b>Primary balance</b>	<b>-0.1</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-1.1</b>	<b>-0.9</b>	<b>-0.7</b>	<b>-0.3</b>	<b>-0.2</b>
One-off and other temporary measures	-0.1	0.2	0.1	0.0	-0.1	-0.1	0.0	0.1
<b>GGB excl. one-offs</b>	<b>-1.3</b>	<b>-2.1</b>	<b>-1.9</b>	<b>-2.4</b>	<b>-2.2</b>	<b>-1.9</b>	<b>-1.7</b>	<b>-0.4</b>
Output gap <sup>2</sup>	-3.3	-2.4	-2.3	-1.3	-1.5	-0.7	0.4	3.7
Cyclically-adjusted balance <sup>2</sup>	-0.2	-0.9	-0.9	-1.9	-1.7	-1.7	-1.9	-1.7
<b>Structural balance (SB)<sup>3</sup></b>	<b>-0.1</b>	<b>-1.1</b>	<b>-1.0</b>	<b>-1.9</b>	<b>-1.6</b>	<b>-1.6</b>	<b>-1.9</b>	<b>-1.7</b>
<i>Change in SB</i>	<i>1.6</i>	<i>-1.1</i>	<i>-0.9</i>	<i>-0.8</i>	<i>-0.6</i>	<i>0.0</i>	<i>-0.2</i>	<i>-</i>
<i>Two year average change in SB</i>	<i>1.5</i>	<i>0.2</i>	<i>0.3</i>	<i>-0.9</i>	<i>-0.7</i>	<i>-0.3</i>	<i>-0.1</i>	<i>-</i>
Structural primary balance <sup>3</sup>	1.3	0.2	0.4	-0.6	-0.2	-0.2	-0.6	-1.8
<i>Change in structural primary balance</i>		<i>-1.1</i>	<i>-0.8</i>	<i>-0.8</i>	<i>-0.6</i>	<i>0.0</i>	<i>-0.3</i>	<i>-</i>
<b>Expenditure benchmark</b>								
Applicable reference rate <sup>4</sup>	n.a.	n.a.	n.a.	1.64	1.64	n.a.	n.a.	-
Deviation <sup>5</sup> (% GDP)	n.a.	n.a.	n.a.	-0.6	-0.3	n.a.	n.a.	-
Two-year average deviation (% GDP)	n.a.	n.a.	n.a.	-0.1	0.5	n.a.	n.a.	-
<b>Notes:</b>								
<sup>1</sup> On a no-policy-change basis.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<sup>4</sup> Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013.								
<sup>5</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.								
<b>Source:</b>								
<i>Convergence programme (CP); Commission 2014 spring forecast (COM); Commission calculations.</i>								

**Table IV. Debt dynamics**

(% of GDP)	Average 2008-2012	2013	2014		2015		2016	2017
			COM	CP	COM	CP	CP	CP
<b>Gross debt ratio</b> <sup>1</sup>	<b>37.8</b>	<b>46.0</b>	<b>44.4</b>	<b>44.9</b>	<b>45.8</b>	<b>46.0</b>	<b>47.1</b>	<b>47.1</b>
Change in the ratio	3.6	-0.1	-1.6	-1.1	1.4	1.1	1.1	0.0
<i>Contributions</i> <sup>2</sup> :								
<b>1. Primary balance</b>	<b>2.7</b>	<b>0.1</b>	<b>0.5</b>	<b>0.5</b>	<b>1.1</b>	<b>0.9</b>	<b>0.7</b>	<b>0.3</b>
<b>2. “Snow-ball” effect</b>	<b>1.0</b>	<b>0.9</b>	<b>-0.1</b>	<b>-0.3</b>	<b>-0.4</b>	<b>-0.2</b>	<b>-0.1</b>	<b>-0.4</b>
<i>Of which:</i>								
Interest expenditure	1.3	1.4	1.4	1.3	1.3	1.4	1.3	1.4
Growth effect	-0.1	0.4	-0.9	-0.8	-1.0	-0.9	-0.9	-1.1
Inflation effect	-0.2	-0.9	-0.6	-0.8	-0.7	-0.7	-0.4	-0.6
<b>3. Stock-flow adjustment</b>	<b>-0.1</b>	<b>-1.1</b>	<b>-2.0</b>	<b>-1.3</b>	<b>0.7</b>	<b>0.4</b>	<b>0.5</b>	<b>0.1</b>
<i>Of which:</i>								
Cash/accruals diff.				-1.4		0.0	0.0	0.0
Acc. financial assets				0.0		0.5	0.5	0.1
Privatisation				0.0		0.0	0.0	0.0
Val. effect & residual				0.0		0.0	0.0	0.0
		<b>2013</b>	<b>2014</b>		<b>2015</b>		<b>2016</b>	<b>2017</b>
			<b>COM</b>	<b>CP</b>	<b>COM</b>	<b>CP</b>	<b>CP</b>	<b>CP</b>
<b>Gap to the debt benchmark</b> <sup>3,4</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Structural adjustment</b> <sup>5</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>To be compared to:</i>								
Required adjustment <sup>6</sup>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Notes:</b>								
<sup>1</sup> End of period.								
<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.								
<sup>3</sup> Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.								
<sup>4</sup> Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.								
<sup>5</sup> Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.								
<sup>6</sup> Defines the remaining annual structural adjustment over the transition period which ensures that - if followed - Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP/CP) budgetary projections for the previous years are achieved.								
<i>Source:</i>								
Convergence programme (CP); Commission 2014 spring forecast (COM); Commission calculations.								

**Table V. Sustainability indicators**

	Czech Republic			European Union		
	2013 scenario	No-policy-change scenario	Convergence programme scenario	2013 scenario	No-policy-change scenario	Convergence programme scenario
S2*	3,0	5,3	5,5	2,4	2,4	0,7
<i>of which:</i>						
Initial budgetary position (IBP)	-0,6	1,3	1,4	0,5	0,4	-1,3
Long-term cost of ageing (CoA)	3,6	4,0	4,1	1,9	2,0	2,0
<i>of which:</i>						
pensions	1,7	2,2	2,3	0,7	0,8	0,9
healthcare	1,2	1,1	1,1	0,9	0,9	0,8
long-term care	0,5	0,4	0,4	0,6	0,6	0,6
others	0,3	0,3	0,2	-0,4	-0,4	-0,3
S1**	-2,0	0,6	0,3	1,5	1,7	-0,2
<i>of which:</i>						
Initial budgetary position (IBP)	-1,5	0,9	0,6	-0,2	-0,4	-2,0
Debt requirement (DR)	-0,8	-0,9	-1,0	1,5	1,8	1,5
Long-term cost of ageing (CoA)	0,3	0,7	0,7	0,2	0,3	0,3
S0 (risk for fiscal stress)***	0,20	:	:	:	:	:
Debt as % of GDP (2013)	46,0			88,9		
Age-related expenditure as % of GDP (2013)	20,1			25,8		

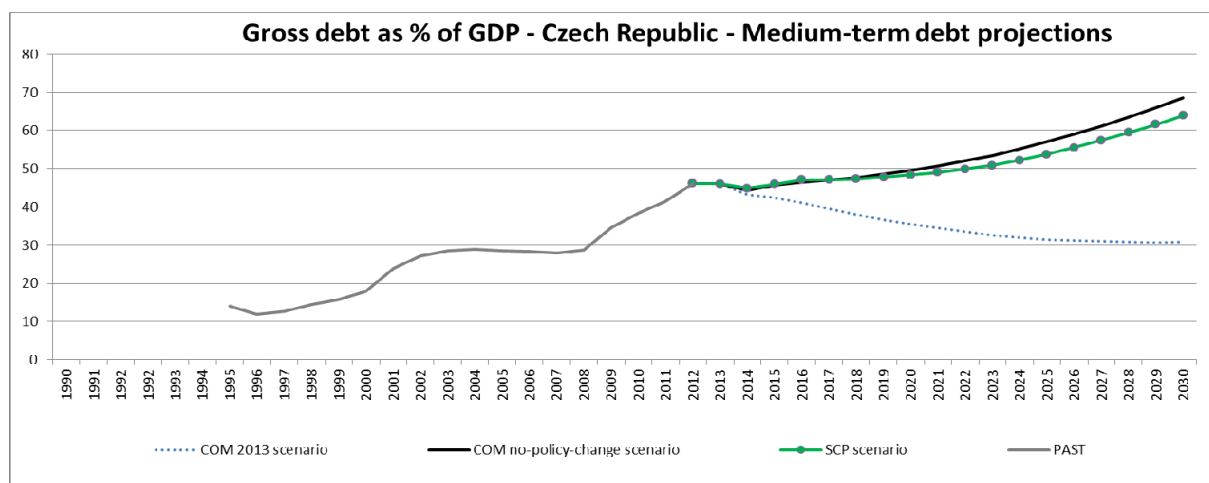
Source : Commission; 2014 convergence programme.

Note : The 2013 scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2013 in line with the Commission's 2014 spring forecast. The 'no-policy-change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2015 in line with the Commission's 2014 spring forecast. The 'convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. Age-related expenditure as given in the 2012 Ageing Report.

\* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: (i) the initial budgetary position (IBP), which gives the gap vis-à-vis the debt-stabilising primary balance and (ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that, in an infinite horizon, the growth in the debt ratio is bound by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds were used for the S2 indicator: (i) if the value of S2 is lower than 2, the country is classed as low risk; (ii) if it is between 2 and 6, it is classed as medium risk; and (iii) if it is greater than 6, it is classed as high risk.

\*\* The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance in the period to 2020 and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure by the target date, arising from population ageing. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is classed as low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 pp of GDP per year until 2020 after the last year covered by the 2014 spring forecast (2015) is required (indicating a cumulated adjustment of 2.5 pp), it is classed as medium risk; and (iii) if the S1 value is greater than 2.5 (i.e. a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is classed as high risk.

\*\*\* The S0 indicator reflects up-to-date evidence on the role played by fiscal and financial competitiveness variables in creating potential fiscal risks. The methodology for the S0 indicator differs fundamentally from that for the S1 and S2 indicators. Unlike S1 and S2, S0 is not a quantification of the required fiscal adjustment effort, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term. The critical threshold for the S0 indicator is 0.43.



**Table VI. Taxation indicators**

	2002	2006	2008	2010	2011	2012
<b>Total tax revenues</b> (incl. actual compulsory social contributions, % of GDP)	34.6	35.3	34.4	33.6	34.6	35.0
<b>Breakdown by economic function</b> (% of GDP) <sup>1</sup>						
Consumption	9.6	10.3	10.3	10.9	11.4	11.7
of which:						
- VAT	6.0	6.4	6.8	6.9	7.1	7.2
- excise duties on tobacco and alcohol	1.0	1.3	1.1	1.4	1.6	1.7
- energy	2.1	2.3	2.2	2.2	2.3	2.2
- other (residual)	0.5	0.3	0.3	0.3	0.5	0.6
Labour employed	17.1	17.1	16.8	16.1	16.6	16.7
Labour non-employed	1.2	1.3	1.2	1.4	1.4	1.4
Capital and business income	5.8	6.0	5.4	4.5	4.6	4.6
Stocks of capital/wealth	0.8	0.7	0.6	0.6	0.7	0.7
<i>p.m.</i> Environmental taxes <sup>2</sup>	2.4	2.5	2.4	2.4	2.5	2.4
<b>VAT efficiency</b> <sup>3</sup>						
Actual VAT revenues as % of theoretical revenues at standard rate	41.0	53.3	57.5	53.5	55.0	56.6
<b>Note:</b>						
1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.						
2. This category comprises taxes on energy, transport and pollution, and resources included in taxes on consumption and capital.						
3. The VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative size of cross-border shopping compared to domestic consumption also influences the value of the ratio, notably for smaller economies. See European Commission (2012), Tax Reforms in EU Member States and OECD (2012), Consumption tax trends for a more detailed discussion.						
<i>Source: Commission</i>						



**Table VII. Financial market indicators**

	2009	2010	2011	2012	2013
Total assets of the banking sector (% of GDP)	113.8	116.9	116.0	125.4	127.8
Share of assets of the five largest banks (% of total assets)	62.4	62.5	61.8	61.5	-
Foreign ownership of banking system (% of total assets)	92.8	89.7	92.3	86.3	-
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1)</sup>	4.6	5.4	5.2	5.2	5.2
- capital adequacy ratio (%) <sup>1)</sup>	14.0	15.3	15.0	15.6	16.6
- return on equity (%) <sup>1),2),3)</sup>	26.4	19.7	18.3	20.4	17.9
Bank loans to the private sector (year-on-year % change)	1.5	4.2	5.9	3.4	3.8
Lending for house purchase (year-on-year % change)	11.7	6.9	7.6	5.6	5.7
Loan to deposit ratio	74.7	74.8	75.4	73.8	72.6
CB liquidity as % of liabilities	0.0	0.0	0.1	0.0	0.0
Banks' exposure to countries receiving official financial assistance (% of GDP)	-	-	-	-	-
Private debt (% of GDP)	68.8	70.2	71.9	72.4	-
Gross external debt (% of GDP)					
- Public	9.8	12.3	11.8	14.3	15.2
- Private	22.9	23.1	23.2	25.4	24.2
Long term interest rates spread versus Bund (basis points)*	161.5	114.1	109.9	128.7	54.2
Credit default swap spreads for sovereign securities (5-year)*	136.4	87.3	97.9	103.8	55.7
<b>Notes:</b>					
<sup>1)</sup> Latest data 2013Q3.					
<sup>2)</sup> FSI Compilation Guide methodology from 2008 onwards; previous years may not be comparable.					
<sup>3)</sup> After extraordinary items and taxes. Tier 1 capital.					
* Measured in basis points.					
<b>Source :</b>					
<i>Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).</i>					

**Table VIII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Employment rate (% of population aged 20-64)	72.4	70.9	70.4	70.9	71.5	72.5
Employment growth (% change from previous year)	2.3	-1.8	-1.0	0.0	0.4	0.9
Employment rate of women (% of female population aged 20-64)	62.5	61.4	60.9	61.7	62.5	63.8
Employment rate of men (% of male population aged 20-64)	82.0	80.2	79.6	79.9	80.2	81.0
Employment rate of older workers (% of population aged 55-64)	47.6	46.8	46.5	47.7	49.3	51.6
Part-time employment (% of total employment, 15 years and more)	4.9	5.5	5.9	5.5	5.8	6.6
Part-time employment of women (% of women employment, 15 years and more)	8.5	9.2	9.9	9.4	9.5	11.0
Part-time employment of men (% of men employment, 15 years and more)	2.2	2.8	2.9	2.5	2.9	3.3
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	8.0	8.5	8.9	8.5	8.8	9.6
Transitions from temporary to permanent employment	36.3	37.6	37.0	38.4	32.6	:
Unemployment rate <sup>1</sup> (% of labour force, age group 15-74)	4.4	6.7	7.3	6.7	7.0	7.0
Long-term unemployment rate <sup>2</sup> (% of labour force)	2.2	2.0	3.0	2.7	3.0	3.0
Youth unemployment rate (% of youth labour force aged 15-24)	9.9	16.6	18.3	18.1	19.5	18.9
Youth NEET rate (% of population aged 15-24)	6.7	8.5	8.8	8.3	8.9	9.1
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	5.6	5.4	4.9	4.9	5.5	5.4
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	15.4	17.5	20.4	23.7	25.6	26.7
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	1.0	3.0	2.0	4.0	2.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	0.0	0.0	0.0	1.0	1.0	:
Labour productivity per person employed (annual % change)	0.8	-2.8	3.5	1.9	-1.4	-1.8
Hours worked per person employed (annual % change)	0.4	-1.2	1.8	0.0	-0.5	-1.7
Labour productivity per hour worked (annual % change; constant prices)	0.4	-1.5	1.7	1.8	-0.9	-0.2
Compensation per employee (annual % change; constant prices)	2.2	-2.9	4.8	3.3	0.2	-3.8
Nominal unit labour cost growth (annual % change)	3.4	2.2	-0.4	0.5	3.3	-0.1
Real unit labour cost growth (annual % change)	1.5	-0.1	1.2	1.4	1.7	-2.0
<b>Notes:</b>						
<sup>1</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.						
<sup>2</sup> Long-term unemployed are unemployed persons for at least 12 months.						
<b>Sources:</b>						
Commission (EU Labour Force Survey and European National Accounts)						

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Sickness/Health care	5.9	5.8	6.4	6.3	6.3
Invalidity	1.4	1.4	1.5	1.5	1.5
Old age and survivors	7.7	8.0	9.0	9.2	9.7
Family/Children	1.6	1.4	1.4	1.3	1.2
Unemployment	0.6	0.6	1.0	0.8	0.7
Housing and Social exclusion n.e.c.	0.1	0.1	0.1	0.1	0.1
<b>Total</b>	<b>17.5</b>	<b>17.5</b>	<b>19.7</b>	<b>19.5</b>	<b>19.8</b>
of which: means tested benefits	0.6	0.4	0.4	0.4	0.4
<b>Social inclusion indicators</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
At-risk-of-poverty or social exclusion <sup>1</sup> (% of total population)	15.3	14.0	14.4	15.3	15.4
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	18.6	17.2	18.9	20.0	18.8
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	12.5	11.7	10.1	10.7	10.8
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	9.0	8.6	9.0	9.8	9.6
Severe Material Deprivation <sup>3</sup> (% of total population)	6.8	6.1	6.2	6.1	6.6
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59)	7.2	6.0	6.4	6.6	6.8
In-work at-risk-of poverty rate (% of persons employed)	3.6	3.2	3.7	4.0	4.5
Impact of social transfers (excluding pensions) on reducing poverty	55.0	52.0	50.3	45.6	45.5
Poverty thresholds, expressed in national currency at constant prices <sup>5</sup>	98 198	99 800	101 694	101 507	101 004
Gross disposable income (households)	2 053 789	2 124 749	2 131 676	2 130 850	2 159 947
Relative median poverty risk gap (60% of median equivalised income, age: total)	18.5	18.8	21.1	17.2	19.1
<b>Notes:</b>					
<sup>1</sup> People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).					
<sup>2</sup> At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.					
<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.					
<sup>4</sup> People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.					
<sup>5</sup> For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)					
<b>Sources:</b>					
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.					

**Table IX. Product market performance and policy indicators**

<b>Performance indicators</b>	<b>2004-2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	4.0	-3.4	4.2	1.8	-1.4	-1.8
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	11.8	-7.3	15.9	5.8	-0.9	-1.4
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	8.8	-10.9	-7.1	-7.2	-9.5	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	0.3	-4.8	6.4	-2.9	-5.0	0.9
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	29.5	33.2	34.8	34.8	n.a.	n.a.
<b>Policy indicators</b>	<b>2004-2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Enforcing contracts <sup>3</sup> (days)	655	611	611	611	611	611
Time to start a business <sup>3</sup> (days)	28.2	20	20	20	20	20
R&D expenditure (% of GDP)	1.3	1.4	1.4	1.6	1.9	n.a.
Tertiary educational attainment (% of 30-34 years old population)	13.5	17.5	20.4	23.7	25.6	26.7
Total public expenditure on education (% of GDP)	4.1	4.4	4.3	4.5	n.a.	n.a.
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	1.5	n.a.	n.a.	n.a.	n.a.	1.4
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	1.2	n.a.	n.a.	n.a.	n.a.	1.6
Product market regulation <sup>4</sup> , Network Industries <sup>5</sup> (Index; 0=not regulated; 6=most regulated)	2.5	n.a.	n.a.	n.a.	n.a.	2.0
<b>Notes:</b>						
<sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
<sup>2</sup> Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
<sup>3</sup> The methodologies, including the assumptions, for this indicator are presented in detail on the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a> .						
<sup>4</sup> The methodologies of the product market regulation indicators are presented in detail on the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,1,00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,1,00.html</a> .						
<sup>5</sup> Aggregate ETCR.						
<b>Source:</b>						
Commission, World Bank - <i>Doing Business</i> (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						

**Table X. Green growth**

		2003-2007	2008	2009	2010	2011	2012
<b>Green Growth performance</b>							
Energy intensity	kgoe / €	0.58	0.50	0.49	0.50	0.48	0.48
Carbon intensity	kg / €	1.88	1.56	1.54	1.55	1.47	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	2.42	2.13	2.04	1.89	1.96	n.a.
Waste intensity	kg / €	n.a.	0.28	n.a.	0.27	n.a.	n.a.
Energy balance of trade	% GDP	-2.5%	-4.3%	-2.9%	-3.4%	-4.1%	-4%
Energy weight in HICP	%	14	15	13	13	14	14
Difference between change energy price and inflation	%	2.7	7.9	7.9	-1.9	3.8	5
Environmental taxes over labour taxes	ratio	13.5%	13.1%	14.2%	13.6%	13.1%	n.a.
Environmental taxes over total taxes	ratio	7.0%	6.8%	7.2%	7.1%	6.8%	n.a.
Industry energy intensity	kgoe / €	0.34	0.24	0.25	0.25	n.a.	n.a.
Share of energy-intensive industries in the economy	% GDP	14.4	14.8	13.9	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.11	0.11	0.10	0.11	0.10
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.03	0.03	0.03	0.03	0.03
Public R&D for energy	% GDP	n.a.	0.02%	0.02%	0.02%	0.02%	0.02%
Public R&D for the environment	% GDP	n.a.	0.01%	0.01%	0.01%	0.01%	0.01%
Recycling rate of municipal waste	ratio	19.4%	21.9%	23.5%	30.7%	35.1%	43.4%
Share of GHG emissions covered by ETS*	%	n.a.	56.5%	55.0%	55.2%	54.8%	52.7%
Transport energy intensity	kgoe / €	0.63	0.61	0.61	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	1.81	1.73	1.70	n.a.	n.a.	n.a.
<b>Security of energy supply</b>							
Energy import dependency	%	26.3%	27.9%	27.1%	25.5%	27.7%	25.2%
Diversification of oil import sources	HHI	n.a.	0.29	0.30	0.29	0.24	n.a.
Diversification of energy mix	HHI	0.31	0.29	0.28	0.28	0.28	0.27
Share renewable energy in energy mix	%	4.0%	4.9%	5.7%	6.2%	6.9%	7.5%

**Country-specific notes:**

The year 2012 is not included in the table due to lack of data.

**General explanation of the table items:**

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO<sub>2</sub> equivalents) divided by GDP (in EUR)

Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)

Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents

\* Commission and EEA.

\*\* For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.

\*\*\* For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.

## Indicators used in box 4 on potential impact on growth of structural reforms

**Final goods sector mark-ups:** price cost margin, i.e. the difference between the selling price of a good or service and its cost. Final goods mark-ups are proxied by the mark-ups in selected services sectors (transport and storage, post and telecommunications, electricity, gas and water supply, hotels and restaurants and financial intermediation but excluding real estate and renting of machinery and equipment and other business activities<sup>66</sup>).

Source: Commission services estimation using the methodology of Roeger (1995) based on EUKLEMS 1996-2007 data.

**Entry costs:** cost of starting a business in the intermediate sector. The intermediate sector is proxied by the manufacturing sector in the model.

Source: starting business costs in % of income per capita, 2012 data. Doing Business Database. [www.doingbusiness.org](http://www.doingbusiness.org)

**Implicit consumption tax rate:** defined as total taxes on consumption over the value of private consumption. In the simulations it is used as a proxy for shifting taxation away from labour to indirect taxes; the implicit consumption tax-rates are increased (halving the gap vis-à-vis the best performers) while labour tax-rates are reduced, so that the combined impact is ex-ante budgetary neutral.

Source: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013, 2011 data.

**Shares of high-skilled and low-skilled:** share of high skilled workers are increased, share of low-skilled workers are reduced (halving the gap vis-à-vis the best performers). Skill definitions: Low-skilled correspond to ISCED 0-2 categories, high-skilled correspond to scientists (in mathematics and computing, engineering, manufacturing and construction). The remainder is medium-skilled.

Source: 2012 data or latest available, EUROSTAT.

**Female non-participation rate:** percentage of female that do not work/search for a job (non-active female population/female of a working age)

Source: 2012 data or latest available, EUROSTAT.

**Low-skilled male non-participation rates:** percentage of low-skilled male that do not work/search for a job (non-active low-skilled male population/ male of a working age)

Source: 2012 data or latest available, EUROSTAT.

**Elderly non-participation rates (55-64y):** it is the percentage of the elderly population (55-64ys) that do not work/search for a job (non-active elderly population/55-64y population)

Source: 2012 data or latest available, EUROSTAT.

**ALMP:** Active Labour Market Policy expenditures in % GDP over the share of unemployed in the population.

Source: 2011 or latest available data. EUROSTAT

**Benefit replacement rate:** % of a worker's pre-unemployment income that is paid out by the unemployment scheme.

Source: average of net replacement rates over 60 months of unemployment, 2012 data, OECD, Benefits and Wages Statistics. [www.oecd.org/els/benefitsandwagesstatistics.htm](http://www.oecd.org/els/benefitsandwagesstatistics.htm).

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<sup>66</sup> The real estate sector is excluded because of statistical difficulties of estimating a mark-up in this sector. The sector renting of machinery and equipment and other business activities is conceptually part of intermediate goods sector.