**COUNCIL OF
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from:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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to:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the Czech Republic's 2012 national reform programme and delivering a Council opinion on the Czech Republic's convergence programme for 2012-2015

Delegations will find attached Commission document COM(2012) 303 final.

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Recommendation for a

COUNCIL RECOMMENDATION

on the Czech Republic's 2012 national reform programme

and delivering a Council opinion on the Czech Republic's convergence programme for 2012-2015

{SWD(2012) 303 final}

Recommendation for a

COUNCIL RECOMMENDATION

on the Czech Republic's 2012 national reform programme

and delivering a Council opinion on the Czech Republic's convergence programme for 2012-2015

THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

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

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

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States[4], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

1 OJ L 209, 02.08.1997, p. 1
2 COM(2012)303 final
3 P7_TA(2012)0048 and P7_TA(2012)0047
4 Council Decision 2012/238/EU of 26 April 2012

(3) On 12 July 2011, the Council adopted a recommendation on the Czech Republic's national reform programme for 2011 and delivered its opinion on the Czech Republic's convergence programme for 2011-2014.

(4) On 23 November 2011, the Commission adopted the second Annual Growth Survey, marking the start of the second European Semester of ex ante and integrated policy coordination, which is anchored in the Europe 2020 strategy. On 14 February 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report[5], in which it did not identify the Czech Republic as one of the Member States for which an in-depth review would be carried out.

(5) On 2 March 2012, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(6) On 25 April 2012, the Czech Republic submitted its convergence programme covering the period 2012-2015 and, on 13 April 2012, its 2012 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(7) Based on the assessment of the 2012 convergence programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. According to the convergence programme, GDP growth is expected to reach 0.2% and 1.3% in 2012 and 2013 respectively, compared to 0% and 1.5% in 2012 and 2013 respectively in the Commission's 2012 spring forecast. The objective of the budgetary strategy outlined in the programme is to reach a balanced budget in 2016. The general government deficit target of 2.9% of GDP in 2013 is in line with the deadline for correcting the excessive deficit set out in the Council recommendations of 2 December 2009. The average annual fiscal effort of 0.9% of GDP over the period 2010-2013, based on the (recalculated) structural budget balance[6], is slightly below the effort of 1% of GDP recommended by the Council. The programme confirms the previous medium-term budgetary objective (MTO) of a deficit of 1% of GDP, which adequately reflects the requirements of the Stability and Growth Pact, to be reached in 2015. The progress towards the MTO is 0.8% and 0.7% of GDP in 2014 and 2015 respectively, based on the (recalculated) structural balance and the rate of growth of government expenditure complies with the expenditure benchmark of the Stability and Growth Pact. The budgetary projections of the programme are subject to several risks. The law on financial compensation to churches, currently discussed in Parliament, would increase the general government deficit by 1.5% of GDP in the year of entry into force. More generally, the nature and extent of the envisaged consolidation

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5 COM(2012) 68 final.

6 Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

measures on both the revenue and the expenditure side entails a significant risk for the sustainability of the fiscal adjustment beyond the programme period. Budgetary adjustment has so far relied mostly on across-the-board cuts, which affect also growth-enhancing expenditure. Additional savings in public administration expenditures amounting to almost 1% of GDP are planned for 2013 - 2015, but details are not sufficiently specified in the programme. Finally, most of the planned revenue measures are of a temporary nature and should expire in 2015. According to the programme, the debt-to-GDP ratio is expected to peak at 45.1% of GDP in 2013 and decline thereafter, mainly on account of the projected continuous improvement of the primary balance.

(8) In 2011, the Czech authorities approved an increase in the reduced VAT rate and in excise duties on tobacco; they also approved a major tax reform affecting labour taxation which should enter into force in 2014. Further changes to the tax system were agreed at government level in April 2012. Some concern environmental and housing taxation, which are currently under-taxed. The proposed temporary nature of provisions in labour taxation would create additional compliance costs and reduce predictability for taxpayers. Furthermore, the low effective taxation of the self-employed compared to employees on account of an extensive recourse to lump-sums and tax deductibles would only be partly addressed by the new proposals. Finally, the government adopted measures to combat fraud in the area of VAT and fuel taxes and took first steps to introduce the single collection point. However, tax compliance still remains an issue and the current tax collection system is not based on an articulated and comprehensive tax compliance strategy.

(9) The Czech government approved, and partly implemented, a reform of the pension system, aimed at restoring fiscal sustainability and raising retirement savings. However, the projected fiscal imbalances in the pension system are still high relative to the EU average. An explicit link between the statutory retirement age and life expectancy was not included in the reform. The capacity of the new funded pillar to contribute to higher average pensions in the future depends on the proportion of workers, especially of younger ones, participating in it and on the expected rate of return over the long run. However, no measures were announced to stimulate participation in this pillar and more guidance for potential savers would be appropriate. Moreover, the new early retirement scheme proposed by the government represents a major risk to credibility and ambition of the reforms to achieve both an effective increase in the retirement age and adequate pensions.

(10) The overall unemployment rate is below the EU average but women with children and other vulnerable groups struggle to realise their potential in the labour market. An earlier return from parental leave, which would prevent the loss in skills, is contingent on greater availability of child care, especially for children below the age of three. In this regard, the government eased the technical requirements for setting up company-based kindergartens and envisages providing tax incentives for a greater take-up of private child care, thereby partially implementing the recommendations. However, as only 3% of children younger than 3 years attend formal child care (compared to 24% in the EU-27, 2009), further measures are needed with a view to enhancing labour market participation of parents with young children.

(11) Several measures were adopted to improve the performance of the public employment service (PES). Regional labour offices were put under the responsibility of a new central labour office and, as part of a broader social-benefits reform, the responsibility for payment of non-insurance social benefits was transferred from the municipalities to labour offices. However, the resulting increased workload will put further strain on the PES staff, whose number declined by 12% in 2011. To improve placement services, a system for outsourcing employment services to private agencies was introduced. However, the fee structure seems inadequate. Further efforts are needed to ensure better quality and effectiveness of training, job search assistance and individualised services. The necessary means and incentives need to be provided. Efficiency assessment should be introduced to improve the targeting if interventions and funding of activation programmes are to be linked to performance.

(12) There is still ample scope for improving the efficiency of public administration, despite recent improvements in some areas, such as e-government services and the reduction of the administrative burden for businesses. With respect to the anti-corruption strategy, the adoption of the new Public Procurement Act, in force since April 2012, has been the main achievement. Nevertheless, proper enforcement and implementation will be crucial for its credibility and effectiveness. The issue of anonymous share holding has not been addressed yet. The Public Servants Act is still under preparation but needs to be adopted without delay in order to provide the administration with the necessary stability. Furthermore, irregularities in public procurement and sub-optimal functioning of the management and control systems for public administration have been important sources of problems with implementation of the EU Funds.

(13) The Czech economy needs to mobilise factors facilitating the transition to growth based on innovation, higher value added and human capital because opportunities for further real convergence based on capital-intensive growth seem rather limited. A reform of tertiary education is currently being discussed. Although it includes an overhaul of the current accreditation process, it is not sufficiently precise on the key issue of quality evaluation standards and, given the absence of systematic data collection and analysis, it lacks support from the academic community. In the wake of the worsening achievements of Czech pupils, the government has undertaken steps to ensure minimal learning outcomes and embarked on a strategy of nation-wide computer-based testing. However, these measures are too narrow to effectively increase the quality and equity of compulsory education.

(14) In the context of the European Semester, the Commission has carried out a comprehensive analysis of the Czech Republic's economic policy. It has assessed the convergence programme and national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in the Czech Republic but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (6) below.

(15) In the light of this assessment, the Council has examined the Czech Republic's convergence programme, and its opinion[7] is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that the Czech Republic should take action within the period 2012-2013 to:

1. Ensure planned progress towards the timely correction of the excessive deficit. To this end, fully implement the 2012 budget and specify measures of a durable nature necessary for the year 2013 so as to achieve the annual average structural adjustment specified in the Council recommendation under the Excessive Deficit Procedure. Thereafter, ensure an adequate structural adjustment effort to make sufficient progress towards the medium-term objective, including meeting the expenditure benchmark. In this context, avoid across-the-board cuts, safeguard growth-enhancing expenditure and step up efforts to improve the efficiency of public spending. Exploit the available space for increases in taxes least detrimental to growth. Shift the high level of taxation on labour to housing and environmental taxation. Reduce the discrepancies in the tax treatment of employees and the self-employed. Take measures to improve tax collection, reduce tax evasion and improve tax compliance, including by implementing the Single Collection Point for all taxes.

2. Introduce further changes to the public pension scheme to ensure their long-term sustainability. Reconsider plans to allow an earlier exit from the labour market. Ensure broad participation of younger workers in the envisaged funded scheme to improve adequacy of pensions.

3. Take additional measures to significantly increase the availability of affordable and quality pre-school childcare facilities.

4. Strengthen public employment services by increasing the quality and effectiveness of training, job search assistance and individualised services, including of outsourced services.

5. Adopt and implement as a matter of urgency the Public Servants Act to promote stability and effectiveness of the public administration to avoid irregularities. ensure adequate implementation of the new Public Procurement Act. Address the issue of anonymous share holding. Ensure correct implementation of EU Funds and step up the fight against corruption.

6. Adopt the necessary legislation to establish a transparent and clearly defined system for quality evaluation of higher education and research institutions. Ensure that the funding is sustainable and linked to the outcome of the quality assessment. Establish an improvement-oriented evaluation framework in compulsory education.

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

Done at Brussels,

For the Council
The President