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From: General Secretariat of the Council

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To: Permanent Representatives Committee/Council

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Subject: Recommendation for a COUNCIL RECOMMENDATION on the 2018 National Reform Programme of the Czech Republic and delivering a Council opinion on the 2018 Convergence Programme of the Czech Republic

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Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2018) 403 final.

## COUNCIL RECOMMENDATION

of ...

**on the 2018 National Reform Programme of the Czech Republic**

**and delivering a Council opinion on the 2018 Convergence Programme of the Czech Republic**

THE COUNCIL OF THE EUROPEAN UNION,

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

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

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

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

Whereas:

- (1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council<sup>2</sup>, the Commission also adopted the Alert Mechanism Report, 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.
- (2) The 2018 country report for the Czech Republic was published on 7 March 2018. It assessed the Czech Republic's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017<sup>3</sup>, the follow-up given to the country-specific recommendations adopted in previous years and the Czech Republic's progress towards its national Europe 2020 targets.
- (3) On 30 April 2018, the Czech Republic submitted its 2018 National Reform Programme and its 2018 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

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<sup>2</sup> Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

<sup>3</sup> OJ C 261, 9.8.2017, p. 1.

- (4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council<sup>4</sup>, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.
- (5) The Czech Republic is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the Government plans for a budgetary surplus in headline terms over 2018-2021. The medium-term budgetary objective — a structural deficit of 1,0 % of GDP — continues to be met with a margin throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to gradually decline to 29,9 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. Risks to the achievement of budgetary targets seem broadly balanced, with an expected rebound of public investment and further growth of public wages. Based on the Commission 2018 spring forecast, the structural balance is forecast to decline to around 0,9 % of GDP in 2018 and 0,2 % of GDP in 2019, remaining above the medium-term budgetary objective. Overall, the Council is of the opinion that the Czech Republic is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

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<sup>4</sup> Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

- (6) The Czech Republic continues to display medium fiscal sustainability risks in the long term. While the costs of ageing pose a challenge for healthcare and long-term care, changes in the pension system warrant particular attention. Updated projections of age-related expenditure point to a higher increase than that indicated in the 2015 "Ageing Report". Pension expenditure is expected to rise from 8,2 % of GDP in 2016 to 10.9 % of GDP in 2070. This expected higher increase in pension expenditure mainly reflects the capping of the statutory retirement age at 65 years. In fact, the alignment of life expectancy with the statutory retirement age is not automatic; instead, the cap is to be reviewed every five years by the Government, starting in 2019. Since it is left to the Government's discretion, the current pension expenditure projections do not take into account these retirement age reviews. Moreover, pension indexation is now more generous, taking into account 50 % of real-wage growth rather than the previous 33 % of real-wage growth. The impact of these changes on expenditure amounts to 2 percentage points of GDP in 2070. Further changes that are currently being discussed, such as an increase in the basic pension amount and higher pensions for older pensioners, also worsen the sustainability indicators. As regards public expenditure on health care, in the long-term it is projected to increase by 1,1 percentage points of GDP, above the estimated average increase of 0,9 percentage points for the Union. In this context, there are signs of inefficient use of resources in out-patient and in-patient care.
- (7) The new fiscal responsibility law in place since the beginning of 2017 has significantly strengthened the Czech Republic's fiscal framework and established an independent fiscal council. A draft law on independent audits is currently in the interservice commenting procedure and aims to address the outstanding transposition of Council Directive [2011/85/EU](#)<sup>5</sup>.

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<sup>5</sup> Council Directive [2011/85/EU](#) of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p.41).

- (8) The Czech National Bank can set recommendatory macro-prudential mortgage-lending limits, but its sanctioning powers are limited since it lacks the formal authority to enforce them. While the Czech banks comply with certain aggregate level limits, they have not fully adhered to the Czech National Bank's 2016 guidelines. Binding legislative limits would likely increase the level of compliance among Czech banks, ensuring financial stability and reduced risks for borrowers. A legislative proposal, amending the Act on the Czech National Bank, is expected to be discussed by the Parliament in 2018.
- (9) The Czech Republic continues to face challenges in improving the transparency and efficiency of public procurement and preventing corruption. While certain steps have been taken to improve the public procurement framework, the level of competition remains a concern, as nearly half of all public tenders result in a single-bid procedure. At the same time, the enactment of the obligatory use of electronic procedures has the potential to boost transparency and efficiency. The Czech authorities have invested in the the state-owned e-procurement platform 'National Electronic Tool', which should become increasingly user-friendly and reliable, in addition to private platforms serving the Czech market. There is still considerable scope for removing administrative barriers and tapping the potential of aggregated and strategic public procurement to get better value for public money. Both central and local authorities have started undertaking targeted initiatives to train staff involved in procurement procedures. Nonetheless, setting up joint procurement measures and acquiring specialist expertise in certain areas remain major challenges. In addition, corruption and bribery are ongoing concerns for businesses and the public. While several major reforms of the anti-corruption strategy were adopted, some areas remain unaddressed.
- (10) While the performance of e-government remains below the Union average, relevant legislative measures have been adopted in order to ensure the increase of accessibility and availability of these services. Certain large-scale initiatives are expected to be introduced in 2018 but their success will depend on the ability of the authorities to raise awareness and provide user-friendly solutions.

- (11) Certain administrative and regulatory burdens are holding back investment. These burdens mainly concern construction permits and tax complexity. It is acknowledged, however, that the authorities adopted an amendment to the Construction Act, which simplifies the building permit procedure by including the environmental impact assessment in the zoning decision or in the joint zoning and building permit. However, it remains unclear whether this could also streamline procedures for large infrastructure projects, since various other authorisations have not been included in this joint permit system. An amendment to the existing law regulating the construction of transport infrastructure is being discussed in the Parliament. While changes have been made to the tax system to improve tax collection, tax regulation and rates have moved up the list of concerns as problematic areas for doing business. The new Government has indicated possible changes in order to increase transparency and simplify the tax system, including the ongoing work to modernise the income tax legislation. Compliance costs have increased slightly and remain above the Union average. Although bringing in additional tax revenues, the "value added tax control statement" has increased the time needed to comply with tax requirements. Despite the significant reduction in hours to comply with the Tax Code compared to the past, the Czech Republic is still at the higher end of the scale. Moreover, new reduced value added tax rates might add to the complexity of the value added tax system, especially for small and medium sized enterprises.
- (12) While the Czech economy is shifting towards more knowledge-intensive activities, several bottlenecks still hamper the development of a well-performing research and innovation system. The increase of business R&D investment is primarily driven by foreign direct investments. R&D expenditure by domestic firms has declined over the last two years. Despite substantial public R&D investment, the Czech Republic underperforms in terms of the quality of its public science base. Policy measures were adopted to build links between academia and businesses, and improve the performance of the public science base, but the results to date have been limited and the reforms are yet to be fully implemented. Moreover, the governance of the research and innovation system remains fragmented.

(13) Quality inclusive education and training are of primary importance in view of increasing bottlenecks on the Czech labour market. Education performance continues to be strongly affected by the socioeconomic background of students. Inclusive education measures are still to be fully implemented, in particular for Roma children. Shortages of qualified teachers, combined with demographic projections, indicate that it could become more challenging to recruit and retain teachers. The planned new career system for teachers, which would have linked continuing professional development, career and salaries, was not adopted by the Parliament. Teachers' salaries remain low compared with those of other workers with tertiary education, but further salary increases are envisaged in the next years. The teaching profession therefore remains relatively unattractive for talented young people. Finally, the success of the reform to make education more inclusive (introduced in 2016 with the support of the European Social Fund) will depend on the availability of sufficient and sustainable national funding, further teacher and teaching-assistant training, and raising public awareness of the benefits of inclusive education.



- (14) The Czech Republic is experiencing strong labour market performance. Employment has risen steadily over the past six years and unemployment has fallen considerably. The potential of women, the low-skilled and disabled people remains nonetheless underutilised. Against the background of labour shortages, there is clear scope for increasing their labour market participation. Employment and gender pay gaps remain high despite recent measures that have made parental leave more flexible and increased the number of childcare facilities. The employment rate among women remains well below that of men. Motherhood still has a major impact on labour market participation, linked to the low availability of affordable childcare, long parental leave entitlements, low use of flexible working arrangements and the lack of long-term care facilities. In 2016, only 4,7 % of children below the age of three were in formal childcare. Although they make up a small proportion of the population, the employment rate of the low-skilled is well below that of the medium- and high-skilled. Similarly, the employment rate of disabled people is below the Union average, despite the record-low general unemployment rate and shortages in the labour market. This could motivate tapping into the unused potential of the disabled. Due to limited capacity, public employment services currently fall short in providing jobseekers with personalised, continuous support. Increasing the outreach and activation capacities of public employment services, together with effective and well-targeted active labour market policies and individualised services, would help boost the participation of these groups. Upskilling initiatives (also covering digital skills) could improve labour market access.
- (15) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of the Czech Republic's economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to the Czech Republic in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in the Czech Republic but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(16) In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion<sup>6</sup> that the Czech Republic is expected to comply with the Stability and Growth Pact.

HEREBY RECOMMENDS that the Czech Republic take action in 2018 and 2019 to:

1. Improve the long-term fiscal sustainability, in particular of the pension system. Address weaknesses in public procurement practices, in particular by enabling more quality-based competition and by implementing anti-corruption measures.
2. Reduce the administrative burden on investment, including by speeding up permit procedures for infrastructure work. Remove the bottlenecks hampering research, development and innovation, in particular by increasing the innovation capacity of domestic firms. Strengthen the capacity of the education system to deliver quality inclusive education, including by promoting the teaching profession. Foster the employment of women, the low-skilled and disabled people, including by improving the effectiveness of active labour market policies.

Done at Brussels,

*For the Council*

*The President*

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<sup>6</sup> Under Article 9(2) of Regulation (EC) No 1466/97.