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Recommendation for a

COUNCIL RECOMMENDATION

**on the 2019 National Reform Programme of the Czech Republic and delivering a
Council opinion on the 2019 Convergence Programme of the Czech Republic**

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THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, 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,

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 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 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, 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 2019 country report for the Czech Republic² was published on 27 February 2019. It assessed the Czech Republic's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and the Czech Republic's progress towards its national Europe 2020 targets.

¹ OJ L 209, 2.8.1997, p. 1.

² SWD(2019) 1002 final.

- (3) On 30 April 2019, the Czech Republic submitted its 2019 National Reform Programme and its 2019 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (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 Council³, 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.⁴
- (5) The Czech Republic is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Convergence Programme, the government expects to move from a budgetary surplus of 0.3% of GDP in 2019 to a deficit of 0.2% in 2020, which is projected to gradually deteriorate to 0.5% by 2022. Based on the recalculated structural balance⁵, the medium-term budgetary objective – which has been changed from a structural deficit of 1% in 2019 to 0.75% of GDP as of 2020 – continues to be overachieved throughout the programme period. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to gradually decline to 29.7% in 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. Risks to the achievement of budgetary targets seem broadly balanced, with expected further growth in public wages and social transfers contrasting with a small reduction in total revenues as a share of GDP. Based on the Commission 2019 spring forecast, the structural balance is forecast to deteriorate to around -0.1% of GDP in 2019 and -0.4% of GDP in 2020, 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 2019 and 2020.
- (6) The Czech Republic faces medium risks for fiscal sustainability of public finances in the long term, mainly due to the costs of ageing. Pension expenditure is the main factor negatively affecting long-term sustainability, as it is expected to grow by around 2 percentage points of GDP by 2070. Long-term risks stem from unfavourable demographics combined with the capping of the statutory retirement age at 65 years. As a result, the old-age dependency ratio, comparing elderly people with the active population almost doubles, reaching approximately 50% in 2070. Recent measures improve the adequacy of pensions. Alongside a more generous indexation of pension benefits, the government increased the basic pension amount and topped up pensions for older pensioners. However, these steps are not accompanied by policies that would improve sustainability. For example, the alignment between gains in life expectancy and the statutory retirement age is not automatic. Currently, any change to the

³ 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). COM(2014) 494 final.

⁴ ⁵ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

retirement age (statutory and early retirement) needs to be proposed by the government and approved by the Parliament. Such measures can also be combined with labour market policies that support longer working careers and the participation of underrepresented groups. The projected increase in age-related public expenditure on healthcare amounts to 1.1 percentage points of GDP by 2070, which also reduces long-term fiscal sustainability. In this context, further consolidation of the hospital sector and investment in primary and integrated health and social care could improve the cost-effectiveness of the healthcare system.

- (7) The Czech National Bank can set recommendatory macro-prudential mortgage lending limits, but according to the current legislation, it has limited sanctioning powers since it lacks the formal authority to enforce them. While in general the Czech banks comply with the recommendations, binding legislative limits would likely increase the level of compliance among banks, ensuring financial stability and reduced risks for borrowers. A legislative proposal, amending the Act on the Czech National Bank, is still under discussion.
- (8) Despite slight improvements, corruption remains a concern for businesses and may hinder economic activity. On the positive side, the reforms introduced in 2017, including on public procurement, are currently being implemented and some pending measures were finally adopted by the government and sent to Parliament for further discussion. These include proposals for extending the role of the Supreme Audit Office to the regions and municipalities, and on nominations to the state owned companies, an area open to conflict of interest and where regulation is essential. However, the proposals on protection of whistleblowers and on lobbying have not yet been adopted.
- (9) The Czech Republic is enjoying strong labour market performance. Employment has risen steadily over the past seven years and unemployment has fallen considerably. Nonetheless, the labour market potential of women with young children, the low-skilled and people with disabilities remains underutilised. Against the background of labour shortages, there is clear scope for increasing their labour market participation. The employment gap and the gender pay gap 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. Low availability of affordable childcare, long parental leave entitlements, low use of flexible working arrangements and the lack of long-term care facilities still have a major impact on labour market participation. In 2017, only 6.5% of children below the age of three were in formal childcare (compared to the EU average of 34.2%). Although the low-skilled make up a small proportion of the population, their employment rate is well below that of the medium- and high-skilled. Similarly, the employment rate of people with disabilities remains low. Due to limited capacity, public employment services currently fall short of 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 would help boost the participation of disadvantaged groups.
- (10) Labour and demographic constraints in a manufacturing-intensive economy warrant more investment in education and training, including for employed adults, to ensure the country meets the challenges brought about by structural changes in the economy, such as future technological changes. Qualitative skills mismatches, including those due to future automation and robotisation, could arise, notably in the digital sector. The new jobs will require new competences and significant investment, particularly in

higher vocational technical skills and digital skills, expected to be needed following the automation of current mechanical jobs. Although various initiatives to introduce a comprehensive skills strategy have taken place over recent years, these have not yet grown into a genuine comprehensive system.

- (11) Education outcomes continue to be strongly affected by the socioeconomic background of students. A reform to make education more inclusive was introduced in 2016 with the support of the European Social Fund. Its success will depend on the availability of sufficient and sustainable national funding, further teacher and teaching-assistant training, and an increase in public awareness of the benefits of inclusive education. While positive overall, the impact of the inclusive education reform on the participation of Roma children in mainstream education remains limited. Low investment, the limited attractiveness of the teaching profession and socio-economic inequalities are holding back the level of education attained. There is a shortage of teachers due to low job prestige, low salaries compared to other professions despite recent increases, and limited career development opportunities. The teaching profession remains relatively unattractive for talented young people. Given this, the shortages of qualified teachers combined with expected unfavourable demographic developments indicate that it could become more challenging to recruit and retain teaching staff in the future.
- (12) Despite the Czech Republic being a transit country, the completion of the European transport networks, including TEN-T corridors, is far from being finalised. Suburban transport infrastructure also remains deficient, limiting housing affordability and people's ability to commute to work. Weak transport links are also deterring business activity, particularly in remote regions. While the process of suburbanisation is ongoing in metropolitan areas, suburban transport networks are lagging behind, particularly for rail infrastructure. The country scores low in terms of low carbon aspects, particularly the percentage of renewable energy in transport and the take-up of electric vehicles. Furthermore, the planned growth of the recharging infrastructure may not be sufficient to cater for future demand. More investment in sustainable transport could also reduce air and noise pollution, alleviating its impact on public health, especially in urban areas. Digital infrastructure is improving but the divide between urban and rural areas persists, as only 59% of rural households are covered by fast broadband networks. Upgrading older networks based on copper infrastructure along with fixed wireless access solutions will not be sufficient for achieving the 2025 connectivity objectives. To address future connectivity needs, investment is needed in very high capacity networks (i.e. optical fibre) and appropriate demand-side measures.
- (13) The energy intensity of the Czech economy remains one of the highest in the EU as energy efficiency is improving only slowly, in particular in the buildings sector. Energy intensity is the highest in the industrial and residential sectors. Improving energy efficiency is an opportunity to increase the Czech Republic's competitiveness, by reducing energy costs for households and businesses, developing cleaner industries and moving up the value chain. Coal dominates the power sector and is the largest source of carbon emissions, posing a substantial threat to local air quality. Greenhouse gas emissions from road transport have increased strongly the last 5 years. On climate adaptation and risk prevention, proper action is lacking as regards suitable prevention, preparedness and disaster resilience.
- (14) Administrative and regulatory burden may be hampering investment. Many Czech firms see the administrative and regulatory burden as a major obstacle to investment. Fast-changing legislation and complex administrative procedures remain major

obstacles to doing business. The cost of enforcing contracts, frequent changes to the tax and labour regulations and difficulty in obtaining construction permits are potentially discouraging investment in the country. The degree of administrative burden also varies substantially among the regions. Recent proposals aim to reduce the complexity of planning procedures, particularly for large infrastructure projects. Furthermore, the government is preparing to draft a new construction law by 2021, with the involvement of social partners. Responsibility for market surveillance of products is spread over various organisations, suffers from overlaps and poses challenges for efficient coordination and effective cooperation.

- (15) Whilst improving in terms of transparency and provided training, public procurement practices still lag behind in terms of competitiveness, due to the high proportion of procedures with only received bid, use of quality criteria and trust in public institutions. The vast majority of public procurement decisions continue to be based on the lowest price as the adoption of a strategic approach is still pending. There has been more emphasis on centralised procurement and on using shared expertise but their rollout is rather slow, despite their proven potential.
- (16) The Czech Republic has not yet created a fully functioning innovation ecosystem based on domestic research and development. The country remains a moderate innovator at EU level, despite an increase in research and development intensity. This performance may be linked to public investment lacking a fully coherent strategy to increase the modest research performance and improve cooperation between the private sector and academia. Productivity gains are mostly driven by large foreign companies, while domestic firms lag behind in terms of value added generation. Moreover, total factor productivity, an indicator of how efficiently capital and labour are being used in production, has been growing at a relatively slow pace. An increased focus on domestic innovation could boost productivity across the entire business spectrum, including for small and medium-sized enterprises.
- (17) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report⁶. This would allow the Czech Republic to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (18) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of the Czech Republic's economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to the Czech Republic in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in the Czech Republic, but also their compliance 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.
- (19) In the light of this assessment⁷, the Council has examined the 2019 Convergence Programme and is of the opinion⁷ that the Czech Republic is expected to comply with the Stability and Growth Pact.

⁶ SWD(2019) 1002 final.

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

HEREBY RECOMMENDS that the Czech Republic take action in 2019 and 2020 to:

1. Improve long-term fiscal sustainability of the pension and health-care systems. Adopt pending anti-corruption measures.
2. Foster the employment of women with young children, including by improving access to affordable childcare, and of disadvantaged groups. Increase the quality and inclusiveness of the education and training systems, including by fostering technical and digital skills and promoting the teaching profession.
3. Focus investment-related economic policy on transport, notably on its sustainability, digital infrastructure, and low carbon and energy transition, including energy efficiency, taking into account regional disparities. Reduce the administrative burden on investment and enable more quality-based competition in public procurement. Remove the barriers hampering the development of a fully functioning innovation ecosystem.

Done at Brussels,

*For the Council
The President*