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COMMISSION STAFF WORKING DOCUMENT

Assessment of the 2012 national reform programme and convergence programme for the CZECH REPUBLIC

Accompanying the document

Recommendation for a

COUNCIL RECOMMENDATION

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

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CONTENTS

EXECUTIVE SUMMARY

Real GDP growth is expected to stagnate in the Czech Republic in 2012, while it should pick up to 1.5 % in 2013. The unemployment rate started to decline at the beginning of 2010 from a level close to 8 % to end on 6.7 % in the fourth quarter of 2011. It is expected to rise to 7.2% in 2012.

The Czech Republic has introduced a set of measures to strengthen the sustainability of the pension system, reform the tax system, improve the performance of the public employment service and increase the transparency and efficiency of public procurement.

However, in a context of increased competition from emerging economies and the steadily decreasing inflows of new equity capital, the key challenge for the Czech economy is to support economic recovery and long-term growth by improving the quality of fiscal adjustment, reducing inefficiencies and addressing the lack of stability in the public administration, making better use of the potential in the labour market, especially for women with children, and better mobilising factors facilitating the transition to growth based on innovation, higher value added and human capital. The growth of innovative enterprises is also constrained by inadequate links between the science base and the business sector and by inefficiencies in public funding of research. Inefficiencies and lack of stability of the public administration do not create a supportive environment for long-term growth. Furthermore, despite the relatively low debt-to-GDP ratio, and the recent reforms, public finances are not yet on a sustainable path.

1. INTRODUCTION

In June 2011 the Commission proposed six country specific recommendations for economic and structural reform policies for the Czech Republic. In July 2011 the Council of the European Union adopted these recommendations which concerned public finances, the taxation system, the pension system, the labour market, the business environment and education. In November 2011 the Commission published its Annual Growth Survey for 2012 in which it set out its proposals for building the necessary common understanding about the priorities for action at national and EU level in 2012.

Against this background, the Czech Republic presented its national reform programme and convergence programme in April 2012. These programmes give details of the progress made by the Czech Republic since July 2011 and of its future plans. This Staff Working Document assesses the implementation of the 2011 country-specific recommendations and of the priorities set in the Annual Growth Survey for 2012, identifies current policy challenges and, in this light, examines the country's latest policy plans.

The policy plans submitted by the Czech Republic are relevant. The policies presented in the national reform programme are integrated in a broad social and economic context. This improves accessibility for the general public, but sometimes the document lacks a clear commitment and the detail necessary in order to assess fully the relevance and ambition of the key policies. The convergence programme confirms the main fiscal policy objective of the Czech authorities which is in line with the Stability and Growth Pact. The Czech Republic has ensured broad coherence between the two documents.

Overall assessment

A comprehensive reform of the pension system has been adopted and steps have been taken to enhance labour market participation of parents with children, improve the performance of the public employment service and improve the quality and transparency of public services and procurement. Only limited progress has been made on implementing the 2011 recommendation on education policy, as no substantial measures have been adopted in this area.

Challenges identified in July 2011 and reiterated in the Annual Growth Survey 2012 remain valid. In the short term, the main challenge is to kick-start economic recovery by better utilising the potential in the labour market, improving the quality of fiscal adjustment, and enhancing and stabilising the regulatory framework and public administration. Higher quality and efficiency in the education and research system would help buttress innovation and human capital, improving the medium- and long-term growth prospects.

2. ECONOMIC DEVELOPMENTS AND CHALLENGES

2.1. Recent economic developments and outlook

Recent economic developments

The Czech economy emerged from the global financial crisis in the second half of 2009, having shed almost 200,000 jobs and 6 percentage points of value added between the pre-crisis peak in the third quarter of 2008 and the return to growth in the second quarter of 2009. Trade played a dominant role in buttressing the initial recovery, as real GDP growth picked up again in 2010 and 2011 but at a pace below the pre-crisis average and too slow to erase the losses suffered during the economic downturn. More recently, the economy has started to lose momentum once again. In 2011 household consumption expenditure fell by 0.5 % on the back of the continuing consolidation efforts, and aggregate investment was hit by the loss of confidence reflecting the adverse developments in the euro area.

The labour market response to the recovery came with a lag and has remained rather uncertain so far. The unemployment rate started to decline at the beginning of 2010 from a level close to 8% to end on 6.4% in the fourth quarter of 2011 (a relatively low value by both Czech domestic and EU standards). Employment and real wages in the public sector continued to fall throughout the year. The average nominal wage in the economy increased by 2.2%, somewhat faster than aggregate productivity (1.4%) and than inflation, which, measured by the harmonised index of consumer prices, reached 2.1% in 2011.

Economic outlook

On the back of slowing activity in the Czech Republic's main trading partners and ongoing consolidation, real GDP growth is expected to stall during 2012 and pick up to 1.5% in 2013. The government's efforts to address fiscal imbalances are forecast to have a negative impact on government consumption expenditure and public investment. Increases in indirect taxes in 2012 and 2013 are expected to push up inflation to 3.3% and 2.2% respectively, which, in a weaker labour market, will weigh on household consumption. The corporate sector remains cautious about upgrading physical capital and is biding its time until the signals about the external environment become firmer. More positive developments, underpinned by the assumption of a return of confidence, are not expected until the end of 2012 and 2013.

The 2012 convergence programme and the 2012 national reform programme share the same economic outlook. Similarly to the Commission services' 2012 Spring forecast, the macroeconomic scenario submitted by the national authorities forecasts near-stagnation of GDP growth in 2012. The macroeconomic scenario underpinning both documents is based on a less dynamic rebound of the external environment, which is reflected in the somewhat slower pace of economic recovery in 2013 than projected by the Commission. The macroeconomic scenario does not include the estimated macroeconomic impact of structural reforms. In the light of the assessment of legal compatibility and of the degree of fulfilment of the convergence criteria the 2012 Convergence Report published by the European Commission on 30 May 2012 considers that the Czech Republic does not fulfil the conditions for adoption of the euro.

2.2. Challenges

The key challenge for the Czech economy is 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 are rather limited[1]. The current model has been marked by rapid accumulation of production factors, especially capital. The build-up of fixed capital was supported by robust inflows of foreign capital attracted by cheap but relatively skilled labour and the proximity to the economic core of the EU. This comparative advantage has been increasingly undermined by competition from emerging economies and the steadily decreasing inflows of new equity capital since the beginning of the decade.

One essential ingredient of the growth model based on innovation and knowledge is human capital. However, Czech study programmes are currently excessively long and underfunded and achieve excellence on an international scale only in relatively rare cases. Added to this, the lower layers of the Czech education system do not fully equip the labour force with the competencies and flexibility needed to adapt to the changing conditions on the labour market. The growth of innovative enterprises is constrained also by inadequate links between the science base and the business sector and by inefficiencies in public funding of research.

[1] The gap in GDP per capita between the Czech Republic and the EU-27 average narrowed from 75% in 1997 to 80% in 2010.

The short-term challenge is to kick-start economic recovery. Currently, the Czech economy is operating in a manner shaped by the weak external environment and the need for fiscal consolidation. Despite the relatively low debt-to-GDP ratio, public finances are unsustainable due to both population ageing[2] and still relatively high structural deficits that were starting to accumulate even before the crisis. While the direct impact of lowering structural deficits on growth is likely to be negative in the short term, consolidation efforts help to sustain market confidence because sound public finances are one of the institutional prerequisites for long-term growth. In this regard, it is therefore important to closely monitor the impact of the current and future reforms on the sustainability and adequacy of pensions. A faster recovery is hindered by several factors:

- The potential of the labour market is underutilised. Policy traps, in particular the insufficient provision of affordable childcare facilities, prevent workers from returning to jobs after parental leave fast enough to retain the skills and human capital built up from previous investments in education. The negative labour-market impact of parenthood hits women much harder than men. Furthermore, the status quo is giving rise to gender employment and unemployment gaps, and a substantial gender pay gap, all of which increase women's financial dependence and their risk of poverty in old age. Moreover, deficiencies persist in the public employment services.

- There is room for improving the quality of the fiscal adjustment. Up until now fiscal consolidation has partly taken the form of across-the-board cuts which were not based on a systematic evaluation of policies and projects competing for public resources. Sustainable fiscal consolidation will require careful consideration of government priorities, even more emphasis on the efficiency of public spending and further efforts to create a more growth-friendly tax system.

- By international standards[3], the Czech Republic does not score favourably on the quality of its institutional and regulatory framework and the efficiency and stability of its public administration. The quality of public administration and of the overall business environment is a crucial factor for enhancing competitiveness and for laying solid foundations for growth in the long term. Addressing the weaknesses fully is a gradual process, which could span a number of years. However, rapid implementation of key reforms in this area could make a difference already in the short to medium term.

3. ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

The main goal of the budgetary strategy in the short term is to bring the government deficit below the 3 % reference value by 2013. In the medium term, the Czech authorities are committed to reaching the objective of a balanced budget in 2016 and to complying with the medium-term budgetary objective (MTO), i.e. a structural deficit of 1% of GDP. The MTO

2 The Czech population will be one of the fastest ageing in the EU. The old-age dependency ratio is projected to rise from 21 % to 61 % between 2008 and 2060 (EU: from 25 % to 53 %).

3 For example, in the World Economic Forum's Global Competitiveness Report the Czech Republic ranks very poorly on institutional dimensions: 121st for public trust in politicians, 102nd for diversion of public funds, 118th for the burden of government regulation, 102nd for the transparency of government decision-making, 90th for the ethical behaviour of firms and 89th for protection of minority shareholders' interests.

adequately reflects the requirements of the Stability and Growth Pact. According to the 2012 convergence programme, the medium-term objective will be achieved in 2015.

The general government deficit reached 3.1% of GDP in 2011 which was significantly lower than the Czech authorities' target of 4.2% announced in the 2011 convergence programme. The difference stems mainly from substantially lower-than-expected public investment. While the 2011 convergence programme still projected an increase in public investment of around 9% year-on-year in 2011, it actually declined by 15% according to the April 2012 fiscal notification. In addition, the budgetary outcome in 2011 was positively influenced by lower-than-expected debt servicing costs and cuts in intermediate consumption. Shortfalls of almost 0.5% of GDP on the revenue side reflected mostly revenues from value added tax and direct taxation but they were more than compensated by the retrenchment of public investment and government consumption on the expenditure side. The Czech authorities complied with the 2011 recommendation to 'implement the planned consolidation in 2011 and take countervailing measures of a permanent nature as needed in case of any revenue shortfalls or expenditure slippages' and implemented all the planned consolidation measures.

The deficit target for 2012 was revised downwards significantly, by 0.5 pps compared with the 2011 convergence programme, mainly on account of the better-than-expected budgetary outcome in 2011. The Czech authorities adopted all the planned consolidation measures as part of the 2012 budget proposal. In addition, further across-the-board cuts in operational expenditure at central government level (0.6% of GDP) were approved in March 2012. According to the 2012 convergence programme the general government deficit is set to decline gradually from 3% of GDP in 2012 to 2.9% in 2013 and 1.9% in 2014. The deficit reduction would continue in 2015 when the nominal deficit is set to reach 0.9% of GDP. The Commission services' 2012 Spring forecast projects the headline deficit to decline to 2.9% in 2012. The policy stance implied by the 2012 convergence programme is restrictive over the programme period with the recalculated structural balance[4] improving from a deficit of 2% of GDP in 2012 to a deficit of 0.6% in 2015. The average annual fiscal effort over the period 2010-2013, based on the recalculated structural balance, amounts to 0.9%, which is slightly below the average structural effort of 1% of GDP recommended by the Council. The structural adjustment amounts to 0.8% in 2014 and 0.7% in 2015 and the rate of growth of government expenditure, taking into account discretionary revenue measures, complies with the expenditure benchmark of the Stability and Growth Pact.

The planned fiscal consolidation over the programming period 2013-2015 relies on measures on both the expenditure and the revenue side with a slightly stronger emphasis on revenue-increasing measures. While some measures had already been announced in the 2011 convergence programme, the most significant part of the overall fiscal adjustment is planned to be brought about by the new consolidation package approved by the government in April 2012 (see Box 1 and the section on the *'Tax system'*). It is important to note that most measures in this recent additional consolidation package will require legislative amendments which have not been approved by Parliament yet and are therefore exposed to clear implementation risks. In addition, most of these measures are of a temporary nature and are expected to be withdrawn after 2015. According to the Commission services' 2012 Spring forecast, which already includes most measures from the new consolidation package, the general government deficit is projected to reach 2.6% of GDP in 2013.

The fiscal adjustment in 2013 will be driven mainly by an increase in the rates of the value added tax and by changes in the personal income tax (see Box 1). Expenditure will be contained by lower indexation of pensions and further cuts in operational expenditure at the

[4] Cyclically adjusted balance net of one-offs and temporary measures, recalculated by the Commission on the basis of the information provided in the programme, using the commonly agreed methodology.

central government level. Despite the net effect of the discretionary measures adding up to around 1% of GDP, the headline deficit target for 2013 is only 0.1 pp lower than for 2012 and the recalculated structural balance will increase by 0.1 pp. In 2014, further increases in direct taxation are envisaged (see the section on the '*Tax system*'), which are to be accompanied by new excise duties on certain products and by savings in government consumption and efficiency increases. For 2015, no major consolidation measures are planned, except for the continued trend of cuts in government consumption. Therefore the improvement in the headline deficit is driven mainly by projected more favourable macroeconomic conditions.

Box 1. Main measures

Main budgetary measures

Revenue	**Expenditure**
2011	
Changes in direct taxes (0.5% of GDP) Other revenue (0.3% of GDP)	Cuts in social benefits (-0.2% of GDP) Cuts in the public sector wage bill (-0.2% of GDP) Cuts in government consumption (-0.4% of GDP)
2012	
Increase in the lower VAT rate from 10% to 14% (0.7% of GDP) Introduction of a lottery tax (0.1% of GDP)	Cuts in operational expenditure of the central government (-0.6% of GDP)
2013	
Changes in the personal income tax (0.2% of GDP) Increase in the value added tax rates and in excise duties (0.5% of GDP) Increase in the property transfer tax and other revenue (0.2% of GDP) Introduction of a private pension pillar (-0.5% of GDP)	Lower indexation of pensions (-0.3% of GDP) Cuts in operational expenditure of the central government (-0.3% of GDP) Higher efficiency of public procurement (-0.1% of GDP)
2014	
Further changes in the personal income tax and social contributions (0.2% of GDP) Introduction of excise duties on selected commodities (0.2% of GDP) Introduction of a tax on insurance premiums (0.1% of GDP) Reduction of the threshold for value added tax registration (0.1% of GDP)	Savings resulting from the reform of public administration (-0.3% of GDP)
2015	
Tax deduction on dividends for corporations (-0.2% of GDP)	Savings resulting from the reform of public administration (-0.3% of GDP)

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. The degree of detail reflects the information made available in the convergence programme and, where available, of a multiannual budget.

The 2011 recommendation on fiscal policy for 2013 explicitly mentioned the need to underpin the 2013 deficit target by more specific measures and to avoid cutting expenditure on growth-enhancing items. Overall, the planned measures on the revenue side are sufficiently specific and quantified. Measures on the expenditure side in 2012 and 2013 mainly take the form of across-the-board cuts in the central government budget. These measures generally lack prioritisation, are not based on a systematic evaluation of the effectiveness and efficiency of public spending programmes and necessarily also affect growth-enhancing expenditure items such as education. In addition, the significant drop in public investment in the last two years likewise militates against protecting growth-enhancing expenditures. With respect to the 2011 country –specific recommendation to ‘improve the efficiency of public investments‘, the Czech authorities are counting on significant improvements which should stem from the reform of public administration (currently under preparation) and the changes in the public procurement law (see section 3.5). However, a more detailed breakdown into concrete measures and their quantification are not available in the programme and the budgeted savings will depend crucially on the actual implementation of the reforms full details of which are not given in the 2012 convergence programme.

The budgetary projections over the programme period are subject to several significant risks. The most important of these is the potential impact on the general government deficit of the draft law on financial compensation to churches for property confiscated after the Second World War. If this were approved, the general government deficit would increase by 1.5% of GDP in the year it enters into force. The second major risk is related to the use of EU funds. As explained in section 3.5, payments from several Operational Programmes have been suspended because of irregularities. This poses a risk to the general government balance as it cannot be excluded that some projects will have to be financed entirely from national sources and will ultimately not be reimbursed from the EU Funds. It is, however, difficult to quantify the potential impact at this stage. A third risk concerns the high uncertainty about the future development of public investment. Public investment declined by almost 30% over the last two years. The unexpected drop in 2011 can to a large extent be attributed to the cautious behaviour of certain public entities which may have postponed their investment projects and thus built up reserves for the future. This implies a risk of higher-than-projected investment growth in the years ahead. On a more general level, the nature and extent of the envisaged consolidation measures poses a risk to the sustainability of the fiscal adjustment beyond the programme period. Most measures on the revenue side are temporary and should expire in 2015. On the expenditure side, savings in public administration totalling almost 1% of GDP should be realised between 2013 and 2015, but the 2012 convergence programme gives no details of how they will be implemented in a sustainable manner without affecting the government priorities, the effectiveness of public services and growth-enhancing public expenditure. There are also some positive risks to budget implementation. The number of people deciding to opt in for the private pension pillar in 2013 could be considerably lower than assumed in the programme, thus implying a less negative impact on the revenue from social contributions. Moreover, the 2013 deficit target in particular is based on relatively conservative assumptions, as a significant consolidation effort is projected to bring only a minor improvement in the headline deficit.

According to the convergence 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. The share of short-term debt is expected to increase to 24.4% in 2015 with the average debt maturity remaining slightly above five years. The share of debt denominated in foreign currency remains low (8% of the overall debt in 2011), which limits the exchange rate risk. Overall, the debt management strategy is broadly appropriate in the current circumstances. Since the debt-to-GDP ratio will remain below the reference rate over the programme period, the debt reduction benchmark is not applicable.

Long-term sustainability

With regard to the sustainability of public finances, the long-term change in age-related expenditure is above the EU average. The initial budgetary position compounds the long-term costs. Assuming no policy change, the public debt ratio would increase to 47% of GDP by 2020. However, full implementation of the programme would put debt on a downward path by 2020. The focus should be on containing long-term public spending trends. Ensuring sufficient primary surpluses over the medium term and further reforming the pension system would improve the sustainability of public finances.

Fiscal framework

The current fiscal framework has been in place since 2004, when the last comprehensive reform of public finances was carried out. The main components of the current fiscal framework include fiscal targeting within the medium-term budgetary framework and an expenditure rule for central government. The medium-term budgetary framework is based on a tri-annual fiscal projection. Nominal expenditure ceilings at central government level are the only numerical and binding fiscal rule in the Czech system. However, enforcement of the ceilings is weak and the link between them and the state budget expenditure is not easily identifiable and clear. Other main weaknesses in the current framework include the limited transparency of budgetary procedures, the lack of systematic evaluation of public spending based on clear performance criteria and the limited coordination between different levels of government in the budgetary cycle.

The Czech authorities are currently preparing a reform of the fiscal framework. This envisages full coverage of the general government sector with numerical rules, introduction of a debt brake, stricter rules for local government, and establishment of a fiscal council. To this end, a constitutional law on fiscal responsibility should be presented to the government by June 2012. The specific proposals mentioned in the 2012 convergence programme have the potential to significantly strengthen fiscal discipline and address the weaknesses of the current framework if they are implemented correctly is ensured. A transition period for the debt brake may nevertheless be considered as the current debt level is already above the envisaged threshold of 40% of GDP. Moreover, it is not apparent from the proposal whether the new fiscal council would have any role in checking the independence and quality of budgetary projections. Strengthening its competence in this direction would contribute to greater transparency and would be in line with good practice.

Tax system

The tax-to-GDP ratio in the Czech Republic is relatively low in comparison with the rest of the EU. In 2010, it stood at 33.8% against the EU average of 38.4%. Revenue from indirect taxes accounts for a relatively high share of the total. This has been increasing steadily, mainly as a result of recent increases in the value added tax rates and excise duties[5]. Capital taxation is low by EU standards[6]. Labour taxation is relatively high overall and is dominated by a low personal income tax rate and comparatively high social contributions. While the tax wedge on labour is slightly below the EU average, the implicit tax rate on labour is well

[5] In 2010, the reduced value added tax rate was raised from 9% to 10% and the standard rate from 19% to 20%. Taxes on fuel, alcohol and tobacco were raised in 2010. The overall fiscal impact of these measures is estimated at approximately 0.3% of GDP.

[6] The implicit tax rate on capital has decreased steadily since 2004 and stood at 16.7% in 2010 which is 10.3 pps below the EU-25 average.

above and among the highest in the EU[7]. Preliminary data for 2011 indicate a further increase in the tax wedge in the Czech Republic.

The country-specific recommendation on taxation invited the authorities to 'continue efforts to exploit the available space for increases in indirect tax revenue to shift taxes away from labour'. In autumn 2011, the authorities approved an increase in the reduced value added tax rate, an increase in excise duties on tobacco and a new tax on lottery companies, all with effect from 1 January 2012. Significant changes to the tax system are planned over the period 2013-2015 (see Box 2).

Box 2 — Main changes to the tax system envisaged in 2013-2015

Labour taxation

Labour taxation will undergo major changes in 2013 and 2014. In autumn 2011, the Czech Parliament approved a comprehensive tax reform, which should enter into force in 2014. The reform overhauls the current concept of the 'super-gross' wage[8], introduces a flat tax of 19% of the gross wage and adjusts the social contributions and health insurance rates for both employees and employers. The reform will also affect the tax base, the tax rate and the minimum social security contributions for the self-employed. However, the framework for lump-sum deductions[9] will remain unchanged. Beyond that, the reform includes the removal or limitation of several tax exemptions and tax deductibles, which should simplify the tax system and broaden the tax base (e.g. interest payments on mortgages will remain tax deductible but the cap will be lowered significantly from CZK 300 000 a year to CZK 80 000).

On top of the agreed tax reform, the convergence programme envisages further changes in the new consolidation package approved by the government in April 2012. The package should remain in force only in 2013-2015 as the measures are supposed to respond to current consolidation needs due to the crisis. The main measures include removal of the basic tax allowance for employees (originally introduced in the tax reform), introduction of a temporary 7 percentage point additional personal income tax surcharge for high-income earners, limitations to tax deductibles for the self-employed and a temporary increase in the personal income tax rate from 19% to 20%.

The combined effect of the tax reform and of the new temporary consolidation package on public finances in 2013-2015 is likely to be positive. Labour taxation is thus expected to increase somewhat over the programme period and decrease thereafter if the consolidation package is withdrawn as planned.

Value added tax and excise duties

The temporary consolidation package envisages a 1 pp increase in both the standard and the reduced value added tax rates to 15% and 21% as of 2013. The previous plan to unify the two value added tax rates at 17.5% would thus be postponed to 2016. The package also proposes several changes to excise duties (e.g. introduction of a carbon tax and a wine tax, further increase in taxes on tobacco and a reduction of exemptions from excise duties on certain commodities)

Other taxes

The tax reform mentioned above encompasses changes to inheritance and gift taxes. It will also introduce some changes to the corporate income tax base (such as tax deductibility of dividends). Apart from that, the consolidation package envisages an increase in property transfer tax by 1 pp.

Single collection point

[7] The tax wedge for the average wage earner reached 42.2 % in 2010 when the EU average was 43.4%. On the other hand, the implicit tax rate on labour stood at 39 % in 2010 compared with an EU average of 36 %.

[8] The "'super-gross"' wage is defined as the gross wage plus the part of social contributions which is paid by employers. The personal income tax is currently set at 15% of the super-gross wage.

[9] The self-employed in some professions can deduct up to 80 % of their expenses as a lump-sum deduction.

The introduction of the single collection point for public revenue (integrating several revenue collection bodies) is an important part of the tax reform. It will be introduced over several years and should be finalised in 2014.

Nevertheless, several issues that limit the efficiency and equity of the current tax system have not been addressed fully. The current system of labour taxation is regressive. The 2008 tax reform introduced a flat tax which, together with the ceilings on social and healthcare contributions, implies a decreasing effective tax rate for high income-tax payers. The introduction of the second tax bracket would be a step towards addressing this issue but its implementation is not yet certain and the measure is planned to be only temporary. Furthermore, the tax wedge on low-income earners, while not excessively high by EU standards[10], could be lowered considering the relatively high unemployment rate among low-skilled workers, which forms a barrier to hiring.

Another important issue is the difference in tax treatment between employees and the self-employed, who are entitled to a significantly lower effective tax rate than employees. This difference is further exacerbated by generous rules on tax deductibility. The current system creates perverse incentives for employers to hire de facto dependent employees as self-employed. Furthermore, it severely reduces the tax revenue obtained from a large group of taxpayers[11]. Limiting the use of lump-sums and tax deductibles for the self-employed, as proposed by the consolidation package, is a step in the right direction. However, more significant changes would be needed to reduce the differences between employees and the self-employed further.

While consumption already bears a significant part of the overall tax burden, property tax is still only a modest source of revenue. The recurrent tax on immovable property almost doubled in 2010, but nevertheless revenue from it as a percentage of GDP is still the fourth lowest in the EU. There is some geographical differentiation in the tax base but it does not take sufficient account of differences in the value of property. Other possible revenue sources include environmental taxation which, with the exception of transport fuel taxes, is currently very low[12]. Taxes on pollution and resources that can provide incentives to improve resource efficiency play a marginal role in the Czech Republic, in particular in the case of the landfill tax. The government currently plans to introduce a carbon tax, cancel the oil tax subsidy for agricultural producers and remove the tax exemption on natural gas used for heating. If implemented, these measures would contribute to reducing the existing distortions and provide additional revenue.

In response to the recommendation to improve tax compliance and reduce tax evasion, the government adopted plans for the progressive establishment of a single collection point for public revenue as an important element of the 2011 tax reform. This, together with new measures introduced during 2011 to combat fraud in value added tax and fuel taxes, will have a positive effect on tax compliance. However, further efforts will be needed. The Czech authorities expect the single collection point to bring substantial reductions of administrative

[10] At 38.9% the tax wedge on low-income earners (67% of the average wage) was below the EU average of 39.8% in 2010. It increased to 39.5% according to the preliminary data for 2011.

[11] The share of self-employed in total employment has been increasing since 1995 and stood at 19% in 2010. The tax revenue from the self-employed has decreased dramatically, particularly since 2008 when the last major changes to the tax system were enacted. It generated only 2.2% of the total personal income tax revenue in cash terms in 2011 after it had still been around 12% in 2008.

[12] Revenue from environmental taxes equals 2.5% of GDP which is close to the EU average of 2.6%. However, environmental taxes other than transport fuel taxes (i.e. other energy taxes and transport and pollution/resources taxes) make up only about 10% of the total according to statistics from 2009.

costs for tax collection authorities and of compliance costs for taxpayers[13] but the savings may well turn out lower than expected. Full harmonisation of the tax and social security legislation has not been accomplished and the significant number of changes proposed to the tax system in a relatively short period of time is likely to create additional compliance costs, increase the overall complexity and reduce predictability and legal certainty for taxpayers. Improving tax compliance in a rapidly changing environment will thus remain a significant challenge for both the tax authorities and taxpayers. Moreover, the current tax collection system is not based on an articulated and comprehensive tax compliance strategy enabling the authorities to use the available resources more effectively and efficiently.

Pension reform

In order to improve long-run fiscal sustainability, the government implemented a reform of the public pension system in 2011, which is expected to reduce its deficits from more than 4 % of GDP to around 2.5 % during the period of greatest financing pressures (2045-2055). Parliament also approved the introduction of a new voluntary funded scheme with effect from 2013[14], together with an overhaul of the existing pension savings scheme. The latter measure aims to increase the level of private contributions but also strengthens the accounting transparency of pension funds and, de facto, ends the obligation on private pension funds to achieve non-negative returns, which has induced very conservative investment strategies yielding real returns close-to-zero over the last ten years.

When assessed jointly, these reforms encompass relevant responses to the challenges of restoring fiscal sustainability and increasing the level of retirement savings. However, despite some considerable progress, the component of the S2 sustainability indicator that reflects the pension liabilities related to ageing is still high[15]. Therefore the latest reform of the public pension system does not fully address this challenge. The Council Recommendation to link the enacted increases in the statutory retirement age directly to life expectancy was not explicitly addressed in the 2011 package. The pension eligibility age in the Czech pension system is set to increase by two months (and more) per cohort of birth without any pre-defined limit[16], which would increase the pension age quickly from the current situation where men are allowed to retire at about 62 and women at 61. However, the absence of any clear and direct link to life expectancy exposes the system to the risk of under- or over-reaction to future changes. The increase in the pension age has not been underpinned by adequate workplace and labour-market measures to raise the effective retirement age.

The capacity of the new funded scheme to contribute to higher average pensions in the future depends on the share of workers who join it and the expected rate of return over the long run. No measures have been announced to stimulate participation; most estimates are based on the assumption of a fairly low opt-in rate of around 15 % of workers. Regarding returns, there is a risk that many participants would, at least initially, choose the conservative scheme investing in state debt (there are four types of investment strategies in all), which offers a low average real return and does not diversify the country risk, but does come with an implicit state guarantee. Given the low levels of financial literacy, establishing a default option that would encourage the take-up of more risk early in the saving phase would help to increase the chances of higher returns over the full cycle of pension build-up. The envisaged

[13] The 2012 Doing Business report by the World Bank and the PWC Paying Taxes 2011 report highlight the heavy tax compliance burden for firms in the Czech Republic.

[14] Both these measures were described in detail in the 2011 Commission Staff Working Document.

[15] The S2 indicator for the Czech Republic stands at 4.9 % of GDP compared with the EU average of 2.9 %, of which the long-term component accounts for 3.8 pps (compared with 2.3 pps in the EU). The latter is driven mainly by pension expenditure (1.9 pps) and health and long-term care (1.6 pps).

[16] The increase in the retirement age for women is faster and depends on how many children they have.

administrative cost of the new funded scheme is broadly in line with established international practice.

One major issue related to the credibility and ambition of the reforms to achieve both an effective increase in the retirement age and adequate pensions is the new early retirement scheme recently proposed by the government as a policy to mitigate the impact of the relatively fast increase in the pension age, offering an alternative to the publicly funded early retirement[17]. Under this scheme, individuals with a given level of savings in the pension savings scheme would be allowed to withdraw them and retire up to five years before the statutory age. The net effect of the scheme on public finances is ambiguous. Lower pension disbursements to those who use their own savings to retire early would be compensated by additional health contributions paid for these persons from the state budget (as for all pensioners) while there would be a loss in social contributions and income taxes. Moreover, if savings are depleted during early retirement, they cannot contribute to higher pensions in the later phase, thus weakening the rationale for the reform of the pension savings scheme. Such a policy not only runs counter to the life-long learning strategy and other efforts made to extend working lives, but also is explicitly discouraged by the Annual Growth Survey for 2012.

3.2. Financial sector

The Czech financial sector has remained stable, showing favourable values for key macro-prudential indicators. Banks remain profitable, well capitalised and liquid with a loan-to-deposit ratio well below 100 % (see Table VII). The capital adequacy ratio remained above 15 % in 2011. The crisis-related increase in credit risk translated into a moderate deterioration of asset quality with non-performing loans still below EU averages. Priced-in sovereign risk is limited and has even diminished since 2009 in the context of low and steady external debt and the stable credit rating of the Czech government debt. Although most of the banking sector is foreign-owned, exposure to the parent banks was less than 15 % in 2011, below the 25 % limit set by the Czech National Bank. The Czech National Bank recently improved bank reporting requirements and supervises transactions between parents and subsidiaries, as Czech banks as a whole remain net creditors to their parent banks.

While the domestic financial sector remains healthy and liquid, the weaker economy and increased credit risk have also affected access to finance for the real economy. In 2011, the growth of bank loans to the private sector slowed down (2.4 % vs. 9.2 % in 2010), as did growth of lending for house purchases (3.7 % vs. 12.6 % in 2010). Access to finance remains one of the main concerns highlighted by Czech businesses, especially in the early stages[18]. With an underdeveloped stock exchange and venture capital market, equity financing remains very limited and the real economy effectively depends on financing provided by banks or foreign owners. Instruments such as seed and venture capital funds are currently being prepared but are still not operational in the Czech Republic[19]. In this regard, the national reform programme contains a welcome reference to the government's recent approval of a seed/venture-capital fund aimed at supporting the creation of new small and medium enterprises and the development of innovative and technologically oriented companies.

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[17] Only workers in manually demanding professions were originally intended to have access to this scheme but this restriction has been dropped.

[18] According to the December 2011 ECB-Commission survey on access to finance for small and medium enterprises the proportion of rejected loan applications in the Czech Republic was higher than the EU average in 2011 and the loan application situation deteriorated between 2009 and 2011.

[19] The European Private Equity and Venture Capital Association estimates that the share of investment in seed and start-ups as a percentage of GDP is lower than the EU average in the Czech Republic.

3.3. Labour market, education and social policies

The labour market has proved quite resilient to the current period of low growth. During the last two years the employment rate rose to 70.9 % in 2011. The overall unemployment rate is below the EU average and that of men (5.5 %) is, in fact, the fourth lowest in the EU. However, women with children and other vulnerable groups struggle to realise their potential on the labour market. Youth unemployment (18 % in 2011) is still below the EU average but has been hit hard by the crisis and has almost doubled since 2008. From a broader perspective, growth in labour productivity per person employed is falling behind some of the Czech Republic's regional peers, which points to the importance of education reform in order to achieve further real convergence.

The government has adopted a set of measures (effective as of 2012) in order to stimulate labour demand and increase the flexibility of the labour market. The key measures include linking severance pay to the length of service and easing the rules for temporary contracts and occasional work. These steps are relevant responses to the priorities identified by the Annual Growth Survey for 2012, as they support labour market turnover and therefore lower the incidence of long-term unemployment, especially amongst young and/or low-skilled people[20]. However, there are segments of the labour market that could provide direct opportunities for improving employment which, as discussed below, have not been fully addressed by recent reforms.

In response to the 2011 recommendation, which invited the Czech Republic to increase the labour-market participation rate of women with children, the government has enacted two reforms, both of which came into force in January 2012. First, it increased the flexibility in drawing the parental allowance. Most parents are now able to choose the level of the monthly allowance out of a given total sum (which means that the length of support is also implicitly chosen). Previous limits on combining the allowance with formal childcare have been lifted for children above the age of two. For younger children, a monthly total of only 46 hours spent in crèches is permitted without losing the allowance. Lifting this constraint will become meaningful once there are an adequate number of places in crèches. Second, the government eased the technical and legal conditions for setting up company-based kindergartens. This is seen as a first step in a broader effort to increase the supply of (private) childcare facilities which, alongside the long maximum duration of parental leave and the low take-up of flexible working arrangements[21], is the main barrier to a faster return of mothers to employment[22]. The planned reform aims to introduce private 'child groups' led by professional nannies and includes new tax subsidies both for families to be able to take up this form of care and for companies to cover the initial cost of setting up crèches and kindergartens.

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[20] Other measures are aiming to raise extra tax revenue or reduce unemployment expenditure. For instance, the reform aims to curb false self-employment by increasing the cost of non-compliance for the shadow employer (e.g. penalties have been drastically increased and the definition of false self-employment has been made clearer). The rules for granting unemployment benefits have also been tightened by introducing the possibility of compulsory public work for groups of unemployed identified by labour offices and a reporting requirement for those suspected of working while on benefits.

[21] Only 5.3 % of Czech employees work part-time, compared with the EU average of 15.9 % (Q4 2011). According to 2009 Eurostat data, 64 % of children older than three attended formal childcare (the EU average is 84 %) while the proportion for younger children was only 3 % (compared with 27 % in the EU-27). The Institute of Health Information and Statistics of the Czech Republic reports that there were only 46 crèches in the whole country in 2010.

[22] The unemployment rate for women was 2.1 pps higher and their employment rate 18.0 pps lower than that of men in Q4 2011. Both gaps were amongst the largest in the EU. The gender pay gap was 26 % in 2010, compared with the EU average of 16 %. The share of population at risk of poverty or social exclusion is currently 13.7 % for women aged over 65 but only 5.3 % for men.

These reforms are relevant contributions to addressing the challenge. The key problem, however, is that the reforms do not go far enough to allow most workers to return to jobs faster after parental leave. First, low- and middle-income parents pay hardly any personal income tax, so they are unlikely to benefit from the extension of tax relief and the greater availability of childcare facilities unless they work for large companies, which are more likely to set up company-based care. Given the inadequate supply of institutional childcare and pre-primary facilities, the reform does not provide adequate incentives to meet the 2002 Barcelona European Council commitment to provide childcare and pre-school facilities to at least 90 % of children between three years old and the mandatory school age and to at least 33 % of children younger than three by 2010. Second, the emphasis on quality of care is mentioned in the national reform programme but, according to the information provided by the Ministry of Labour and Social Affairs, childcare practitioners will not be required to have relevant qualifications for working with children. This is a step back compared with current standards in pre-primary education in terms of building human capital and a lost opportunity for improving the future employment opportunities for children from disadvantaged families. The 2011 recommendation on participation in the labour market also invited the government to increase the availability of part-time jobs but no specific measures have been taken in this direction. Since women with children are the typical holders of flexible jobs in other Member States, greater availability of childcare is a pre-condition for progress in this area.

Several measures have been implemented in line with the 2011 recommendation on the performance of the public employment service. Regional labour offices have been placed under the responsibility of a new central labour office and, as part of a broader social benefits reform, responsibility for payments of non-insurance social benefits, together with staff, have been transferred from the municipalities to labour offices with effect from January 2012. However, the increased workload which this implies will put further strain on the staff of the public employment service, whose number declined by 12 % in 2011, and the quality of services. Incentives to seek work have been strengthened and jobseekers can now be required to participate in public works after two months on the register or face deregistration if selected by the labour office. In 2011, jobseekers faced a higher probability of being removed from the labour office register for non-compliance with registration conditions than of being placed in a job by caseworkers[23].

To improve placement services and reduce the workload of the public employment service, a system for outsourcing employment services to private agencies was introduced in 2011. Based on the information provided by the authorities, contracts will be allocated through public procurement and jobseekers will be randomly assigned to agencies which have been awarded contracts. However, no information is available on whether broad participation in competitions for the contracts and systemic evaluation of each agency will be ensured. A large part of the fee is paid upfront to the private provider and only a very small part of the agency fee[24] is linked to the duration of the placement.

Both the expenditure on active labour market policies and the share of participants in regular activation measures is particularly low in the Czech Republic. While a reform of the active labour market policy was adopted in 2011, progress on implementation of the 2011 recommendation on increasing the quality and effectiveness of activation programmes has been limited. The conditions for the programme have been made stricter to limit abuse, in particular of support for the disabled, and jobseekers can now select their training programme from a list of accredited schemes. That said, no additional funding has been allocated to

[23] In 2011, the number of jobseekers who were removed from the register for refusing work or failing to fulfil other conditions was 85,400 while the number of actual placements was only 58,800.

[24] Currently just a small part of the fee (CZK 500) for the agency is awarded only if jobseekers remain employed for longer than six months.

training programmes and no substantial training programmes have been introduced that would cater for specific needs and effectively target older workers, young people, low-skilled workers and other vulnerable groups. No progress has been made in linking funding of active labour market policy programmes to results. A number of studies evaluating activation programmes data for 2007 were produced for the Ministry of Labour and Social Affairs, but there has been no systematic evaluation of the net impact and expenditure efficiency which would feed into the policy-making process. Furthermore, ongoing and planned cuts in the funding of regular data collection activities by the Statistical Office[25] are having an adverse effect on the quality of the data available for policy-oriented empirical research to drive policy-making.

In order to counter the expected slowdown in potential growth, the Council recommended that the Czech Republic improve the performance of tertiary education, with upgrading of the quality evaluation system seen as the first step necessary. Currently quality evaluation is done ex ante: each study programme (there are about 8,000 of them) is accredited based on a set of minimum standards but what happens after accreditation is not systematically followed up. A link has been introduced between the budget of each higher education institution and a set of quality indicators in the current system of funding, primarily to mitigate the funding pressures stemming from the growing numbers of students. The link is, however, fairly loose and there is no clear evidence that it has an impact on improving the quality of output.

Over the reporting period, but partly building on earlier proposals, the government responded to the recommendation with a complex reform of tertiary education. It aims, as of 2013, to enhance the accreditation system, differentiate between higher education institutions, adjust their governance structures and strengthen the link between results and funding. Clearer profiling of higher education institutions providing first degrees or higher qualifications is expected to improve the quality and employability of first-degree graduates[26]. The current draft framework law is, in principle, relevant and ambitious. However, greater emphasis on systematic data collection and analysis for use in the public debate would bolster the reform, which faces strong opposition from the academic community and has again been delayed.

Regarding compulsory education, the results of the PISA (2009) survey point to a worsening of the achievements of Czech pupils in all areas tested[27] and suggest that schools are failing to bridge the gaps associated with pupils' socio-economic background. In 2011, the government took steps to tackle both these issues: the share of pupils progressing to selective schools is set to decrease gradually and minimum standards for learning outcomes are being developed. Basis on this, the plan is to launch a nation-wide computer-based testing of all 10 and 14 year-old pupils in 2014. While the first measure is a particularly pertinent response, the other one is only partly relevant. First, compulsory testing based on minimum learning standards targets a problem that, given the good performance of Czech schools according to the early school-leaving indicator, is already addressed by existing policies. It is, however, unlikely to stimulate additional quality. Second, computer-based testing is known to be too narrow to assess progress on many competences that are the key to smooth integration into the labour market. This is particularly the case when it is not embedded in a wider, improvement-oriented framework that would define the expected performance standards and integrate evaluation policies at the key levels: system, school, teacher and pupil[28].

[25] The data sources include the Labour Force Survey, the EU-SILC and the household budget survey amongst others.

[26] The pass-through rate to the second degree is very high at 85%, which is also due to the system of financing of higher education institutions which is predominantly based on head count.

[27] Mainly in reading literacy, where the Czech Republic ranks as the 7th worst-performing Member State.

[28] See also the 2012 OECD Review on Evaluation and Assessment Frameworks for Improving School Outcomes.

Finally, the level of public expenditure on education is below the EU average (4.8 % of GDP in 2010, compared with 5.5 % in the EU) and the gap is widest in primary and pre-primary education, where the below-average supply of pre-primary education facilities is a major explanatory factor. Expenditure on tertiary education (about 1.0% of GDP) is around the EU average and has been stable in recent years. This masks a growing substitution between funding provided directly from the state budget and resources channelled through EU funds. Because of this substitution, centres of excellence, which are mostly located in the Prague region and therefore out of reach of most EU funding programmes, face constraints on the amount of predictable and sustainable funding. In the longer term, this could undermine the build-up of human capital and the transition to a knowledge-based economy. In addition, modernisation of the whole education system might be affected in the near future by the slow absorption of EU funds under the Operational Programme on Education.

The share of the population at risk of poverty or social exclusion remained the lowest in the EU at 14.4 % in 2010. The social reform implemented in 2011 aimed at increasing the effectiveness of social transfers and at targeting people in real need better. The 2012 national reform programme identifies employment policy as the most effective tool for reducing poverty and sets objectives in additional areas such as inclusive education, social services, financial literacy, affordable housing and support for social inclusion. However, the measures planned lack sufficient detail allowing a sound impact assessment.

The statistical coverage of socially excluded communities in the Czech Republic is limited. Nevertheless, Roma account for up to 80 % of the population of these communities and face significant barriers to better integration[29]. Inactivity rates of Roma are estimated to be very high and entrenched with close to 40 % of the working-age population describing themselves as unemployed. Access to education for marginalised Roma is limited, as only one in every three children attends kindergarten or other pre-school facilities, and the education system fosters segregation through the widespread practice of putting Roma children into sub-standard schools designed to cater for the mentally challenged. Estimates suggest that one third of Roma children are educated in such sub-standard institutions[30], limiting their chances of integration into the labour market. In 2009, the government adopted the Roma Integration Plan for 2010-2013, which outlined education, employment, healthcare and housing measures to improve inclusion. However, the Plan lacks quantified targets and implementation deadlines and does not put sufficient emphasis on early education and desegregation measures in education.

3.4. Structural measures promoting growth and competitiveness

Indicators of cost competitiveness point to no serious concerns for the Czech economy in the short term. Labour productivity has been constantly improving although not as rapidly as in some other regional peers. The real effective exchange rate has appreciated strongly over the last decade, driven mainly by increasing unit labour costs. However, to a certain extent, this is a natural development for catching-up countries and in the Czech Republic it has not hindered the considerable improvement in export performance so far. Hence, there appears to be no evidence of any structural deterioration in price and cost competitiveness. Looking towards the future, factors such as the institutional framework, the quality and availability of infrastructure, energy policy and innovation performance will increasingly determine the feasibility of improving the competitive position of the Czech economy.

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[29] Gabal, Analysis and Consulting (2006): Analysis of socially excluded Roma localities and capacity of subjects active in this area.

[30] Czech School Inspection Report (March 2010) on Summary Findings from the Thematic Control Activity in Former Special Schools.

Research and innovation

In 2010, public R&D investment spending was 0.63 % of GDP, approximately the same level as in 2007, one of the lowest in the EU. On top of that, the Czech Republic does not fully use the EU funds available for R&D investment since implementation on the ground is significantly delayed which might result in de-commitment of funds. The Czech Republic is performing relatively well on business expenditure on R&D, which stood at 0.97 % of GDP in 2010, largely thanks to a strong manufacturing sector with marked specialisation in innovative sectors. However, business expenditure on R&D is highly concentrated in a few multinational corporations that account for 60 % of all private R&D investment and the level of private R&D performed by domestic companies is still rather low.

Progress towards the main R&D and innovation objectives identified in the 2011 national reform programme over the last year has been mixed. Two strategies (the International Competitiveness Strategy for 2012-2020 and the National Innovation Strategy) were adopted with the aim of underpinning the importance of innovation as a source of competitiveness for the Czech economy. At the same time, a new and more targeted set of national R&D and innovation priorities is being defined and will be submitted to the government by the end of June 2012. The approval of the tax reform[31], tax incentives for R&D activities contracted out to universities and research organisations and the creation of a seed and venture capital fund (co-funded by the European Regional Development Fund) are further steps in the right direction. On the other hand, implementation in other areas has been rather slow. No concrete steps on how to achieve the national target for public R&D investment of 1 % of GDP are outlined in the 2012 national reform programme and the medium-term budgetary framework envisages no increase in public R&D funding until 2014. The governance of the national research and innovation system would benefit from better coordination and clarification of the roles of the different government players, as well as from closer cooperation between public, academic and private circles. While the 2012 national reform programme acknowledges this problem, it provides no concrete measures to address it.

Similarly, the evaluation of R&D results and the mechanism for allocating public R&D funds have been a recurrent problem for many years, with the current system resulting in inefficiencies, misdirected incentives and insufficient quality of the scientific and technological output. A new methodology for evaluating R&D performance is being prepared but this process is rather slow considering its crucial importance for raising research quality and attracting R&D investment from both Czech and foreign businesses. A closely related issue is the inadequate cooperation between research and businesses. Some progress in this regard is expected from the Competence Centres, which are to be introduced for medium- to long-term projects.

Energy, climate and resource efficiency

The Czech Republic has one of the highest rates of greenhouse gas emissions intensity in the EU, due to the high energy intensity and an unfavourable fuel mix (high carbon dependence in particular). Energy supply accounts for roughly 50 % of greenhouse gas emissions, and more than 85 % of all greenhouse gas emissions stem from coal. Effective transformation of the Czech economy would, most of all, require significant energy-efficiency improvements across all sectors and a substantial shift in the fuel mix towards lower-emission energy sources and technologies.

Based on the latest projections, the Czech Republic is expected to meet its greenhouse gas emissions target, limiting the increase of greenhouse gas emissions to 9% (compared with 2005), without any need for additional policies or greater flexibility. In spite of this positive

[31] See Box 2 for a more detailed explanation.

trend, there is still significant untapped emission reduction potential. Progress has been made in several areas over the last year, notably with the approval of the Clean Air Act during the first quarter of 2012 and the adoption of the Second National Energy Efficiency Action Plan in August 2011, which envisages large savings in the household sector, particularly through improvements in the energy efficiency of buildings supported from both national and European funds. However, several policy developments referred to in the 2011 national reform programme are still suffering from delays. Adoption of the key strategy paper outlining the government's long-term energy policy has been postponed and is now expected to take place later this year. Furthermore, in the absence of a clear long-term energy strategy, the Czech Republic has not yet set its energy efficiency target under the Europe 2020 Strategy.

The National Renewable Energy Action Plan outlines the current and future measures and sets sectoral targets for promoting energy from renewable sources. In this context, the capacity of the electricity grid in the Czech Republic to cater for increases in renewable energy generation from both domestic and foreign sources remains a cause for concern. Smarter grids are a precondition for greater penetration of renewable energy and further improvements in energy efficiency. Some measures have been taken recently to address this issue, including increased smart metering and a pilot regional smart grid project. Nonetheless, considerable further efforts will be needed in order to attain the targets. In addition, the framework to support renewable energy is subject to frequent changes, which has a negative impact on predictability and legal certainty for investors.

The Czech Republic currently landfills 68 % of its municipal waste while recycling only 15 % and incinerating 16 %. Despite an encouraging increase in recycling/composting rates, it is unlikely to meet the recycling target of 50 % by 2020 without substantial investment. Landfill taxes are very low and thus do not effectively support the waste hierarchy or contribute to resource efficiency. An amendment raising the dumping fee at landfills is currently being prepared by the Ministry of the Environment.

Transport

One of the bottlenecks to growth is the need to improve transport infrastructure, increase its capacity and quality and offer more effective interconnections between all forms of transport. The rail network is one of the densest in Europe, but the quality remains low, partly due to the lack of intermodal logistics centres linking railways with other modes of transport. The infrastructure needs renewal and maintenance, and the effective speed on the main lines is not competitive with road transport. There has been gradual liberalisation of the railway sector with a new competitor entering the market. The 2011 national reform programme includes a commitment to draft a Czech transport policy for the period 2014-2020. This policy is being prepared and should be submitted for government approval before the end of 2012. Although the 2011 national reform programme outlined an ambitious list of rail and road projects, including investment in two public intermodal centres, very little progress has been made, also due to the recent cuts in infrastructure expenditure (most of the resources were channelled through the EU funds).

3.5. Modernisation of public administration

Evidence[32] suggests that there is still ample room for improving the efficiency of public administration, despite recent improvements in some areas. Key problems highlighted in

[32] The DG REGIO study 'Quality of government in EU Member States and regions' (2010) classifies the Czech Republic in the group of Member States with the lowest quality of governance. The country ranks 57th in the Corruption Perception Index published by Transparency International and 62nd in the Doing Business report

many surveys and reports include excessive bureaucracy, corruption, low enforceability of law, frequent changes in the legal framework and inefficient public spending. High staff turnover is one of the main hurdles for attaining stability and effective public administration.

The 2011 recommendation on public administration specifically mentioned the need to speed up implementation of the government's anti-corruption strategy. Overall, there has been some progress in this respect. In particular, the government adopted a draft law proposal on widening the supervision of the Supreme Audit Office to municipalities and state-owned enterprises, an amendment to the Penal Code or a new law on financial supervision in public administration. The adoption of an amended Public Procurement Act (in force since April 2012) has been the main achievement of the strategy in the past year. It includes modifications that should result in greater transparency and reduce the scope for corruption. Nevertheless, proper enforcement and implementation will be crucial for the credibility and effectiveness of the public procurement reform. It is therefore necessary to put in place appropriate monitoring mechanisms to review progress, boost the administrative capacity of the Office for Protection of Competition and set clear deadlines for its decisions.

Progress on other issues outlined in the 2011 recommendation on public administration has been rather limited. Adoption of the Public Servants Act, which is a crucial prerequisite for a stable, more transparent and professional public service, has been postponed numerous times, having a significantly negative impact on the implementation of the EU Funds in the Czech Republic. A new draft act should be presented to the government in September 2012 but its entry into force is not foreseen before 2014. Adoption of this act will also be one of the ex-ante conditions for use of the EU Funds in the new programming period 2014-2020.

The issue of anonymous shareholding[33] highlighted in the 2011 recommendation on public administration has not been fully addressed yet. The existence of anonymous shares was identified as encouraging corruption and leading to conflicts of interest in tendering procedures, also in relation to use of the EU Funds. Abolition of anonymous shares was originally scheduled in 2012 but was not approved by the Czech Parliament. A new act currently being prepared to increase the transparency of legal entities is expected to enter into force in 2013 at the earliest. A transition period will be provided for companies to register all outstanding shares until 2014.

Irregularities in public procurement and sub-optimum functioning of the management and control systems for public administration have been the main sources of problems with implementation of the EU Funds. In the course of 2011, payments from several Operational Programmes were interrupted by the European Commission. In March 2012, a letter warning of suspension of all Operational Programmes financed from the European Regional Development Fund and the Cohesion Fund was sent to the Czech authorities. Subsequently, an action plan outlining specific steps which need to be taken before the end of June 2012 in order to avoid the suspension was agreed between the Commission and the Czech authorities.

The efficiency of contract enforcement in the Czech Republic is relatively low[34]. The 2011 national reform programme mentions several legislative and non-legislative measures, such as adoption of a new Civil Code and modernisation of the Commercial Code. The 2012 national reform programme also refers to the enactment of a new registry law aimed at simplifying

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published by the World Bank. The WEF Global Competitiveness Report 2011-2012 also classifies the Czech Republic as one of the worst performers with respect to irregular payments and bribes.

[33] The Czech Republic is one of the few countries in the world allowing a unique type of company ownership — anonymous shares in paper form. Ownership of companies issuing anonymous shares is often not fully transparent which poses a problem in public procurement procedures.

[34] The 2012 Doing Business report issued by the World Bank ranks the Czech Republic 22nd in the EU with respect to enforcing contracts, with resolution of an average commercial dispute taking 611 days.

registry proceedings. Effective implementation of these measures will be crucial to improve the efficiency of contract enforcement.

Business environment

Some progress has been achieved in the area of e-government (co-funded by the European Regional Development Fund) and administrative burdens. The 2012 national reform programme also outlines additional measures in this area. In 2010, 91% of businesses and 22% of citizens were using e-government services. All basic administration registers are currently being tested and will be fully operational in July 2012. The government's target of reducing administrative burdens by 25% by 2012 might not be fully achieved but good progress has been made over the last year. The Czech Republic is still one of the worst performers in the EU with respect to the ease of starting up a business[35]. Some steps have been taken to eliminate the minimum capital requirements and to simplify registration procedures but achieving the target of three days for the start-up time by 2012, as set by the Competitiveness Council in May 2011, is highly unlikely. In addition, the Czech Republic scores badly on payment culture[36] (i.e. long payment times, delays in payments in both the public and private sectors and high payment losses). The Late Payment Directive, which aims to improve the payment situation in the EU, is currently being transposed into Czech legislation and should enter into force in 2013. Additional restrictions remain in the form of specific legal form requirements for lawyers, shareholding requirements for engineers and architects and authorisation requirements for incoming service providers such as tax advisers and land surveyors.

[35] For further information: see http://ec.europa.eu/enterprise/policies/sme/business-environment/start-up-procedures/progress-2011/index_en.htm

[36] The Czech Republic scores among the worst-performing countries in the 2011 European Payment Index. Average delays in payments by both the public and private sectors increased from 10 to 13 days in 2010 to 15 to 17 days in 2011.

4. OVERVIEW TABLE

2011 commitments	Summary assessment
Country-specific recommendations (CSRs)	
CSR 1: Implement the planned consolidation in 2011 and take countervailing measures of a permanent nature as needed in case of any revenue shortfalls or expenditure slippages. Adopt fiscal measures as planned in the convergence programme for 2012 and underpin the target for 2013 by more specific measures; subject to this, avoid cutting expenditure on growth-enhancing items. Improve the efficiency of public investments, and continue efforts to exploit the available space for increases in indirect tax revenue to shift taxes away from labour, improve tax compliance and reduce tax evasion. Ensure an average fiscal effort over the period 2010-2013 of 1% of GDP, in line with the Council recommendations on correcting the excessive deficit, which will allow meeting the EDP deadline with a sufficient margin in 2013.	With respect to the part of the recommendation relating specifically to 2011 and 2012, the Czech authorities have adopted and implemented all the planned consolidation measures. The measures planned in 2013 on the revenue side are sufficiently specific and quantified. Some measures on the expenditure side take the form of across-the-board cuts in the central government budget. These will necessarily also affect growth-enhancing expenditure items such as education. In addition, the significant drop in public investment in the last two years likewise appears to militate against protecting growth-enhancing expenditure. The Czech authorities are counting on the significant improvements in the efficiency of public investments which should stem from the reform of public administration and the changes in the public procurement law. However, the budgeted savings will depend crucially on the actual implementation of the reforms, full details of which are not fully specified in the convergence programme. Concerning taxation, in the autumn the authorities approved an increase in the reduced VAT rate, an increase in excise duties on tobacco and a new tax on lottery companies, all with effect from 1 January 2012. Significant changes to the tax system are planned over the period 2013-2015. Nevertheless, several issues that limit the efficiency and equity of the current tax system have not been addressed fully. With respect to the tax compliance issue, the government adopted plans for the progressive establishment of a single collection point for public revenue. This, together with new measures introduced during 2011 to combat fraud in VAT and fuel taxes, will have a positive effect on tax compliance. However, further efforts will be needed. The average annual fiscal effort over the period 2010-2013 based on the recalculated structural balance adds up to 0.9%, which is slightly below the recommended structural effort of 1%.
CSR 2: Implement the planned pension reform in order to improve the long-term sustainability of public finances and to ensure the future adequacy of pensions. Additional efforts should focus on further changes to the public pillar to ensure that the system is not a source of fiscal imbalances in the future, and on the development of private savings. With a view to raising the effective retirement age, measures such as a link between the statutory retirement age and life expectancy could be considered. Ensure that the envisaged funded scheme attracts broad participation, and is designed to keep administrative costs transparent and low.	The CSR has been partly implemented. The government has implemented a reform of the public pension system, with the aim of restoring fiscal sustainability and raising retirement savings. However, the projected fiscal imbalances in the pension system are still high (relative to the EU average) and an explicit link between the retirement age and life expectancy was not included in the reform. A reform introducing a new fully funded pension scheme was approved in 2011, together with an overhaul of the existing pension savings scheme. Both reforms are planned to be implemented from 2013. These reforms are relevant responses to the

	need to ensure adequate pensions in the future but their effectiveness is limited by the lack of measures to stimulate participation in the new scheme and inadequate guidance for savers to invest in strategies with a sufficiently high average return. Moreover, the new early retirement scheme proposed by the government undermines the credibility and ambition of these reforms.
CSR 3: Enhance participation in the labour market by reducing the barriers for parents with young children to re-enter the labour market through increased availability of and access to affordable childcare facilities. Increase the attractiveness and availability of more flexible forms of working arrangements, such as part-time jobs.	The CSR has been partly implemented. An earlier return from parental leave and wider spread of part-time jobs is contingent on greater availability of childcare, 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 new forms of private childcare. However, the impact of these measures is likely to be limited to persons either employed with large enterprises and/or on above-average salaries.
CSR 4: Improve the performance of the public employment service in order to increase the quality and effectiveness of training, job search assistance and individualised services, linking funding of the programmes to results. In cooperation with stakeholders, extend tailor-made training programmes for older workers, young people, low-skilled workers and other vulnerable groups.	The CSR has been partly implemented. Since 2011 some reforms have been adopted to increase the performance of the public employment service. The public employment service was centralised to increase the efficiency of the labour office. Responsibility for payment of non-insurance social benefits was shifted to labour offices from municipalities to ensure closer coherence and cooperation between employment and social policies. The conditions applying to the social system were tightened to limit abuse and target the benefits better. These measures improved the efficiency of the public employment service but they do not address the quality and effectiveness of the labour office programmes or linking funding of programmes to results. Jobseekers have been given a choice of training programme from a selected list of accredited programmes to strengthen the labour market relevance of training. However, no steps have been taken to develop accredited tailor made programmes or to provide additional funding targeted at specific groups such as older workers, young people, low-skilled workers and other vulnerable groups.
CSR 5: Take the necessary measures to improve the quality of public services in areas essential for the business environment. In this context, speed up the implementation of the anti-corruption strategy in line with the identified targets, adopt the Public Servants Act to promote stability and effectiveness of the public administration and take steps to address the issue of anonymous shareholding.	The CSR has been partially implemented. There has been some progress with introducing e-government services and reducing the administrative burden for businesses. With respect to the anti-corruption strategy, 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 the credibility and effectiveness of the public procurement reform. Adoption of the Public Servants Act, which is a crucial prerequisite for a stable, more transparent and professional public service, has been postponed numerous times, which has had a significantly negative impact on implementation of the EU funds in the Czech Republic. A new draft act should be presented to the government in September 2012 but

	it is not expected to enter into force before 2014. The issue of anonymous shareholding highlighted in the 2011 recommendation on public administration has not been fully addressed yet. Abolition of anonymous shares was originally scheduled in 2012 but was not approved by Parliament. A new act currently being prepared to increase the transparency of legal entities is expected to enter into force by 2013 at the earliest.
CSR 6: Establish a transparent system of quality evaluation of academic institutions and link it to its funding in order to improve the performance of tertiary education.	The CSR has been partly implemented. The government has introduced a set of quality indicators but its link to funding is fairly loose and there is no clear evidence that it has an impact on improving the quality of output. The government has also proposed new measures that are relevant to improving the performance of higher education institutions. The proposal is, however, vague on the key issue of quality evaluation standards and, given the absence of systematic data collection and analysis, lacks the support of the academic community. No measures have been adopted yet.
Europe 2020 (national targets and progress)	
Employment rate target: 75 %	The employment rate reached 70.9 % in 2009, 70.4 % in 2010 and 70.9 % in 2011. Some progress has been made towards this target, although it is too early to judge which part of the improvements posted in 2011 is due to the strong cyclical component and which due to policies.
R&D target: 1 % of GDP (public sector only)	Gross domestic expenditure on R&D (as a percentage of GDP) stood at 1.48 % of GDP in 2009 and 1.56 % in 2010. The share of government expenditure on R&D stood at 0.63 % of GDP in 2010, approximately the same level as in 2007. No progress has been made towards this target.
Greenhouse gas (GHG) emissions target: +9 % (compared with 2005 emissions, ETS emissions are not covered by this national target)	Change in greenhouse gas emissions between 2005 and 2010: +0% (data correspond to the current ETS scope)
Renewable energy target: 13 % Share of renewable energy in all modes of transport: 10 %	The share of renewable energy in gross final energy consumption was 8.5 % in 2009. The share of renewable energy sources in consumption of transport fuels was 3.4 % in 2009. Last year, the Czech Republic adopted the National Action Plan for energy from renewable sources. Overall, some progress has been made towards this target.
Energy efficiency - reduction of energy consumption in Mtoe: not available	The Czech authorities have not yet set the national target for energy efficiency. The method of assessing national progress on energy efficiency is currently under discussion between the institutions in the context of the proposed Energy Efficiency Directive.
Early school leaving target: 5.5 %	The target was achieved in 2009 already (5.4 %) and the indicator further improved (to 4.9 %) in 2010, when the target was set.
Tertiary education target: 32 % of persons aged 30-34	Significant progress has been made towards this

years	target. The indicator improved from 17.5 % in 2009 to 20.4 % in 2010. Based on the high number of students currently enrolled in tertiary education, it is expected to increase further.
Maintaining the number of persons at risk of poverty or social exclusion at the 2008 level (15.3 % of the total population) with efforts to reduce it by 30 000	The number of persons at risk of poverty or social exclusion is still below the 2008 level (1.566 million) and stood at 1.448 million in 2009 and 1.495 million in 2010. Therefore the targets have been achieved for the time being.

5. ANNEX

Table I. Macro-economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012	2013
Core indicators								
GDP growth rate	2.2	3.6	5.7	-4.7	2.7	1.7	0.0	1.5
Output gap [1]	-3.1	-2.1	4.6	-1.7	-0.9	-0.8	-2.1	-2.2
HICP (annual % change)	7.1	2.5	3.2	0.6	1.2	2.1	3.3	2.2
Domestic demand (annual % change) [2]	2.6	3.5	4.2	-5.6	1.9	-1.0	-1.0	0.9
Unemployment rate (% of labour force) [3]	5.5	8.0	6.2	6.7	7.3	6.7	7.2	7.2
Gross fixed capital formation (% of GDP)	29.9	27.5	26.3	24.8	24.4	23.9	23.6	23.7
Gross national saving (% of GDP)	26.7	23.9	25.1	20.7	20.7	20.9	20.7	20.7
General government (% of GDP)								
Net lending (+) or net borrowing (-)	**-5.6**	**-5.1**	**-2.1**	**-5.8**	**-4.8**	**-3.1**	**-2.9**	**-2.6**
Gross debt	**13.8**	**25.3**	**28.3**	**34.4**	**38.1**	**41.2**	**43.9**	**44.9**
Net financial assets	**43.9**	**16.9**	**11.7**	**2.7**	**-2.3**	**n.a**	**n.a**	**n.a**
Total revenue	38.9	39.8	39.7	39.1	39.3	40.3	40.4	40.5
Total expenditure	44.5	44.9	41.8	44.9	44.2	43.4	43.3	43.1
of which: Interest	1.1	1.0	1.1	1.3	1.4	1.4	1.4	1.5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.2**	**-0.6**	**-1.5**	**3.0**	**1.6**	**0.9**	**1.6**	**1.3**
Net financial assets, non-financial corporations	**n.a**	**-95.1**	**-96.0**	**-93.0**	**-95.0**	**n.a**	**n.a**	**n.a**
Net financial assets, financial corporations	**n.a**	**-4.3**	**-4.3**	**-3.2**	**-2.9**	**n.a**	**n.a**	**n.a**
Gross capital formation	21.7	19.1	18.5	13.7	15.1	15.5	14.2	14.1
Gross operating surplus	25.9	27.8	29.4	29.2	29.0	28.8	28.4	28.2
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**5.1**	**1.4**	**0.9**	**1.5**	**0.9**	**0.7**	**0.0**	**0.0**
Net financial assets	**n.a**	**68.0**	**59.1**	**59.9**	**62.7**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	31.6	31.3	31.5	31.9	31.7	31.6	31.7	31.6
Net property income	4.9	3.8	3.7	3.5	3.2	3.2	3.4	3.4
Current transfers received	16.0	17.2	16.8	18.7	18.7	19.1	19.3	19.2
Gross saving	6.8	5.5	5.4	6.0	5.8	5.0	5.0	4.8
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.8**	**-4.2**	**-2.8**	**-1.3**	**-2.3**	**-1.5**	**-1.2**	**-1.3**
Net financial assets	**3.6**	**16.4**	**29.6**	**34.5**	**38.5**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-2.9	-1.0	2.7	4.1	3.2	4.1	4.8	5.0
Net primary income from the rest of the world	-0.9	-3.3	-5.3	-6.7	-6.7	-6.8	-6.9	-7.1
Net capital transactions	0.0	0.3	0.4	2.1	2.1	2.0	2.0	1.9
Tradable sector	54.6	55.0	54.0	51.0	50.8	51.1	n.a	n.a
Non-tradable sector	36.2	35.9	36.4	39.1	39.3	38.7	n.a	n.a
of which: Building and construction sector	7.0	6.0	6.1	6.4	6.5	6.0	n.a	n.a
Real effective exchange rate (index, 2000=100)	92.5	117.9	147.9	155.8	159.3	162.5	159.1	158.7
Terms of trade in goods and services (index, 2000=100)	102.0	103.1	100.3	100.5	97.9	95.7	95.3	94.8
Market performance of exports (index, 2000=100)	95.4	110.1	129.0	137.6	143.9	151.7	154.0	155.3

Notes:

[1]The output gap constitutes the gap between actual and potential gross domestic product at 2000 market prices.

[2]The indicator for domestic demand includes stocks.

[3]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.

Source:

Commission spring 2012 forecast

Table II. Comparison of macroeconomic developments and forecasts

	2011		2012		2013		2014	2015
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	1.7	1.7	0.0	0.2	1.5	1.3	2.2	2.8
Private consumption (% change)	-0.5	-0.5	-0.4	-0.4	0.5	0.2	2.0	2.8
Gross fixed capital formation (% change)	-1.2	-1.2	0.0	-0.5	2.1	2.1	2.8	3.2
Exports of goods and services (% change)	11.0	11.0	3.6	3.2	5.7	3.7	4.8	5.1
Imports of goods and services (% change)	7.5	7.5	2.5	2.1	5.1	2.8	4.1	4.8
Contributions to real GDP growth:								
- Final domestic demand	-0.8	-0.8	-0.6	-1.1	0.8	0.5	1.3	2.2
- Change in inventories	-0.1	-0.1	-0.3	0.3	0.0	0.0	0.2	0.2
- Net exports	2.6	2.6	0.9	1.0	0.7	0.8	0.8	0.5
Output gap[1]	-0.8	-0.8	-2.1	-1.8	-2.2	-1.9	-1.6	-0.8
Employment (% change)	0.3	0.3	-0.1	-0.3	0.2	0.1	0.2	0.4
Unemployment rate (%)	6.7	6.7	7.2	7.0	7.2	7.2	7.1	6.9
Labour productivity (% change)	1.4	1.4	0.1	0.5	1.3	1.2	2.0	2.5
HICP inflation (%)	2.1	2.1	3.3	3.5	2.2	2.3	1.9	2.1
GDP deflator (% change)	-0.7	-0.7	1.9	2.0	1.1	1.4	1.4	1.5
Comp. of employees (per head, % change)	1.6	1.6	2.0	2.5	2.1	2.9	3.6	4.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.5	-1.5	-1.2	-1.1	-1.3	-0.9	-0.8	-0.8

Note:

[1]In per cent of potential GDP, with potential GDP growth according to the programme as recalculated by the Commission.

Source :

Commission spring 2012 forecasts (COM); Convergence programme (CP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2011	2012		2013		2014	2015	Change: 2011-2015
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**40.3**	**40.4**	**40.2**	**40.5**	**40.2**	**40.4**	**40.2**	**-0.1**
of which:								
- Taxes on production and imports	11.5	12.1	12.1	12.5	12.4	12.4	12.4	0.9
- Current taxes on income, wealth, etc.	7.5	7.4	7.4	7.6	7.7	7.9	7.8	0.3
- Social contributions	15.5	15.5	15.4	15.2	14.8	15.2	15.4	-0.1
- Other (residual)	5.8	5.5	5.3	5.2	5.3	4.9	4.6	-1.2
Expenditure	**43.4**	**43.3**	**43.2**	**43.1**	**43.1**	**42.2**	**41.1**	**-2.3**
of which:								
- Primary expenditure	42.0	41.9	41.7	41.6	41.5	40.5	39.3	-2.7
of which:								
Compensation of employees	7.3	7.2	7.2	7.2	7.1	6.8	6.5	-0.8
Intermediate consumption	5.9	5.5	5.5	5.3	5.2	4.8	4.4	-1.5
Social payments	19.9	20.1	20.0	19.9	19.9	19.6	19.2	-0.7
Subsidies	2.0	1.9	1.9	1.9	1.9	1.8	1.8	-0.2
Gross fixed capital formation	3.6	3.7	3.6	3.7	3.6	3.6	3.7	0.1
Other (residual)	3.2	3.4	3.5	3.5	3.9	4.0	3.8	0.6
- Interest expenditure	1.4	1.4	1.5	1.5	1.6	1.7	1.8	0.4
General government balance (GGB)	**-3.1**	**-2.9**	**-3.0**	**-2.6**	**-2.9**	**-1.9**	**-0.9**	**2.2**
Primary balance	**-1.7**	**-1.4**	**-1.5**	**-1.1**	**-1.3**	**-0.1**	**0.8**	**2.5**
One-off and other temporary measures	-0.2	-0.3	-0.3	0.0	-0.1	0.0	0.0	0.2
GGB excl. one-offs	**-2.9**	**-2.6**	**-2.7**	**-2.6**	**-2.8**	**-1.9**	**-0.9**	**2.0**
Output gap[2]	-0.8	-2.1	-1.8	-2.2	-1.9	-1.6	-0.8	0.0
Cyclically adjusted balance[2]	-2.8	-2.1	-2.3	-1.8	-2.2	-1.3	-0.6	2.2
Structural balance[3]	**-2.6**	**-1.8**	**-2.0**	**-1.8**	**-2.1**	**-1.3**	**-0.6**	**2.0**
Change in structural balance		*0.8*	*0.6*	*0.0*	*0.0*	*0.8*	*0.7*	
Structural primary balance[3]	-1.2	-0.4	-0.5	-0.3	-0.5	0.4	1.2	2.4
Change in structural primary balance		*0.8*	*0.7*	*0.1*	*0.1*	*0.9*	*0.8*	
Expenditure benchmark								
Public expenditure growth[4] (real)		-2.53	-3.26	-1.25	-1.73	-2.38	0.18	-
Reference rate[5,6]		2.43	2.43	2.43	2.43	*2.43*	*2.43*	-
Lower reference rate[5,7]		1.25	1.25	1.25	1.25	*1.25*	*1.25*	-
Deviation in % of GDP from applicable reference rate		-1.61	-1.85	-1.04	-1.20	*-1.42*	*-0.40*	-
Two-year average deviation in % of GDP from applicable reference rate		n.a.	n.a.	-1.33	-1.52	*-1.31*	*-0.91*	-

Notes*:*

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically adjusted balance according to the programme as recalculated by the Commission on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically adjusted (primary) balance excluding one-off and other temporary measures.

[4]Modified expenditure aggregate used for the expenditure benchmark, growth rates net of non-discretionary changes in unemployment benefit and of discretionary measures.

[5]The reference rates applicable to 2014 onwards will be available from mid-2012. For illustrative purposes, the current reference rates have also been applied to the years 2014 onwards.

[6]The (standard) reference rate applies starting in the year following the one in which the country reaches its MTO.

[7]The lower reference rate applies as long as the country is adjusting towards its MTO, including the year in which it reaches the MTO.

Source :

Convergence programme (CP); Commission spring 2012 forecasts (COM); Commission calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2006-10	2011	2012		2013		2014	2015
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**31.5**	**41.2**	**43.9**	**44.0**	**44.9**	**45.1**	**44.8**	**43.4**
Change in the ratio	1.9	3.1	2.8	2.8	1.0	1.1	-0.3	-1.4
Contributions[2]*:*								
1. Primary balance	**2.0**	**1.7**	**1.4**	**1.5**	**1.1**	**1.3**	**0.1**	**-0.8**
2. 'Snowball' effect	**0.1**	**1.0**	**0.7**	**0.7**	**0.4**	**0.5**	**0.2**	**-0.2**
Of which:								
Interest expenditure	1.2	1.4	1.4	1.5	1.5	1.6	1.8	1.7
Growth effect	-0.7	-0.6	0.0	-0.1	-0.7	-0.6	-1.0	-1.2
Inflation effect	-0.3	0.3	-0.8	-0.8	-0.5	-0.6	-0.6	-0.7
3. Stock-flow adjustment	**-0.2**	**0.4**	**0.7**	**0.6**	**-0.5**	**-0.6**	**-0.6**	**-0.4**
Of which:								
Cash/accruals diff.				1.1		-0.4	-0.4	-0.3
Accum. financial assets				-0.4		-0.3	-0.2	-0.1
Privatisation				0.0		0.0	0.0	0.0
Val. & residual effects				0.0		0.0	0.0	0.0

Notes:

[1]End of period.

[2]The snowball 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, the accumulation of financial assets, and valuation and other residual effects.

Source :

Convergence programme (CP); Commission spring 2012 forecasts (COM); Commission calculations.

Table V. Sustainability indicators

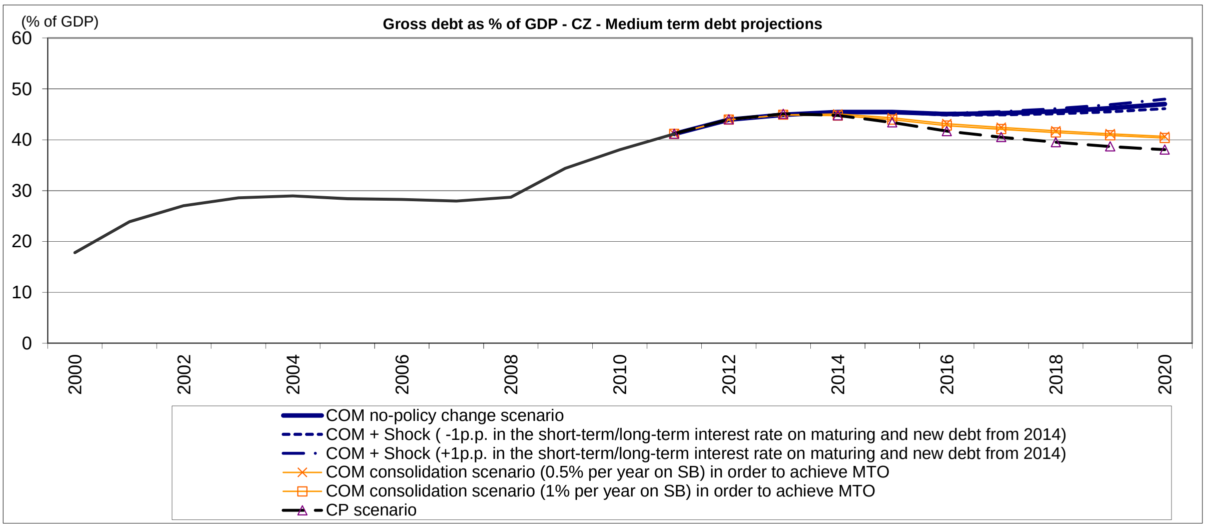
	CZ		EU27	
	No policy change scenario	SCPs scenario	No policy change scenario	SCPs scenario
S2	4.9	3.4	2.9	0.7
of which:				
Initial budgetary position (IBP)	1.1	-0.5	0.7	-1.6
Long-term change in the primary balance (LTC)	3.8	3.9	2.3	2.4
of which:				
pensions	1.9	2.1	1.1	1.2
health care and long-term care	1.6	1.5	1.5	1.5
other	0.3	0.3	-0.3	-0.3
S1 (required adjustment)*	0.4	-1.5	2.2	-0.1
Debt, % of GDP (2011)	41.2		82.8	
Age-related expenditure, % of GDP (2011)	20.1		25.8	

Source: Commission, 2012 stability and convergence programmes.

Note: The 'no policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the spring 2012 forecast until 2013. The 'SCPs' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented

* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.

Graph I. Medium-term debt projection



Source: Commission, 2012 stability and convergence programmes.

Table VI. Taxation

	2001	2005	2007	2008	2009	2010
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	33.7	35.7	35.9	34.4	33.6	33.8
Breakdown by economic function (% of GDP)[1]						
Consumption	9.8	10.8	10.5	10.3	10.9	10.9
of which:						
- VAT	6.1	6.9	6.3	6.8	6.9	7.0
- excise duties on tobacco and alcohol	1.0	1.2	1.7	1.1	1.4	1.4
- energy	2.2	2.4	2.2	2.2	2.2	2.2
- other (residual)	0.5	0.3	0.3	0.3	0.3	0.3
Labour employed	16.4	17.2	17.2	16.8	15.7	16.3
Labour non-employed	1.2	1.1	1.3	1.2	1.3	1.4
Capital and business income	5.5	5.9	6.1	5.4	5.1	4.5
Stocks of capital/wealth	0.9	0.7	0.7	0.6	0.6	0.7
p.m. Environmental taxes[2]	2.4	2.6	2.4	2.4	2.4	2.4
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	42.1	56.9	54.5	57.5	56.0	53.9

Note:

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 (2012), 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. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. 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'). See European Commission (2011), Tax reforms in EU Member States, European Economy 5/2011, for a more detailed explanation.

Source: Commission

Table VII. Financial market indicators

	2007	2008	2009	2010	2011
Total assets of the banking sector (% of GDP)	108.0	101.8	114.4	117.4	114.5
Share of assets of the five largest banks (% of total assets)	65.7	62.1	62.4	62.4	…
Foreign ownership of banking system (% of total assets)	87.7	97.8	89.8	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans) [1), 2)]	2.7	3.2	5.2	5.4	5.5
- capital adequacy ratio (%) [1)]	11.5	12.3	14.1	15.5	15.3
- return on equity (%) [1), 3)]	24.4	21.7	25.8	19.7	18.7
Bank loans to the private sector (year-on-year % change)	30.8	15.1	2.3	9.2	2.4
Lending for house purchase (year-on-year % change)	41.9	19.2	13.5	12.6	3.7
Loan to deposit ratio	71.6	77.0	74.7	74.8	75.4
CB liquidity as % of liabilities	0.0	1.0	0.0	0.0	0.0
Banks' exposure to countries receiving official financial assistance (% of GDP)[4)]	…	…	…	…	…
Private debt (% of GDP)	…	47.4	54.1	57.0	…
Gross external debt (% of GDP) [4)]					
- Public	7.9	7.5	9.6	12.2	11.8
- Private	20.8	21.0	22.3	22.9	22.7
Long term interest rates spread versus Bund (basis points)*	8.6	64.9	161.5	114.1	109.9
Credit default swap spreads for sovereign securities (5-year)*	9.5	35.2	82.4	85.9	106.7

Notes:

1) Latest available in June 2011. FSI Compilation Guide methodology from 2008 onwards; previous years may not be comparable.

2) The capital adequacy ratio is defined as total capital divided by risk weighted assets.

3) Net income to equity ratio. After extraordinary items and taxes. Tier 1 capital.

4) Latest data 2011Q3.

* Measured in basis points.

Source :

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), Eurostat (residential property prices) and ECB (all other indicators).

Table VIII. Labour market and social indicators

Labour market indicators	2006	2007	2008	2009	2010	2011
Employment rate (% of population aged 20-64)	71.2	72.0	72.4	70.9	70.4	70.9
Employment growth (% change from previous year)	1.3	1.9	1.6	-1.4	-1.0	0.4
Employment rate of women (% of female population aged 20-64)	61.8	62.4	62.5	61.4	60.9	61.7
Employment rate of men (% of male population aged 20-64)	80.4	81.5	82.0	80.2	79.6	79.9
Employment rate of older workers (% of population aged 55-64)	45.2	46.0	47.6	46.8	46.5	47.6
Part-time employment (% of total employment)	5.1	5.1	5.0	5.6	6.0	5.5
Part-time employment of women (% of women employment)	8.7	8.6	8.6	9.3	10.0	9.5
Part-time employment of men (% of men employment)	2.3	2.4	2.3	2.8	3.0	2.5
Fixed term employment (% of employees with a fixed term contract)	8.7	8.6	8.0	8.5	8.9	8.5
Unemployment rate[1] (% of labour force)	7.2	5.3	4.4	6.7	7.3	6.7
Long-term unemployment[2] (% of labour force)	3.9	2.8	2.2	2.0	3.0	2.7
Youth unemployment rate (% of youth labour force aged 15-24)	17.5	10.7	9.9	16.6	18.3	18.0
Youth NEET[3] rate (% of population aged 15-24)	9.2	6.9	6.7	8.5	8.8	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	5.1	5.2	5.6	5.4	4.9	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	15.2	15.5	17.7	20.2	22.6	:
Labour productivity per person employed (annual % change)	5.6	3.5	0.8	-3.5	4.5	1.4
Hours worked per person employed (annual % change)	-1.0	-0.8	0.4	-2.0	1.7	-1.1
Labour productivity per hour worked (annual % change; constant prices)	6.7	4.4	0.4	-1.6	2.7	2.6
Compensation per employee (annual % change; constant prices)	5.5	2.8	2.2	-3.1	5.6	2.3
Nominal unit labour cost growth (annual % change)	0.4	2.6	3.4	2.4	-0.7	0.2
Real unit labour cost growth (annual % change)	-0.1	-0.7	1.5	0.5	1.0	0.9

Notes:

[1] According to ILO definition, age group 15-74)
[2] Share of persons in the labour force who have been unemployed for at least 12 months.
[3] NEET are persons that are neither in employment nor in any education or training.

Sources:
Commission (EU Labour Force Survey and European National Accounts)

Table VIII. Labour market and social indicators (continued)

Expenditure on social protection benefits (% of GDP)	2005	2006	2007	2008	2009
Sickness/Health care	6.26	5.96	5.88	5.79	6.40
Invalidity	1.38	1.49	1.43	1.42	1.53
Old age and survivors	6.81	6.78	6.94	7.31	8.30
Family/Children	1.34	1.31	1.61	1.39	1.44
Unemployment	0.63	0.56	0.60	0.61	1.05
Housing and Social exclusion n.e.c.	0.08	0.07	0.06	0.06	0.08
Total	18.4	18.0	18.0	18.0	20.4
of which: Means tested benefits	0.96	0.89	0.57	0.37	0.35
Social inclusion indicators	**2006**	**2007**	**2008**	**2009**	**2010**
Risk-of-poverty or exclusion[1] (% of total population)	18.0	15.8	15.3	14.0	14.4
Risk-of-poverty or exclusion of children (% of people aged 0-17)	22.7	21.5	18.6	17.2	18.9
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	12.7	10.9	12.5	11.7	10.1
At-risk-of-poverty rate[2] (% of total population)	9.9	9.6	9.0	8.6	9.0
Value of relative poverty threshold (single household per year) - in PPS	4956	5305	5835	6062	5793
Severe material deprivation[3] (% of total population)	9.6	7.4	6.8	6.1	6.2
Share of people living in low work intensity households[4] (% of people aged 0-59 not student)	8.9	8.6	7.2	6.0	6.4
In-work at-risk-of poverty rate (% of persons employed)	3.5	3.3	3.6	3.2	3.7

Notes:

[1] 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 households with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.

[3] 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.

[4] People living in households with very low work intensity: share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.

Sources:

For expenditure on social protection benefits ESSPROS; for social inclusion EU-SILC.

Table IX. Product market performance and policy indicators

Performance indicators	2002-2006	2007	2008	2009	2010	2011
Labour productivity[1] total economy (annual growth in %)	4.3	3.6	0.7	-3.5	4.5	2.0
Labour productivity[1] in manufacturing (annual growth in %)	8.6	7.3	6.8	-6.4	12.9	n.a.
Labour productivity[1] in electricity, gas, water (annual growth in %)	7.0	5.3	4.3	-6.9	n.a.	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	1.2	0.3	-2.6	1.9	-1.7	n.a.
Patent intensity in manufacturing[2] (patents of the EPO divided by gross value added of the sector)	0.5	0.6	0.5	n.a.	n.a.	n.a.
Policy indicators	**2002-2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Enforcing contracts[3] (days)	n.a.	653	653	611	611	611
Time to start a business[3] (days)	n.a.	17	20	20	20	20
R&D expenditure (% of GDP)	1.3	1.5	1.4	1.5	1.6	n.a.
Tertiary educational attainment (% of 30-34 years old population)	12.8	13.3	15.4	17.5	20.4	n.a.
Total public expenditure on education (% of GDP)	4.4	4.2	4.1	n.a.	n.a.	n.a.
	2005	**2006**	**2008**	**2009**	**2010**	**2011**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	1.6	n.a.	n.a.	n.a.
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	1.6	n.a.	n.a.	n.a.
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	2.1	2.0	2.0*	n.a.	n.a.	n.a.

Notes:

[1]Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

[2] 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.

[3] The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology.

[4] The methodologies for the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

[5] Aggregate ETCR.

*figure for 2007.

Source:

Commission, World Bank - *Doing Business* (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table X. Indicators on green growth

Czech Republic		2001-2005	2006	2007	2008	2009	2010
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.66	0.59	0.55	0.53	0.51	0.53
Carbon intensity	kg / €	2.07	1.75	1.67	1.55	1.53	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	2.58	2.31	2.22	2.12	2.03	n.a.
Waste intensity	kg / €	n.a.	0.30	0.28	0.28	n.a.	n.a.
Energy balance of trade	% GDP	-2.6%	-2.8%	-3.4%	-4.5%	-3.0%	-3.5%
Energy weight in HICP	%	13	14	14	15	13	13
Difference between change energy price and inflation	%	3.68	10.4	0.1	7.9	7.9	-1.9
Environmental taxes over labour taxes	ratio	14.4%	13.6%	13.1%	13.2%	14.3%	n.a.
Environmental taxes over total taxes	ratio	7.3%	7.0%	6.7%	6.9%	7.2%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.42	0.30	0.26	0.22	0.22	n.a.
Share of energy-intensive industries in the economy	% GDP	14.1	14.7	14.7	14.8	13.9	n.a.
Electricity prices for medium-sized industrial users	€ / kWh	0.05	0.07	0.08	0.11	0.11	0.10
Public R&D for energy	% GDP	n.a.	0.01%	0.01%	0.02%	0.02%	n.a.
Public R&D for the environment	% GDP	n.a.	0.02%	0.01%	0.01%	0.02%	n.a.
Recycling rate of municipal waste	ratio	15.0%	14.2%	15.2%	14.5%	14.5%	n.a.
Share of GHG emissions covered by ETS	%	n.a.	57.3%	59.7%	57.0%	55.5%	n.a.
Transport energy intensity	kgoe / €	0.66	0.58	0.56	0.47	0.51	n.a.
Transport carbon intensity	kg / €	1.91	1.66	1.60	1.34	1.43	n.a.
Change in the ratio of passenger transport and GDP	%	-2.8%	-4.6%	-3.8%	-2.3%	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	26.2%	27.8%	25.0%	27.6%	26.9%	n.a.
Diversification of oil import sources	HHI	n.a.	0.52	0.49	0.50	0.55	n.a.
Diversification of energy mix	HHI	0.32	0.30	0.31	0.29	0.28	n.a.
Share of renewable energy in energy mix	%	3.7%	4.2%	4.6%	4.9%	5.7%	n.a.

Country-specific notes:

The year 2011 is not included in the table due to lack of data.

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN explanations given 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 CO2 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 EUR)

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

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 (in kgoe) divided by gross value added of industry (in EUR)

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

Passenger transport growth : measured in %-change in passenger kilometres

Energy import dependency: net energy imports divided by gross inland energy consumption incl. of 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 of renewable energy in energy mix: percentage-share in gross inland energy consumption, expressed in tonne oil equivalents