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**Assessment of the 2011 national reform programme and convergence programme for
the CZECH REPUBLIC**

Accompanying the document

Recommendation for a

COUNCIL RECOMMENDATION

**on the National Reform Programme 2011 of the Czech Republic and delivering a
Council Opinion
on the updated convergence programme of the Czech Republic, 2011-2014**

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1. INTRODUCTION

The Czech economy experienced a sharp decline in GDP growth during the global financial crisis, which resulted in three successive quarters of negative growth and significant job losses. A moderate recovery, supported by improved economic conditions among its main trading partners and a fiscal stimulus, started to take shape from the end of 2009. The marked deterioration in the government deficit, as a consequence both of the economic crisis and of the measures taken to alleviate its impact, led the Czech government to begin fiscal consolidation already in 2010. Consolidation is expected to make further progress in 2011 and, according to the commitment in the Convergence Programme ("CP") submitted to the European Commission on 5 May 2011, it is set to continue in the years to come, although at a decreasing pace. Economic policy measures contributing to the achievement of Europe 2020 objectives are outlined in the National Reform Programme ("NRP") submitted to the Commission on 29 April 2011.

2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2.1 RECENT ECONOMIC DEVELOPMENTS

In the years before the crisis, the Czech Republic enjoyed a period of sound economic performance, during which no major external macroeconomic imbalances emerged. Given the appreciation of the nominal exchange rate and increases in unit labour costs, which exceeded those of its trading partners, the price and cost competitiveness of Czech exports deteriorated. However, the Czech Republic managed to double its share of exports in world trade between 2000 and 2008, suggesting significant increases in non-price competitiveness. The export capacity of the economy improved also on account of large FDI inflows of nearly 6% of GDP on average between 2000 and 2008, mainly to manufacturing industries (around 40% of total FDI inflows).

On the domestic side, rapid economic growth was not combined with major signs of overheating. Despite quite significant increases in loans to the private sector, especially in the second half of the last decade, the ratio of private debt to GDP increased only marginally and in 2009 stood at 78% of GDP, one of the lowest levels in the EU. An important stabilizing factor is that only a minor share of loans to the private sector is denominated in foreign currencies (8.3% in mid-2008). Available data on real estate prices suggest some price surge before the crisis, but do not indicate the emergence of a major price bubble. Inflation has been kept broadly in check (with the exception of 2008 which was largely due to the steep increase in indirect taxes), and was also cushioned over time by the constantly appreciating Czech currency.

Due to the openness of the Czech economy, the trade channel played a dominant role during the 2009 downturn, with real GDP declining by 4.1%. As regards 2010, economic performance was strongly influenced by vigorous growth on the part of its trading partners. On the other hand, consumption of households declined in the second half of the year, also as a reaction to the fiscal austerity measures announced for 2011. Overall, annual real GDP growth rebounded to 2.3%.

The labour market reacted strongly and very rapidly to the crisis: the unemployment rate nearly doubled from its record low of 4.3% in the third quarter of 2008 to 7.8% in the first quarter of 2010. The employment rate for the 20-64 age group fell from a historical high of 72.4% in 2008 to 70.9% in 2009 and 70.4% in 2010.

The Czech financial market has remained stable and has weathered the global financial crisis remarkably well. Czech banks have remained well capitalized and no rescue measures for the financial sector were required. For a number of years the profitability of the Czech banking sector has been the highest in the EU and it also remained high during the crisis years. The stability of the financial sector can also be attributed to a low exposure to structured instruments, which amongst other things is linked to the rather conservative business model of Czech economic agents and banks.

2.2 OUTLOOK

A gradual economic recovery is expected in the coming years. For 2011, the continuing revival of exports is likely to be dampened by the impact of budgetary consolidation measures. As a result, net exports are projected to account for about three quarters of real GDP growth in 2011, which is forecast to reach 2%. In 2012, the still strong export growth, coupled with more robust domestic demand, is expected to drive GDP growth up further to 2.9%.

Price increases in 2011 are driven by rising world food and commodity prices, but the impetus from domestic sources is expected to remain fairly contained, given the slack in the economy. Overall, inflation as measured by the harmonised index of consumer prices (HICP) is expected to reach 2.3% in 2011 and 2.5% in 2012, as economic conditions improve and wage pressures materialise.

Labour market conditions remain fragile. The unemployment rate is projected to decrease from 7.3% in 2010 to 6.8% in 2011, considering that a faster decrease is likely to be prevented by layoffs in the public sector. On the other hand, employment is expected to stagnate over the forecast horizon, due to the reduction in the working age population on account of population ageing.

The crisis is expected to have had a negative impact on potential growth. While the average growth rate of potential output between 2000 and 2008 is estimated to have reached 3.1%, it is expected to decline to 1.8% in 2012. This outcome is a combination of several negative developments. The contribution of capital accumulation is expected to be subdued on account of sluggish growth in the capital stock, while a slow decline in the unemployment rate, combined with the impact of ageing, will weigh on the labour market component. Lastly, the contribution of total factor productivity - a measure of the economy's technological dynamism - is not expected to reach pre-crisis levels, because the positive effects of new FDI will gradually fade out due to the productivity catch-up.

According to the Commission services' Spring 2011 forecast, the general government deficit is projected to decrease from 4.7% of GDP in 2010 to 4.4% in 2011 and to fall further to 4.1% of GDP in 2012, driving the government debt from 38.5% of GDP in 2010 to 42.9% in 2012.

3. MONITORING, PROCEDURAL ISSUES AND GOVERNANCE

The NRP preparation was steered by the Government Office (Prime Minister's office), in cooperation with different ministries. Since January 2011, the Government Office has held several rounds of extensive consultations with stakeholders, social partners, working bodies of the Council of Economic and Social Agreement, regions and academia, and also with the National Economic Council (a government advisory body). The opposition parties appear to have played only a limited part in this structured dialogue. The National Reform Programme was adopted by the Government on 27 April 2011. The NRP has been discussed by only one Chamber of Parliament - the Senate - at its own request. In its session of 4 May, therefore,

after the endorsement by the Government, the Senate adopted a negative position on the reform plan, for which only the opposition voted.

The CP was prepared by the Ministry of Finance, in cooperation with the relevant services, and was adopted by the Government on 4 May. Prior to adoption, the programme had been discussed within the competent committees in both Chambers of the Parliament; the final version was submitted to the Parliament on 6 May. The CP is consistent with the NRP.

The 2020 targets, which the Czech Republic set for itself in the NRP, lay the ground for addressing these challenges and will be instrumental for the Czech Republic in becoming a smart, sustainable and inclusive economy.

Table 1. Czech national 2020 targets

Europe 2020 targets	Current situation in the Czech Republic ¹	Czech Europe 2020 targets in the NRP
R&D investment (% of GDP)	1.53% (2009), of which public sector R&D 0.61%	1% for the public sector and overall
Employment rate (20-64) (%)	70.4% (2010)	75% with sub-targets for different categories of the most vulnerable
Reduction in number of people in or at risk of poverty or exclusion		1) maintaining the number of persons at risk of poverty or social exclusion at the level of 2008 ² 2) reducing it by 30 000.
Early school leaving (%)	5.6% (2009)	5.5%
Tertiary education attainment (%)	17.5% (2009)	32%
Energy efficiency – reduction of energy consumption in Mtoe ³		Target not set
Reduction in greenhouse gas emissions (compared to 2005 levels) (from sources not covered by the Trade Emissions System)	+1% ⁴	+9% ⁵
Renewable energy (% of total energy use)	7% (2008)	13%

4. POLICY CHALLENGES, AGENDA AND ASSESSMENT

4.1 CHALLENGES

The key policy challenges faced by the Czech economy centre around three areas:

(1) reducing the high structural deficit and improving the long-term sustainability of public finances;

¹ Eurostat figures.

² In 2008 15.3% of the total population was at risk of poverty or social exclusion.

³ As estimated by the Commission. Mtoe = Million tonnes of oil equivalent.

⁴ This quantity corresponds to the 2005-2008 evolution of the emissions not covered by the EU Emissions Trading System. As the scope of the Emissions Trading System evolved between 2005 and 2008, these emissions are estimated on the basis of the main relevant UNFCCC source categories (as opposed to the difference between total emissions and EU ETS verified emissions).

⁵ The national emissions limitation target defined in Decision 2009/406/EC (or "Effort Sharing Decision") concerns the emissions not covered by the EU Emissions Trading System. It is expressed as the minimum relative decrease (if negative) or the maximum relative increase (if positive) compared to 2005 levels.

(2) improving the functioning of the labour market by addressing the remaining structural weaknesses; and

(3) sustaining growth by addressing the weaknesses in the business environment, including the regulatory environment and the efficiency of public administration.

Addressing these points would bring immediate gains in terms of higher GDP growth, as they introduce greater macroeconomic stability, support the utilisation of the full potential of the labour force and promote entrepreneurship.

Over the medium- to long-term horizon, the growth potential of the Czech economy would benefit further from upgrading the quality of human capital to improve labour productivity, as well as promoting innovation capacity and business R&D to support diversification of the economy and an orientation towards high value-added production and services. While measures in these two areas are unlikely to produce an immediate impact on the economy, they have been highlighted as important for further development, which so far has been mostly driven by the acquisition of technology from abroad.⁶ The measures would also help reduce the exposure to competition from emerging countries, which have already gained ground in formerly traditional Czech industries (such as textiles). While this vulnerability is shared with other EU economies, the high degree of openness of the Czech economy and narrow geographical concentration of its exports make it all the more pressing and relevant to start engaging in action to overcome these limitations.

Policy advice in these areas has been offered in the context of the Stability and Growth Pact for public finances and through the ECOFIN Council's endorsement of the major bottlenecks to growth. The Czech Government identified an additional bottleneck to growth, namely the necessity to improve transport infrastructure.

4.2 ASSESSMENT OF THE POLICY AGENDA

4.2.1 Macroeconomic Policies

4.2.1.1 Public Finances

Overall, the macroeconomic projections in the CP underpinning the budgetary targets seem to be more subdued in 2011 and 2012 than those in the Commission services' spring forecast.⁷ The composition of growth also seems to be quite divergent, with much weaker domestic demand in the programme (inter alia because of the planned further reduction in real government consumption expenditure that is assumed in the programme for 2012), offset in part by a significantly stronger contribution from net exports. On the other hand, the programme assumes that employment will pick up more quickly than projected in the Commission services' forecast, implying a more positive effect on revenue from direct taxes and social security contributions. HICP inflation and GDP deflator figures in 2012 in the

⁶ The revealed comparative advantage index shows that the increase in Czech exports is dominantly due to easy-to-imitate research-intensive goods. In addition, exports and imports of high-tech products are broadly balanced, which points to large import intensity of otherwise solid high-tech exports. Finally, most of the spending on innovation takes the form of purchases of new machines and equipment, while the share of spending on own research is low compared both to the EU average and to countries closest to the Czech Republic in terms of the level of economic development (Slovenia and Portugal).

⁷ The assessment of the Commission services is based on the reference scenario in the programme. The programme further includes two alternative scenarios. The first one is based on the assumption of slower real GDP growth in the EU (i.e. 1.1% in 2012 and 1.3% in both 2013 and 2014) and the other assumes only a gradual increase in oil prices, which has a trajectory not consistent with the Commission services' external assumptions, and has only a limited impact on both macroeconomic and fiscal aggregates in the scenario.

programme also differ significantly from the Commission services' forecast, mainly on account of the effect of assumed VAT rate changes, which were not included in the Commission services' forecast based on the usual no policy change assumption. For 2013 and 2014, the programme assumes real GDP growth well above the Commission services' medium-term potential growth estimates (a difference of more than 1 pp. in 2013 and more than 2 pps. in 2014).

As regards the implied cyclical conditions, the programme assumes that the output gap will close more slowly during 2011 and 2012, due to both lower real GDP growth and somewhat higher potential GDP growth primarily stemming from the projected better employment prospects. Overall, the reference macroeconomic scenario underlying the programme is plausible until 2012 and optimistic for 2013 and 2014.

Compared with the February 2010 update of the convergence programme, the government deficit figures for 2011 and 2012 were revised downwards in the most recent update of the programme, including on account of the better-than-expected outcome for the 2010 deficit (difference of 0.6 pp.). Budgetary policies too have changed substantially since the previous update, and additional consolidation measures were implemented for 2011. Further consolidation measures are in the pipeline for 2012 and beyond (see Box 1). The 2011 consolidation package was mainly expenditure-based, but revenue-enhancing measures were also envisaged. However, the April 2011 ruling of the Czech Constitutional Court abolished the 50% one-off tax levied on subsidized returns from the building savings scheme. This is expected to have an immediate negative impact (of around 0.15% of GDP) on revenue from personal income tax (PIT), as compared to the figures presented in the programme.

The main goal of the medium-term budgetary strategy is to bring the government deficit below the 3% reference value by the deadline set by the Council, i.e. by 2013, and to continue consolidation afterwards in order to prepare the ground for reaching the medium-term objective ("MTO") of a balanced budget in 2016 (i.e. beyond the programme horizon). The commitment to achieve the MTO was not included in the previous update of the programme; specifying an explicit target, although it is outside the programme period, helps to anchor the programme's medium-term strategy.

According to the programme, the general government deficit is projected to gradually decrease from 4.2% of GDP in 2011 to 3.5% and 2.9% of GDP in 2012 and 2013 respectively, reaching 1.9% of GDP in 2014. The policy stance implied by the programme is mildly restrictive over the programme period, with the structural balance (calculated according to the commonly agreed methodology) improving from a deficit of around 3.1% in 2011 to a deficit of approximately 1.8% in 2014. The structure of the planned budgetary adjustment is predominantly based on the expenditure side, when assessed across the whole programme period.

In 2012, the consolidation effort is expected to hinge largely on revenue-enhancing measures (see Box 1). A large part of the adjustment is due to be achieved through a 4 pps. increase in the lower rate of VAT. The Czech Republic appears to have further space to increase indirect taxes, which stood at 11.8% of GDP in 2010, compared to the EU average of 13.4%. For 2013, a structural reform of the PIT is being discussed, which is expected to have an overall negative effect on tax revenue. Moreover, the start of the pension reform, which is also scheduled in 2013, would decrease revenue since part of social contributions would be redirected to the privately funded pension scheme (see 4.2.1.2). However, a further reduction in the government deficit is expected, largely as a result of projected favourable cyclical conditions, and also on the back of envisaged further savings in public administration.

Box 1. Main measures
Main budgetary measures (% of GDP)

Revenue	Expenditure
2011	
<ul style="list-style-type: none"> • Changes to the personal income tax and social contributions (0.5%) 	<ul style="list-style-type: none"> • Cuts in social benefits and in other current and capital expenditure (-1.2%) • Cuts in the public sector wage bill (-0.3%)
2012	
<ul style="list-style-type: none"> • Increase in the lower VAT rate by 4 pps. (0.7%) • Introduction of a tax on gambling (0.2%) 	n.a.
2013	
<ul style="list-style-type: none"> • Introduction of a private pension pillar (-0.5%) • Reform of the PIT (-0.3%) • Tax deduction on dividends for corporations (-0.2%) • Further changes to the VAT (0.1%) 	<ul style="list-style-type: none"> • Revision of the agenda of ministries, efficiency gains due to changes in public procurement (-0.5%)
2014	
<ul style="list-style-type: none"> • Decrease in social contributions paid by the self-employed (-0.3%) 	n.a.

Main macro-structural measures

For 2013, there are plans for a **structural reform of personal income tax (PIT)**, with a view to simplifying the system by reducing the number of tax exemptions, for example. The reform would reduce the effective PIT rate. Within the next 2-3 years, **further steps in the health-care reform** are to be gradually implemented, which should improve the efficiency of the system by also introducing new control mechanisms and defining health-care standards. A number of measures targeting **better control of public procurement** are envisaged, including electronic auctions and enhancing the powers of supervisory and judiciary institutions. The anti-corruption strategy is due to be fully implemented by 2014. Measures aimed at **making the labour market more flexible** are in prospect for 2012-2013, such as linking the severance pay to the length of service or easing the restrictions on non-permanent employment.

Although there seem to be no substantial risks in relation to the budgetary projections stemming from the programme's underlying macroeconomic scenario for 2011 and 2012, for the latter years of the programme period, consolidation seems to rely heavily on improving cyclical conditions. Overall, the annual average fiscal effort for 2011-2013 implied by the programme is estimated to be 0.6% of GDP, followed by a decline of 0.6% in the structural balance in 2014. When assessed against the projected rate of medium-term potential output

growth and taking into account the one-off increase in expenditure in 2011, expenditure projections appear to ensure an appropriate adjustment path towards the MTO.⁸

There are a number of risks to the budgetary targets arising from the adoption and implementation of the planned measures. Specifically, it may be difficult to maintain the planned freeze in the public sector for the 2012-2014 wage bill (excluding education and health care), given the cuts already implemented in 2011. As regards the VAT changes, the programme anticipates their negative impact on public expenditure (namely on medicines and operational expenditure), but expects them to be offset by further savings in the system in 2012 and partially also in 2013. However, there is considerable uncertainty given the limited scope for savings due to the ongoing retrenchment in operational expenditure. Moreover, adjustments in the VAT rates in 2013 (the lower rate is expected to increase further by 3.5 pps. compared to 2012 and the higher rate is expected to decrease by 2.5 pps.) could have a negative effect on VAT revenue, *ceteris paribus*, as the majority of goods are currently taxed at the higher rate. The programme, however, expects a positive impact due to an additional measure that would increase the share of firms registered to submit VAT returns. Nevertheless, the number of newly registered firms may be much smaller than would be needed to offset the shortfall from changes in the VAT tax rates. For 2013, the planned savings in operational expenditure related to a revision of the agenda of ministries, and savings from changes in the public procurement system are not presented in detail and may be difficult to achieve. There are also some positive risks to budget implementation, as the number of people deciding to opt-in for the private pension pillar as early as 2013 could be considerably lower than assumed in the programme, and with a less negative impact on the revenue from social contributions.

The debt-to-GDP ratio is expected to peak in 2013 and decline thereafter. The main driving forces for the adjustment should be the improving primary balance and relatively strong nominal GDP growth assumed for the outer years. Important stabilising factors underlying projected debt developments are the low share of short-term debt, both present and projected, and the current low share of debt denominated in foreign currency, which limits the risks due to exchange rate fluctuations.

The Czech Republic is at high risk with regard to the long-term sustainability of public finances. The long-term cost of ageing is above the EU average. The current budgetary position compounds the cost of ageing. Based on the current fiscal position, debt would increase to 64.4% of GDP by 2020. Full implementation of the programme would allow for a much smaller increase to 41.6% by 2020. Achieving primary surpluses over the medium term and undertaking reforms of pension and health-care systems with a view to containing the future increase in this expenditure would contribute to reducing the risks to the sustainability of public finances. The reform efforts of the Czech government in the area of pensions are discussed in section 4.2.1.2.

There are some risks to the quality of public finances regarding expenditure on growth-enhancing items. Following the radical across-the-board expenditure cuts in 2010, in particular in government gross fixed capital formation,⁹ to address the shortfalls in several revenue items, the programme envisages large increases in public investment in the years

⁸ For a country that has reached its MTO, fiscal policy is considered “prudent” if expenditures in year *t* do not grow faster than a reference rate of medium term potential GDP growth, unless the excess of expenditure growth is matched by discretionary revenue measures. In case the country has not yet reached its MTO, expenditure growth should be capped at (approximately) 1 pp. below the reference rate of medium term potential GDP growth, unless the excess of expenditure growth is matched by discretionary revenue measures.

⁹ By 0.9% of GDP compared to plan and of 0.5% of GDP compared to 2009.

ahead. The implementation of these investment projects may be at risk, in particular if the efficiency savings underpinning the 2013 consolidation strategy prove difficult to achieve. In addition, given the challenges to the Czech Republic's long term growth prospects, as discussed in section 4.2.3, there is a need to safeguard expenditure, especially on items such as R&D and education.

4.2.1.2 Reform of the pension system

With a view to addressing the sustainability of public finances, the government has put forward two packages of reforms.

The first package, which is close to being approved by the Parliament, targets the public Pay-As-You-Go pillar, which has been in deficit since 2009. It includes, first, a new pension formula to address the ruling of the Czech Constitutional Court, which called for a lower degree of redistribution in the pension system. The formula increases the pensions of high-wage earners and lowers the medium-range pensions. In addition, a ceiling for contributions was set in 2008. Secondly, the rise in the statutory retirement age will continue at a somewhat faster pace so as to make it a uniform 67 years in 2041 for men and women, irrespective of the number of children. The increase in the retirement age will continue after 2041 by two months a year without a pre-determined limit. Thirdly, the government will not be allowed to increase pensions beyond what is possible on the basis of the current indexation rule.

This set of parametric reforms goes some way towards addressing the Czech Republic's sustainability problem. However, the reform may not be sufficient to address the challenges created by population ageing while, at the same time, it allows some leeway to introduce further measures that would generate additional savings without compromising the adequacy of pensions.

First, the limit on individual contributions is expected to be set at a lower level than the one envisaged for health insurance; equal ceilings for both kinds of contributions would generate additional revenue for the public pension pillar, while increasing the simplicity of the tax and contribution system. Secondly, the transition period over which the planned increase in the retirement age will take place is long, given the funding pressures which are already evident now and which will become even more apparent after 2030. Further increasing the statutory retirement age beyond 67 years in line with life expectancy rather than the current proposal of two months per year (after 2041) would encourage greater transparency and reduce implementation risks. Finally, changing the current indexation rule¹⁰ to allow pensions to be indexed only to prices, as is the case in many Member States, would be an effective way to curb the projected increase in expenditure.

A second package of measures outlined in the NRP, which has not yet been formally approved by the government, includes the introduction of a voluntary second private pillar in 2013. Under this scheme, it would be possible to divert 3 pps. out of the social security contribution of each individual to private pension funds, under the condition that private savings also increase by an additional 2 pps. By default, everyone will be included only in the public pillar with an option to enter the second, private pillar before reaching 35 years of age.

The purpose of establishing the second pillar is to increase diversification in retirement incomes by promoting the development of private savings. However, the suggested form of the pillar creates few incentives to join the scheme. The voluntary basis of the system opens

¹⁰ Currently, the minimum growth in pensions is determined according to a formula that takes into account price growth (fully) and a third of real wage growth.

up the possibility that participation will be limited to mostly high-earning workers.¹¹ Since they are the people who contribute most to the system relative to the pensions they can receive, there is a risk of negative repercussions on the general government budget in the long term. By introducing automatic enrolment in both pillars, expected participation would be higher and the reform would achieve both greater diversification and a more significant increase in private savings.

The introduction of the funded pillar will lead to a transitional deficit created by re-directing 3 pps. of contributions to private funds, which the government plans to offset by increasing indirect taxes. However, it is uncertain whether the tax increase will be sufficient to cover this shortfall in contributions, while it is clear that it does not address the outstanding funding needs of the pension system.

Finally, the CP and the NRP specify the planned portfolio profiles of pension funds, but they do not provide detailed information on their likely operating costs. It is important to design the system so that the administrative costs of pension funds are kept as low as possible to ensure that supplementary pension pillars contribute effectively to retirement incomes.

The present pension system performs well in terms of securing the living standards of the elderly: the at-risk-of-poverty rate is low by EU standards, although it has increased in recent years. In view of the further ageing of population and expected pressure on pension systems, it is important to monitor closely the impact of current and future reforms on the adequacy of pensions.

4.2.2 Labour Market Policies

The Czech labour market is perceived as moderately flexible, although there remain important challenges in specific segments.

Firstly, the Czech Republic has the largest employment impact of ‘motherhood’ in the EU, indicating that women with children face difficulties when re-integrating into the labour market after maternity leave.¹² The issue is significant not only because of the considerable share of the labour force concerned, but also because of its wider economic repercussions: longer spells out of work are consistent with a high gender employment gap (18.8 pps. versus 13.3 pps. in EU, 2009) and the highest gender pay gap of all Member States. Moreover, it may also lead women to postpone the decision to have children, thus adding to demographic imbalances which are already serious in the light of the projected reductions of the working-age population (Ageing Report, 2009). Early return to work remains difficult despite the government's effort to give parents greater choice in determining the length of parental leave. The problem can be attributed partly to the fact that firms may be unwilling to provide part-time employment contracts¹³, which often used by employees with small children in other Member States, and partly to the limited availability of affordable child-care facilities, especially for children below the age of three.¹⁴

¹¹ This will be reinforced by the still high redistributive role of the public pillar and inheritability of pensions from the private pillar (suggested as one of the payment options).

¹² In 2009 the employment rate of women (in the age of 20-49) without children was almost 50 pps. higher than that of women with children under six years of age, while the average difference was 17.4 pps. in the EU.

¹³ The share of women working on a part-time basis was 8% in 2009, compared to 31% in the EU. The share of part-time and fixed-term contracts of all workers in total employment is 11.2%, compared to 28.7% in EU.

¹⁴ According to the OECD Family Database, the average enrolment rate in childcare facilities in the Czech Republic for children below the age of 3 is below the EU average (2.2% in 2008, as compared to 29.2%). The enrolment rate of older children (3-5 years) stood at 79.7% in 2008, as compared to 80.7% in the EU.

With the aim of increasing the employability of women, the NRP has announced improvements in the flexibility of social benefits and labour-market instruments relevant for families, which would increase the freedom to balance work and family life. Availability of child-care services as well as the diversification of their provision will be supported. The NRP highlights the need for care to be provided by the private sector, to which end the government intends, amongst other measures, to ease the conditions for running company-based kindergartens.

These measures have the potential to ease the barriers to employment experienced by some mothers, but are not likely to help those working in small- or medium-sized enterprises or disadvantaged families. Building on the long-standing tradition of high-quality public child care would make it easier to achieve the national employment target, as well as increasing the chances of better school attainment among the most vulnerable. For the future, ensuring the sustainability and affordability of child-care services' provision is likely to require additional measures and possibly funding. In this context, savings could be achieved by shortening paid parental leave (its full-time equivalent is currently 63 weeks, well above the EU average of 39 weeks). Increasing the attractiveness and availability of part-time jobs is also, especially in the case of mothers, a suitable instrument for harmonising work and family life in the Czech context. As a result of these measures, the Czech Republic could achieve better transition of women back to work after maternity, strengthen gender equality and, at the same time, address the demographic problem through greater participation of women in the labour force.

While the overall unemployment rate (7.3%) remains firmly below the EU average, there is a worrying trend in terms of the number of persons who have been unemployed for one year or longer, which is most prominent amongst the young. Long-term unemployment is consistent with under-funded and relatively low-scale active labour market policies (ALMP), the budget of which as a proportion of GDP is substantially less than the EU average. Consequently, the share of participants in regular activation measures, when compared with the total number of persons wanting to work, is low (11.5% compared to 31% in EU, in 2008), and therefore enlarging the scope of the ALMP and learning from the evaluation of existing projects would generate substantial effects on employment. Measures to promote life-long learning may also be effective, since the current participation of Czech population in life-long learning is low in general (6.8% compared to 9.3% in EU) and particularly so for older workers and the inactive population.

The remaining rigidities on the labour market include the complexity of the dismissal procedure, the length of the notice period, and the generosity of severance payments for workers with shorter employment histories. These rigidities are reflected in a very high level of the employment protection index for regular contracts (3.05 compared to the OECD average of 2.11, in 2008) while temporary contracts are much less protected (0.88 vs. 1.77). This NRP outlines several measures that would contribute to increasing labour-market flexibility, such as adjustment the conditions for non-permanent employment and severance pay and easing requirements for dismissals. Making dismissals less costly, reducing the administrative burden on employers and supporting more flexible work arrangements may help revive the labour market in general and contribute to achieving the employment sub-targets, especially for the young and less educated workers.

Combating poverty and promoting social inclusion

In the Czech Republic, the percentage of people at-risk-of-poverty or social exclusion declined to 14% in 2009 and is well below the EU average (23.1%). The Czech Republic is characterised by a comprehensive social protection system and the prominent role of social transfers in preventing poverty. The observed downward trend relates to most age cohorts.

Among the determinants of poverty, the most pervasive one is unemployment, especially long-term unemployment.

The Czech national target for poverty reduction aims to maintain the number of persons at risk of social exclusion at the level of 2008 and, conditions permitting, reducing it by 30 000. The NRP identifies employment policy as the main tool for reducing poverty and complements it by promoting the development of social services. However, an integrated approach to address the problems of disadvantaged groups would be most efficient. The information included in the NRP does not allow a detailed assessment of the target's achievability. A more ambitious target may help reduce this risk and provide greater support to effective and well-targeted policies.

Education

Despite the relatively low rate of early school leaving in the Czech Republic (5.4% in 2009), recent international studies have revealed shortcomings¹⁵ in quality and equity at the primary and lower-secondary level, related in particular to inadequate training of teachers. Limited availability of pre-school facilities also plays a role, as it may create an education deficit which is difficult to remedy, particularly for children from low socio-economic backgrounds. At the tertiary level, while the ratio of young people enrolled in universities is currently above the EU average, due to recent measures aimed at easing access to tertiary education, the Czech Republic still had the second lowest tertiary attainment rate in the EU in 2009 and progress between 2000 and 2009 was also below the EU average. In addition, the ranking of Czech tertiary education institutes in international surveys of quality remains low.¹⁶ Furthermore, spending per learner in formal education (in comparable prices) is in the lower quarter of the EU countries and is especially limited in the case of primary education.

The NRP correctly identifies the main weaknesses of the Czech education system and outlines measures for all stages of education. At the lower levels, it aims to improve teachers' competences in order to cope with the envisaged increase in inclusiveness of education. Appropriate sequencing and communication of reforms remains an important issue, so that schools and teachers are well prepared to handle these changes. Recent reforms (i.e. the curriculum reform) have had limited success, mainly because of insufficient initial and in-service training and a lack of understanding of the aims of the reforms.

Regarding tertiary education reform, the NRP indicates that most measures are likely to be implemented by 2013. The main principle of the reform is to increase the quality of tertiary education by linking the financing criteria primarily to the quality of each institution. Smooth functioning of the system would be conditional on the transparency of the quality evaluation and its ownership by all stakeholders. An important part of the package is the introduction of deferred tuition fees, which could help to address, at least partially, the issue of underfunding. The urgency of completing the tertiary education reform is also an outstanding issue, given its links to innovation and competitiveness.

¹⁵ The scores achieved by Czech pupils have deteriorated (mainly in literacy) and the Czech republic is second amongst OECD countries as regards the impact of the socio-economic background in a particular school on educational attainment, indicating that primary education has not been successful in removing the disadvantages associated with a pupils background.

¹⁶ For instance, in the European Commission's 2010 Report on Education the Czech Republic scores last among 16 surveyed EU countries in terms of employability of its graduates. No Czech institution features in the top 200 of the latest Times Higher Education World University Rankings.

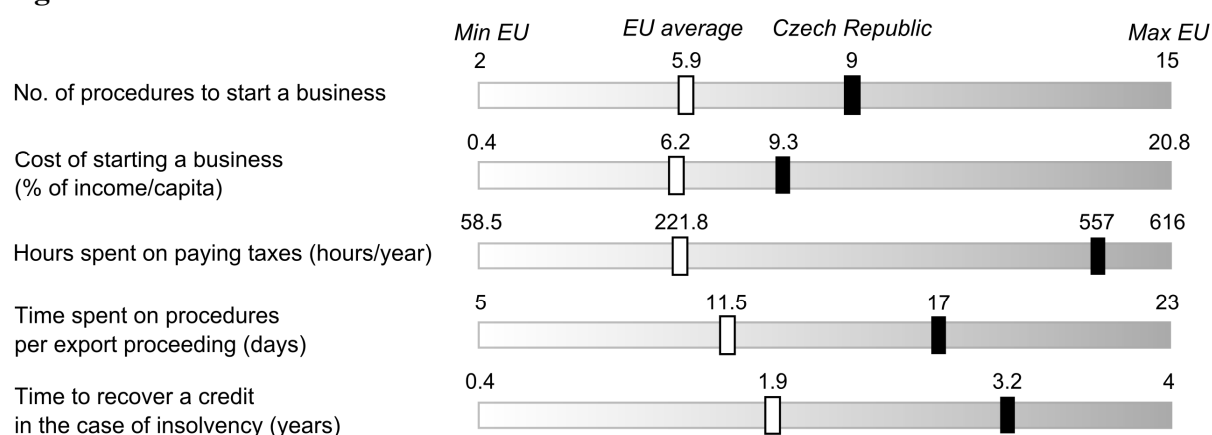
4.2.3 Growth enhancing structural measures

The performance of the education sector and the quality of public administration in areas essential for entrepreneurship are the most obvious sources of growth in the long term, as they contribute to promoting human capital and providing an environment for the smooth functioning of the business sector. Potential output could be further supported by enhancing the quality of both the R&D framework and transport infrastructure, and energy efficiency.

Public administration and business environment

According to several international surveys the Czech legal and regulatory framework ranks below the EU average in terms of quality. Policy making based on evidence and impact assessment is not universally applied and the frequent changes in the regulatory framework put pressure on the business environment. The time spent on tax administration is about twice that of Slovakia, Poland or Hungary and nearly three times the EU average.

Figure 1. Selected issues for the business environment



Source: Doing Business 2011 (World Bank), Staff calculations

A major challenge in improving the efficiency of public administration is to reduce its exposure to the political cycle. Frequent reorganisations in institutions managing important chapters of the state budget and the Structural Funds seriously impede the institutional memory and the efficiency of public administration. However, the adoption of the Public Servant Act has been repeatedly postponed. Corruption perception is to be relatively high in the Czech Republic.¹⁷ Two aspects of the regulatory framework are particularly prone to such practices, namely: a specific type of company shares that permit the wholly anonymous transfer of wealth, and the current public procurement rules. Regarding the former, companies with this type of shares may participate in public bids without identifying their owners, and therefore there is no possibility of detecting a conflict of interest. As for the latter, authorities often misuse the existing procurement rules, in particular by drafting tailor-made tender specifications or by applying unsubstantiated selection criteria.

The Czech Republic launched a 'better regulation' agenda in 2007 and major progress has been made in implementing the Action Plan for Reducing Red Tape, as highlighted in the NRP: the government committed itself to reducing the administrative burden on businesses to 30% in 2020 compared to 2005. Creation of unnecessary regulatory burden in the course of the legislative process could be addressed by improving the regulatory impact assessment

¹⁷ According to recent studies, the Czech Republic ranks 7th lowest of all Member States in the International Corruption Perception Index of Transparency International.

process, due in the second quarter of 2011. However, the status of the current body responsible for the impact assessments cannot ensure adequate scrutiny of the quality of impact assessments. The NRP also entails an undertaking to draft the Public Servant Act by the end of 2011, which is particularly important given the delay that has already affected this measure.

With regard to the public procurement system, the government has recently adopted measures to increase its transparency by introducing standardised basic selection and evaluation criteria, lowering the ceiling for the application of the public procurement rules and other measures. The revision of the Public Procurement Act which came into force in 2011 was an attempt to address the challenge of anonymous shares by introducing compulsory disclosure of owners holding more than 10% of the shares. Nevertheless, full anonymity of the shareholders does not allow any verification of the information provided and the NRP does not include any further measures in this respect.

Research and Innovation

R&D expenditure fell short of the EU average by about a quarter in 2009, but - at 1.5% of GDP - it outperformed some other Member States in the region. However, most of the business R&D expenditure is made by large multinational corporations, which may not bode well for the innovative capacity of domestic small and medium-sized enterprises (SMEs), forcing them to compete at the cost margin. The relatively low level of excellence of scientific output, inadequate availability of scientific and engineering graduates and weak links between the science base and industry bear out concerns about the efficiency of public spending on research and innovation, which are also echoed in the NRP.¹⁸ Overall, the framework supporting R&D, including the programmes co-financed by the EU cohesion policy, appears to focus on capacity building in R&D¹⁹ rather than on achieving tangible results such as new patents, and it is still fragmented in too many institutions and operational programmes. Moreover, access to finance remains difficult for innovative enterprises, especially in the early stage of financing.

In order to ensure faster scientific and technological convergence, the Czech authorities established a target of 1% of GDP for public R&D intensity in 2020. The target is defined in terms of public expenditure, which accounts for the lesser part of overall R&D spending. Monitoring and boosting the development of the private component, including by establishing a venture capital fund, will be instrumental in ensuring an adequate level of overall spending. As a way of tackling the inefficiencies in the public R&D framework, the NRP is calling for a new evaluation system for public R&D spending. This may have the potential to be a very powerful instrument, but critically its effects will depend on the details, which are not discussed in the programme. Introducing a multiannual public funding framework, together with the new assessment system, would help secure the sustainability of public R&D investments and contribute to achieving the national target.

Energy and environment

¹⁸ In terms of scientific quality, only 7.4% of the publications are among the top 10% most cited worldwide. The share of researchers in the labour force (0.57%) is also below the EU average. The low share of R&D expenditure of university and public research organisations financed by the private sector, below 1%, and the low number of public-private co-publications, evidence the relatively weak links between science and industry.

¹⁹ Anecdotal evidence can be found in *Assessment of research, development and innovation programmes completed in 2009* published by the Czech R&D Council (2011). According to their analysis, only 3% of applied R&D spending in programmes administered by surveyed line ministries produced patents, designs or prototypes. The remaining 97% was spent on scientific articles and proceedings.

The Czech Republic is the fourth most energy intensive country in the EU mainly due to the high intensity of its industry (such as metallurgy, steel and coal). Electricity and gas markets in the Czech Republic are still dominated by incumbents and Czech business is confronted by relatively high electricity prices.²⁰ Moreover, given its geographical location and interest in regional integration, the Czech Republic plays a significant role in electricity transfer, which imposes a burden on its grid and requires substantial investments in transmission networks and interconnection capacity. A better performing and smarter grid (transmission and distribution) is also a precondition for the greater penetration of renewable energies (in the light of the 2020 target) and further energy efficiency improvements.

The NRP highlights the ongoing work on the revision of the State energy concept and reiterates the importance of a wider use of nuclear energy as a key element delivering the low carbon economy and security of energy supply. The NRP also refers to the National Renewable Energy Action Plan, which aims to reach the Czech Republic's 2020 renewable energy target of 13% of renewable energy sources in gross final energy consumption. As regards energy efficiency, the NRP acknowledges the need to reduce the consumption of primary energy sources, but has not set any specific target for 2020. The NRP lists ongoing measures to improve energy intensity, although these are unlikely to bring about any substantial reduction in primary energy consumption. On the other hand, the European Regional Development Fund allocation in energy savings has increased substantially in this programming period. The current projections of Czech authorities do not envisage any decrease in primary energy consumption by 2020.

Transposition of the Third Internal Market package will further liberalise markets with electricity and gas, and further diversification of gas suppliers brings increased security of supply.

The recent trend in greenhouse gas emissions appears to be in line with the 2020 national target defined at European level (+9% compared to 2005 levels). However, it would be important to carefully monitor progress, especially in the event of a strong economic recovery and in the road transportation sector, given its relative importance in national emissions. Additional emissions reduction measures could bring co-benefits (energy savings, reduction of atmospheric pollution, increased security of energy supply, green jobs, revenues through the possibility to transfer unused emissions allocations to other Member States).

Transportation

When it comes to transport infrastructure, the Czech Republic has one of the highest railway densities in the region (with correspondingly high maintenance requirements), but the quality of the network remains low, partly due to the lack of intermodal logistic centres linking railways with other modes of transport. Despite the relatively rapid development of the motorway network, the absence of a fast road connection between several major cities and the lack of by-passes around residential areas, all contribute to the unfavourable situation in some areas.

The NRP outlines an ambitious list of rail and highway projects, including investment in two public intermodal centres, which may help deal with the challenges mentioned above. A renewed transportation planning strategy is appropriate in order to coordinate the investments

²⁰ According to EUROSTAT, the Czech Republic in 2010 ranked the Member States with the 8th highest electricity prices for medium size enterprises (in euro per kWh). It is the 4th most energy intensive economy and has the 8th highest energy intensity in industry in 2008 (in kg of oil equivalent per euro of gross value-added at constant prices).

and to be in line with European priorities and commitments. In terms of operational measures, the NRP envisages that public-private partnerships (PPP) will play a key role in facilitating further investment. While the PPP mode of financing has been used effectively in some Member States, and while charging tolls on busy motorways seems to be an appropriate case for implementing PPP, the evidence suggests that careful policy design is a critical factor in its successful application. These concerns are highlighted by the weaknesses in Czech public procurement system mentioned above.

5. SUMMARY

The budgetary consolidation strategy outlined in the update of the Convergence Programme of the Czech Republic relies for the most part on revenue-enhancing measures in 2012, while expenditure-based consolidation is envisaged for 2013. However, the consolidation measures, including those for 2012, are subject to significant risks in terms of adoption and implementation. The annual average fiscal effort for 2011-2013 as forecast in the programme is estimated to reach 0.6% of GDP. The reforms outlined in the programme will contribute to improving the quality of public finances, but the sharp decline in public investment recorded in 2010 bears out the concerns about safeguarding the expenditure on growth-enhancing items. The current unfavourable budgetary situation also impinges on the long-term sustainability of public finances. Taking into account the significant projected cost of ageing, which is above the EU average, the Czech Republic is at high risk with regard to the long-term sustainability of public finances. In the absence of further reform, the public pension pillar - which is likely to remain the main source of retirement income in the future - is likely to result in considerable deficits after 2030.

The economic policies of the Czech Republic outlined in the National Reform Programme contribute to increasing participation on the labour market, improving the functioning of business environment and developing a skilled labour force. However, there remains scope for more comprehensive action in some areas, notably in easing the access to the labour market for mothers with young children, as well as in narrowing the implementation gaps in modernising the quality of public administration. Continuing education reform and monitoring the quality of academic institutions will improve the prospects for growth in the longer term.

ANNEX

Table I. Macro economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012
Core indicators							
GDP growth rate	2.0	3.2	5.4	-4.1	2.3	2.0	2.9
Output gap ¹	-2.9	-2.1	4.1	-2.1	-1.9	-1.8	-0.8
HICP (annual % change)	7.1	2.5	3.2	0.6	1.2	2.3	2.5
Domestic demand (annual % change) ²	3.0	3.7	3.4	-3.7	1.4	0.6	2.0
Unemployment rate (% of labour force) ³	5.5	8.0	6.2	6.7	7.3	6.8	6.4
Gross fixed capital formation (% of GDP)	29.7	27.2	24.7	22.5	21.0	21.3	21.5
Gross national saving (% of GDP)	26.3	22.8	24.4	20.5	20.0	20.5	21.2
General Government (% of GDP)							
Net lending (+) or net borrowing (-)	-5.9	-5.1	-2.4	-5.9	-4.7	-4.4	-4.1
Gross debt	14.3	26.3	29.5	35.3	38.5	41.3	42.9
Net financial assets	45.1	17.2	10.8	1.7	n.a	n.a	n.a
Total revenue	39.3	39.9	41.1	40.1	40.5	41.2	41.2
Total expenditure	45.1	45.0	43.6	46.0	45.2	45.6	45.2
<i>of which: Interest</i>	1.1	1.1	1.1	1.3	1.4	1.8	1.8
Corporations (% of GDP)							
Net lending (+) or net borrowing (-)	-2.8	-0.2	0.1	6.3	3.8	2.7	2.9
Net financial assets; non-financial corporations	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Net financial assets; financial corporations	n.a	-0.1	0.4	n.a	n.a	n.a	n.a
Gross capital formation	21.1	19.3	16.2	10.9	12.7	13.7	13.9
Gross operating surplus	25.7	27.6	28.7	28.8	28.5	28.5	29.2
Households and NPISH (% of GDP)							
Net lending (+) or net borrowing (-)	4.5	0.1	0.9	0.1	0.8	1.3	1.0
Net financial assets	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Gross wages and salaries	32.5	32.0	32.6	34.1	34.2	34.2	34.0
Net property income	5.0	3.5	3.4	2.8	3.0	3.2	3.3
Current transfers received	15.9	16.9	17.4	19.1	19.2	19.3	19.0
Gross saving	6.5	4.1	5.2	5.0	5.1	5.0	4.6
Rest of the world (% of GDP)							
Net lending (+) or net borrowing (-)	-4.2	-5.3	-1.4	0.6	-0.2	-0.4	-0.2
Net financial assets	3.4	18.7	29.3	30.5	n.a	n.a	n.a
Net exports of goods and services	-3.5	-2.0	4.0	5.6	4.8	4.8	5.5
Net primary income from the rest of the world	-1.5	-4.0	-5.2	-5.9	-6.6	-6.7	-6.9
Net capital transactions	0.0	0.4	0.4	1.9	2.1	2.1	1.7
Tradable sector	55.1	54.8	53.5	51.0	51.2	n.a	n.a
Non tradable sector	35.4	35.8	36.5	38.9	38.7	n.a	n.a
<i>of which: Building and construction sector</i>	6.8	5.8	5.8	6.6	6.4	n.a	n.a
Real effective exchange rate (index, 2000=100)	92.0	118.2	148.8	160.9	165.2	171.3	171.3
Terms of trade goods and services (index, 2000=100)	99.2	104.4	105.0	106.6	104.3	102.8	102.8
Market performance of exports (index, 2000=100)	97.2	111.1	141.4	155.4	165.2	170.4	176.5
Notes:							
¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2000 market prices.							
² The indicator on 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.							
<i>Source:</i>							
<i>Commission services' spring 2011 forecast</i>							

Table II. Comparison of macro economic developments and forecasts

	2010		2011		2012		2013	2014
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	2.3	2.3	2.0	1.9	2.9	2.3	3.3	4.0
Private consumption (% change)	0.4	0.5	0.4	0.7	2.0	1.9	3.3	4.2
Gross fixed capital formation (% change)	-4.6	-4.6	2.4	0.7	3.8	3.2	5.6	7.2
Exports of goods and services (% change)	18.0	18.0	9.8	12.2	10.3	10.8	10.7	11.5
Imports of goods and services (% change)	18.0	18.0	8.4	10.6	9.7	10.1	10.7	12.0
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	-0.7	-0.7	0.2	-0.3	1.9	1.1	2.6	3.7
- Change in inventories	2.0	2.0	0.3	0.4	0.0	0.1	0.0	0.0
- Net exports	1.0	1.0	1.4	1.8	0.9	1.1	0.6	0.2
Output gap ¹	-1.9	-1.9	-1.8	-2.1	-0.8	-2.0	-1.4	-0.4
Employment (% change)	-0.8	-0.8	0.0	0.1	0.0	0.5	0.6	0.7
Unemployment rate (%)	7.3	7.3	6.8	6.9	6.4	6.5	6.1	5.5
Labour productivity (% change)	3.1	3.1	2.0	1.7	2.9	1.8	2.7	3.3
HICP inflation (%)	1.2	1.2	2.3	2.2	2.5	3.4	1.6	2.1
GDP deflator (% change)	-1.1	-1.1	0.2	-0.5	1.9	2.7	1.6	1.8
Comp. of employees (per head, % change)	2.9	3.3	2.5	3.1	4.1	4.3	4.3	5.4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-0.2	-0.2	-0.4	-0.6	-0.2	0.0	-0.1	-0.6
<u>Note:</u>								
¹ In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.								
<u>Source:</u>								
Commission services' spring 2011 forecasts (COM); Convergence programme (CP).								

Table III. Composition of the budgetary adjustment

(% of GDP)	2010	2011		2012		2013	2014	Change: 2010-2014
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	40.5	41.2	42.0	41.2	42.3	41.1	40.1	-0.4
<i>of which:</i>								
- Taxes on production and imports	11.5	11.5	12.0	11.5	12.5	12.4	12.0	0.5
- Current taxes on income, wealth, etc.	7.1	7.3	7.6	7.4	7.5	6.9	6.8	-0.3
- Social contributions	15.8	15.8	15.8	15.8	15.8	15.5	15.1	-0.7
- Other (residual)	6.2	6.6	6.6	6.5	6.5	6.3	6.2	0.0
Expenditure	45.2	45.6	46.2	45.2	45.7	44.0	42.0	-3.2
<i>of which:</i>								
- Primary expenditure	43.8	43.9	44.4	43.4	44.0	42.3	40.4	-3.4
<i>of which:</i>								
Compensation of employees	8.0	7.6	7.5	7.3	7.2	6.8	6.5	-1.5
Intermediate consumption	6.4	6.4	6.5	6.3	6.5	6.2	5.9	-0.5
Social payments	20.0	19.9	20.1	19.6	19.6	19.3	18.5	-1.5
Subsidies	1.9	2.0	2.0	2.0	2.0	2.0	1.9	0.0
Gross fixed capital formation	4.6	4.7	5.0	4.8	5.2	4.9	4.6	0.0
Other (residual)	2.8	3.2	3.2	3.4	3.4	3.1	3.0	0.2
- Interest expenditure	1.4	1.8	1.8	1.8	1.7	1.7	1.6	0.2
General government balance (GGB)	-4.7	-4.4	-4.2	-4.1	-3.5	-2.9	-1.9	2.8
Primary balance	-3.3	-2.7	-2.4	-2.3	-1.7	-1.2	-0.3	3.0
One-off and other temporary measures	0.1	-0.2	-0.3	-0.2	-0.3	0.0	0.0	-0.1
GGB excl. one-offs	-4.8	-4.2	-3.9	-3.9	-3.2	-2.9	-1.9	2.9
Output gap ²	-1.9	-1.8	-2.1	-0.8	-2.0	-1.4	-0.4	1.5
Cyclically-adjusted balance ²	-4.0	-3.8	-3.4	-3.8	-2.8	-2.4	-1.8	2.3
Structural balance³	-4.1	-3.5	-3.1	-3.6	-2.5	-2.4	-1.8	2.4
<i>Change in structural balance</i>		<i>0.6</i>	<i>1.0</i>	<i>-0.1</i>	<i>0.7</i>	<i>0.1</i>	<i>0.6</i>	
Structural primary balance ³	-2.7	-1.8	-1.3	-1.8	-0.8	-0.7	-0.2	2.5
<i>Change in structural primary balance</i>		<i>0.9</i>	<i>1.3</i>	<i>0.0</i>	<i>0.6</i>	<i>0.1</i>	<i>0.5</i>	
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 Commission services on the basis of the information in the programme.								
³ Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
Source:								
<i>Convergence programme (CP); Commission services' spring 2011 forecasts (COM); Commission services' calculations</i>								

Table IV. Debt dynamics

(% of GDP)	average 2005-09	2010	2011		2012		2013	2014
			COM	CP	COM	CP	CP	CP
Gross debt ratio ¹	30.7	38.5	41.3	41.4	42.9	42.4	42.8	42.0
Change in the ratio	1.0	3.2	2.8	2.9	1.6	1.0	0.4	-0.8
<i>Contributions</i> ² :								
1. Primary balance	1.9	3.3	2.7	2.4	2.3	1.7	1.2	0.3
2. “Snow-ball” effect	-0.3	1.0	0.9	1.3	-0.1	-0.1	-0.3	-0.8
<i>Of which:</i>								
Interest expenditure	1.2	1.4	1.8	1.8	1.8	1.8	1.7	1.6
Growth effect	-0.9	-0.8	-0.8	-0.7	-1.1	-0.9	-1.3	-1.6
Inflation effect	-0.5	0.4	-0.1	0.2	-0.8	-1.0	-0.6	-0.7
3. Stock-flow adjustment	-0.6	-1.1	-0.8	-0.8	-0.5	-0.5	-0.5	-0.3
<i>Of which:</i>								
Cash/accruals diff.	-0.4	-0.8		-0.6		-0.3	-0.2	-0.2
Acc. financial assets	-0.1	-0.2		-0.2		-0.2	-0.2	-0.2
<i>Privatisation</i>	-0.8	0.0		0.0		0.0	0.0	0.0
Val. effect & residual	-0.1	-0.1		0.0		0.0	0.0	0.0
Notes:								
¹ End of period.								
² The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other								
<i>Source:</i>								
Convergence programme (CP); Commission services' spring 2011 forecasts (COM); Commission services' calculations								

Table V. Long-term sustainability

Czech Republic	Baseline scenario (2010)			Programme scenario		
	S1	S2		S1	S2	
Value	5.8	7.6		3.2	5.2	
<i>of which:</i>						
Initial budgetary position (IBP)	3.5	3.5		1.1	1.1	
Debt requirement in 2060 (DR)	-0.1	-		-0.2	-	
Long-term change in the primary balance (LTC)	2.4	4.1		2.4	4.1	
	2010	2015	2020	2010	2015	2020
Debt as % of GDP	38.5	53.6	64.4	38.5	42.4	41.6

Note: The 'baseline' scenario (2010) depicts the sustainability gap under the assumption that the 2010 budgetary position remains unchanged over the medium-term (until the end of the period covered by the programme). The 'programme' scenario depicts the sustainability gap under the assumption that the budgetary plans of the programme are fully implemented.

Figure. Medium term debt projection

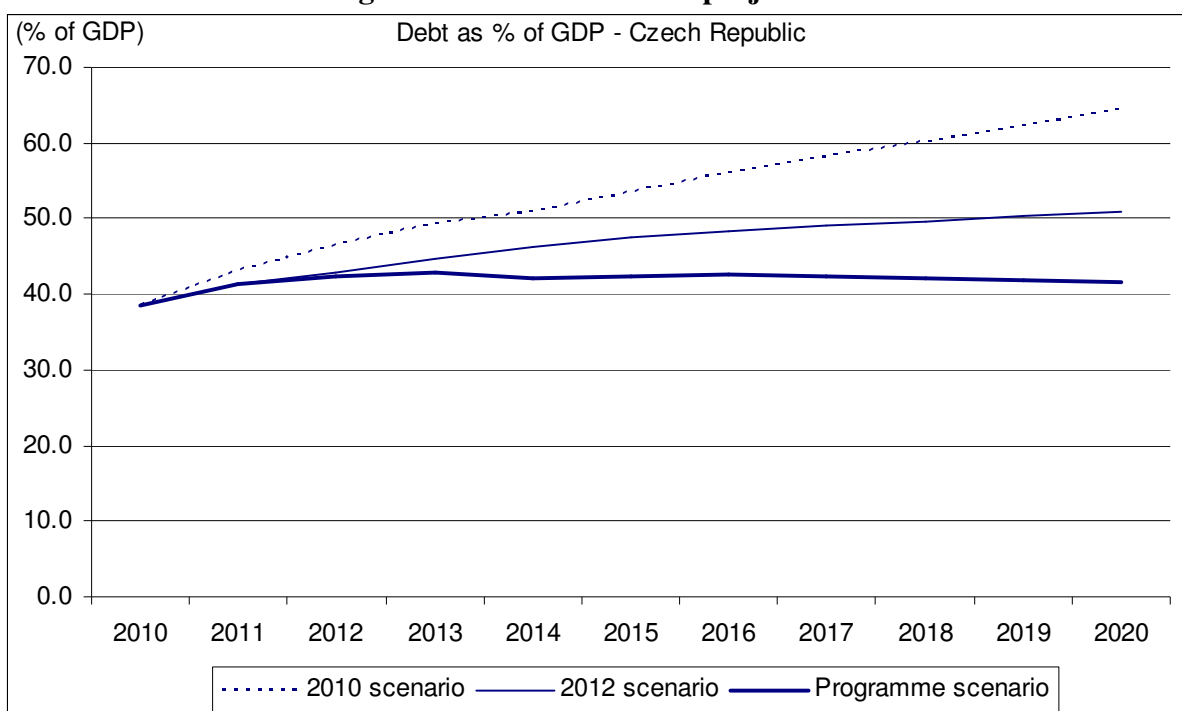


Table VI. Financial market indicators

	2006	2007	2008	2009	2010
Total assets of the banking sector (% of GDP)	98.3	102.4	111.5	118.0	118.7
Share of assets of the five largest banks (% of total assets)	64.1	65.7	62.1	62.4	...
Foreign ownership of banking system (% of total assets)	96.9	91.4	90.8	89.7	...
Financial soundness indicators:					
- non-performing loans (% of total loans) ¹⁾	3.7	2.8	3.3	5.4	6.6
- capital adequacy ratio (%) ^{1) 2)}	11.4	11.5	12.3	14.1	15.6
- profitability - return on equity (%) ^{1) 3)}	22.5	24.4	21.7	25.8	23.1
Private credit growth (annual % change)	28.5	27.2	35.4	1.4	5.9
Residential property prices (y-o-y % change)
Exposure to countries receiving/repaying official financial assistance (% of GDP) ⁴⁾
Private debt (% of GDP) ⁵⁾	40.9	47.7	47.3	52.2	58.2
Gross external debt (% of GDP)					
- Public	8.1	8.2	7.8	9.8	12.5
- Private	22.0	21.5	22.0	21.8	23.5
Long term interest rates spread versus Bund (basis points)*	3.7	8.6	64.9	161.5	114.1
Credit default swap spreads for sovereign securities (5-year)*	36.0	9.5	35.2	82.4	85.9
Notes:					
¹⁾ Latest available in 2010 September. 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⁾ Covered countries are IE, EL, PT, RO, LV and HU.					
⁵⁾ Due to data gaps on debt securities in 2006-2007, only the loans to GDP ratio is provided for these years.					
* Measured in basis points.					
Source:					
Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission services (long-term interest rates), World Bank (gross external debt), Eurostat (residential property prices) and ECB (all other indicators).					

Table VII. Labour market and social indicators

Labour market indicators	2005	2006	2007	2008	2009	2010
Employment rate (% of population aged 20 - 64)	70.7	71.2	72.0	72.4	70.9	70.4
Employment growth (% change from previous year)	1.0	1.9	2.7	1.2	-1.2	-0.8
Employment rate of women (% of female population aged 20 - 64)	61.3	61.8	62.4	62.5	61.4	60.9
Employment rate of men (% of male population aged 20 - 64)	80.1	80.4	81.5	82.0	80.2	79.6
Employment rate of older workers (% of population aged 55 - 64)	44.5	45.2	46.0	47.6	46.8	46.5
Part-time employment (% of total employment)	4.9	5.0	5.0	4.9	5.5	5.9
Fixed term employment (% of employees with a fixed term contract)	8.6	8.7	8.6	8.0	8.5	8.9
Unemployment rate ¹ (% of labour force)	7.9	7.2	5.3	4.4	6.7	7.3
Long-term unemployment ² (% of labour force)	4.2	3.9	2.8	2.2	2.0	3.0
Youth unemployment rate (% of youth labour force aged 15-24)	19.2	17.5	10.7	9.9	16.6	18.3
Youth NEET ³ rate (% of population aged 15-24)	13.3	9.2	6.9	6.7	8.5	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	6.2	5.1	5.2	5.6	5.4	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	13.0	13.1	13.3	15.4	17.5	:
Labour productivity per person employed (annual % change)	5.2	4.8	3.4	1.2	-3.0	3.1
Hours worked per person employed (annual % change)	0.6	-0.2	-0.6	0.7	-3.6	0.9
Labour productivity per hour worked (annual % change; constant prices)	4.6	5.0	4.0	0.5	0.6	2.2
Compensation per employee (annual % change; constant prices)	5.2	4.8	2.9	4.4	-2.1	4.0
Nominal unit labour cost growth (annual % change)	-0.3	1.1	2.9	5.1	3.5	-0.3
Real unit labour cost growth (annual % change)	0.0	0.0	-0.5	3.2	1.0	0.2

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 services (EU Labour Force Survey and European National Accounts)

Table VIII. Labour market and social indicators - continued

Expenditure on social protection benefits (% of GDP)	2004	2005	2006	2007	2008
Sickness/Health care	6.58	6.54	6.20	6.10	6.04
Invalidity	1.47	1.44	1.54	1.48	1.49
Old age and survivors	7.69	7.90	7.77	7.89	8.30
Family/Children	1.57	1.40	1.37	1.66	1.45
Unemployment	0.73	0.66	0.58	0.62	0.64
Housing and Social exclusion n.e.c.	0.62	0.58	0.56	0.25	0.21
Total	18.7	18.5	18.0	18.0	18.1
of which: Means tested benefits	1.28	1.01	0.93	0.59	0.38
Social inclusion indicators	2005	2006	2007	2008	2009
Risk-of-poverty or exclusion ¹ (% of total population)	19.6	18.0	15.8	15.3	14.0
Risk-of-poverty or exclusion of children (% of people aged 0-17)	25.6	22.7	21.5	18.6	17.2
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	14.7	12.7	10.9	12.5	11.7
At-Risk-of-Poverty rate ² (% of total population)	10.4	9.9	9.6	9.0	8.6
Value of relative poverty threshold (single HH per year) - in PPS	4584	4956	5304	5832	6060
Severe Material Deprivation ³ (% of total population)	11.8	9.6	7.4	6.8	6.1
Share of people living in low work intensity households ⁴ (% of people aged 0-59 not student)	8.8	8.9	8.6	7.2	6.0
In-work at-risk-of poverty rate (% of persons employed)	3.5	3.5	3.3	3.6	3.2
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 household 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 for social protection benefits ESSPROS; for social inclusion EU-SILC.					

Table IX. Product market performance and policy indicators

Performance indicators	2001-2005	2006	2007	2008	2009	2010
Labour productivity ¹ total economy (annual growth in %)	3.6	5.5	3.2	2.1	-3.5	2.3
Labour productivity ¹ in manufacturing (annual growth in %)	5.7	12.0	7.3	6.8	-6.4	n.a.
Labour productivity ¹ in electricity, gas, water (annual growth in %)	3.7	14.4	5.3	4.2	-6.8	n.a.
Labour productivity ¹ in the construction sector (annual growth in %)	0.0	4.8	0.3	-2.5	1.3	n.a.
Patent intensity in manufacturing ² (patents of the EPO divided by gross value added of the sector)	0.5	0.5	0.2	n.a.	n.a.	n.a.
Policy indicators	2001-2005	2006	2007	2008	2009	2010
Enforcing contracts ³ (days)	n.a.	653	653	653	611	611
Time to start a business ³ (days)	n.a.	24	17	20	20	20
R&D expenditure (% of GDP)	1.3	1.6	1.5	1.5	1.5	n.a.
Tertiary educational attainment (% of 30-34 years old population)	12.8	13.1	13.3	15.4	17.5	n.a.
Total public expenditure on education (% of GDP)	4.3	4.6	4.2	4.1	n.a.	n.a.
	2003	2005	2006	2008	2009	2010
Product market regulation ⁴ , Overall (Index; 0=not regulated; 6=most regulated)	2.0	n.a.	n.a.	1.6	n.a.	n.a.
Product market regulation ⁴ , Retail (Index; 0=not regulated; 6=most regulated)	0.9	n.a.	n.a.	1.6	n.a.	n.a.
Product market regulation ⁴ , Network Industries ⁶ (Index; 0=not regulated; 6=most regulated)	3.0	2.1	2.0	2.0*	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 designated 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, of this indicator is presented in detail at the website http://www.doingbusiness.org/methodology .						
⁴ The methodologies of the Product market regulation indicators are presented in detail at 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.						
6 Aggregate ETCR.						
*figure for 2007.						
Source :						
Commission services, World Bank Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						