Council of the European Union

Brussels, 1 July 2025
(OR. en)

10961/25

ECOFIN 893
UEM 347
SOC 460
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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	COUNCIL RECOMMENDATION on the economic, social, employment, structural and budgetary policies of Czechia

Delegations will find attached the above-mentioned draft Council Recommendation, as revised and agreed by various Council committees and finalized by the Economic and Financial Committee, based on the Commission Proposal COM(2025) 203 final.

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Czechia

THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

[1] OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

Whereas:

General considerations

(1) Regulation (EU) 2024/1263, which entered into force on 30 April 2024, specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances and sustainable and inclusive growth and resilience through reforms and investments, and preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the TFEU. The European Semester includes, in particular, the formulation, and the surveillance of the implementation of country-specific recommendations. The Regulation also promotes national ownership of fiscal policy and emphasises its medium-term focus, combined with more effective and coherent enforcement. Each Member State must submit to the Council and the Commission a national medium-term fiscal-structural plan, containing its fiscal, reform and investment commitments, over 4 or 5 years, depending on the length of the national legislative term. The net expenditure[2] path in these plans has to comply with the Regulation's requirements, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60% of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3%-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in the Regulation, the adjustment period may be extended by up to three years.

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[2] Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: 'net expenditure' means government expenditure net of (i) interest expenditure; (ii) discretionary revenue measures; (iii) expenditure on programmes of the Union fully matched by revenue from Union funds; (iv) national expenditure on co-financing of programmes funded by the Union; (v) cyclical elements of unemployment benefit expenditure; and (vi) one-offs and other temporary measures.

(2) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility (the 'RRF'), entered into force on 19 February 2021. The RRF provides financial support to Member States for implementing reforms and investments, delivering a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the RRF fosters economic and social recovery while driving sustainable reforms and investments, in particular promoting the green and digital transitions and making Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the Union and support the continued implementation of the European Pillar of Social Rights.

(3) Regulation (EU) 2023/435 of the European Parliament and of the Council[4] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This helps achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Czechia added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

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[3] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

[4] Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1, ELI: http://data.europa.eu/eli/reg/2023/435/oj).

(4) On 1 June 2021, Czechia submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of that Regulation, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V. On 8 September 2021, the Council adopted its Implementing Decision approving the assessment of the recovery and resilience plan for Czechia[5], which was amended under Article 18(2) on 16 October 2023 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[6]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5), stating that Czechia has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement requires that the achievement of preceding milestones and targets for the same reform or investment has not been reversed.

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[5] Council Implementing Decision of 8 September 2021 on the approval of the assessment of the recovery and resilience plan for Czechia (ST 11047/21 INIT; ST 11047/21 ADD 1).

[6] Council Implementing Decision of 16 October 2023 amending the Implementing Decision of 8 September 2021 on the approval of the assessment of the recovery and resilience plan for Czechia (ST 13383/23 INIT; ST 13383/23 ADD 1).

(5) On 21 January 2025, the Council, upon the recommendation of the Commission, adopted a recommendation endorsing the national medium-term fiscal-structural plan of Czechia[7]. The plan was submitted in accordance with Article 11 and Article 36(1), point (a), of Regulation (EU) 2024/1263, covers the period from 2025 until 2028 and presents a fiscal adjustment spread over four years.

(6) On 26 November 2024, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2025 Alert Mechanism Report, in which it did not identify Czechia as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2025 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[8] on 13 May 2025 and the Joint Employment Report on 10 March 2025.

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[7] Council Recommendation of 21 January 2025 endorsing the medium-term fiscal-structural plan of Czechia, OJ C/2025/666, 10.2.2025.

[8] Council Recommendation of 13 May 2025 on the economic policy of the euro area (OJ C, C/2025/2782, 22.5.2025, ELI: http://data.europa.eu/eli/C/2025/2782/oj).

(7) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the EU's global competitiveness over the next five years. It identifies the three transformative imperatives of sustainable economic growth: (i) innovation; (ii) decarbonisation and competitiveness; and (iii) security. To close the innovation gap, the EU aims to foster industrial innovation, support the growth of start-ups through initiatives like the EU Start-up and Scale-up Strategy, and promote the adoption of advanced technologies like artificial intelligence and quantum computing. In pursuit of a greener economy, the Commission has outlined a comprehensive Affordable Energy Action Plan and a Clean Industrial Deal, ensuring that the shift to clean energy remains cost-effective, competitiveness-friendly, particularly for energy-intensive sectors, and is a driver for growth. To reduce excessive dependencies and increase security, the Union is committed to strengthening global trade partnerships, diversifying supply chains and securing access to critical raw materials and clean energy sources. These priorities are underpinned by horizontal enablers, namely regulatory simplification, deepening of the single market, financing competitiveness and a Savings and Investments Union, promotion of skills and quality jobs, and better coordination of EU policies. The Competitiveness Compass is aligned with the European Semester, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.

(8) In 2025, the European Semester for economic policy coordination continues to develop alongside the implementation of the RRF. The full implementation of the recovery and resilience plans remains essential for delivering on the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. These country-specific recommendations remain equally relevant for the assessment of amended recovery and resilience plans in accordance with Article 21 of Regulation (EU) 2021/241.

(9) The 2025 country-specific recommendations cover the key economic policy challenges that are not sufficiently addressed by measures included in the recovery and resilience plans, taking into account the relevant challenges identified in the 2019-2024 country-specific recommendations.

(10) On 4 June 2025, the Commission published the 2025 country report for Czechia. It assessed Czechia's progress in addressing the relevant country-specific recommendations and took stock of Czechia's implementation of the recovery and resilience plan. Based on this analysis, the country report identified the most pressing challenges Czechia is facing. It also assessed Czechia's progress in implementing the European Pillar of Social Rights and in achieving the Union's 2030 headline targets on employment, skills and poverty and social exclusion reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

Assessment of the Annual Progress Report

(11) On 21 January 2025 the Council recommended the following maximum growth rates of net expenditure for Czechia: 4.5% in 2025, 2.5% in 2026, 2.6% in 2027, and 2.9% in 2028, which corresponds to the maximum cumulative growth rates calculated by reference to 2023 of 10.1% in 2025, 12.9% in 2026, 15.8% in 2027, and 19.2% in 2028. On 30 April 2025 Czechia submitted its Annual Progress Report[9], on adherence to the recommended maximum growth rates of net expenditure and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations. The Annual Progress Report also reflects Czechia's biannual reporting on the progress made in achieving its recovery and resilience plan in accordance with Article 27 of Regulation (EU) 2021/241.

(12) Russia's war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission recommended to activate the national escape clause (NEC) of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending and this proposal was welcomed by the European Council of 6 March 2025. Following the request of Czechia on 22 May 2025, on [date; OJ: please insert here as date 8 July 2025] the Council, upon the recommendation of the Commission, adopted a recommendation allowing Czechia to deviate from, and exceed, the recommended maximum growth rates of net expenditure[10].

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9 The 2025 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en.

10 Council recommendation allowing Czechia to deviate from the maximum growth rates of net expenditure as set by the Council under Regulation (EU) 2024/1263 (Activation of the national escape clause), OJ [OJ: please insert in this footnote the reference and date of adoption of Council Recommendation contained in document ST 10465/25].

(13) Based on data validated by Eurostat[11], Czechia's general government deficit decreased from 3.8% of GDP in 2023 to 2.2% in 2024, while the general government debt rose from 42.5% of GDP at the end of 2023 to 43.6% at the end of 2024. According to the Commission's calculations, these developments correspond to a net expenditure growth rate of 0.0% in 2024. In the Annual Progress Report, Czechia estimates the net expenditure growth in 2024 at 2.8%. The Commission estimates that the net expenditure growth was lower than in the Annual Progress Report. The difference between the Commission's calculations and the estimates of national authorities is due to the Commission's recording of one-off expenditure for 2023 creating a higher base for 2024, and the impact of discretionary revenue measures owing to methodological differences between Czechia and the Commission. Based on the Commission's estimates, the fiscal stance[12], which includes both nationally and EU financed expenditure, was contractionary, by 2.4% of GDP, in 2024.

(14) According to the Annual Progress Report, the macroeconomic scenario underpinning the budgetary projections by Czechia expects real GDP growth at 2.0% in 2025, while HICP inflation is projected at 2.3% in 2025. The Commission Spring 2025 Forecast projects real GDP to grow by 1.9% in 2025 and 2.1% in 2026, and HICP inflation to stand at 2.2% in 2025 and 2.0% in 2026.

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[11] Eurostat-Euro Indicators, 22.4.2025.

[12] The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

(15) In the Annual Progress Report, the general government deficit is expected to remain at 2.2% of GDP in 2025, while the general government debt-to-GDP ratio is set to increase to 44.5% by the end of 2025. These developments correspond to net expenditure growth of 3.3% in 2025. The Commission Spring 2025 Forecast projects a general government deficit of 2.3% of GDP in 2025. According to the Commission's calculations, these developments correspond to net expenditure growth of 4.0% in 2025. These higher projections of net expenditure growth than in the Annual Progress Report are due to the Commission's lower forecast of national co-financing of EU programmes in 2025, and lower recording of one-off expenditure in 2025 by the Commission. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be broadly neutral in 2025. The general government debt-to-GDP ratio is set to increase to 44.5% by the end of 2025. The increase of the debt-to-GDP ratio in 2025 mainly reflects the negative headline balance, partly offset by nominal GDP growth.

(16) General government expenditure amounting to 0.6% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.4% of GDP in 2024, according to the Commission Spring 2025 Forecast. Expenditure financed by Recovery and Resilience Facility non-repayable support enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Czechia.

(17) General government defence expenditure in Czechia amounted to 0.9% of GDP in 2021, 1.0% of GDP in 2022 and 1.2% of GDP in 2023[13]. According to the Commission Spring 2025 Forecast, expenditure on defence is projected at 1.3% of GDP in both 2024 and 2025. This corresponds to an increase of 0.4 percentage points of GDP compared to 2021. The period when the national escape clause is activated (2025-2028) allows Czechia to reprioritise government expenditure or increase government revenue so that lastingly higher defence expenditure would not endanger fiscal sustainability in the medium term.

(18) According to the Commission Spring 2025 Forecast, net expenditure in Czechia is projected to grow by 4.0% in 2025 and 4.0% cumulatively in 2024 and 2025. Based on the Commission Spring 2025 Forecast, the net expenditure growth of Czechia in 2025 is projected to be below the recommended maximum growth rate, both annually and when considering 2024 and 2025 together.

(19) The Annual Progress Report does not include budgetary projections beyond 2025. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2025 Forecast projects a general government deficit of 2.2% of GDP in 2026. These developments correspond to net expenditure growth of 4.8% in 2026. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be broadly neutral in 2026. The general government debt-to-GDP ratio is projected by the Commission to increase to 45.4% by the end of 2026. The increase of the debt-to-GDP ratio in 2026 mainly reflects the negative headline balance, partly offset by nominal GDP growth.

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[13] Eurostat, government expenditure by classification of functions of government (COFOG). Due to methodological differences between the COFOG and NATO definitions, expenditure based on the COFOG definition may differ from the expenditure based on the NATO definition.

Key policy challenges

(20) The tax and benefit system puts a heavy burden on low-income earners. Low-income earners often receive little or no financial benefit from working due to high health and social contributions (not deductible) and to benefits that decrease as income rises. For a single worker with 50% of average earnings and without children, Czechia has one of the highest labour tax wedges – the gap between the net take-home pay of workers and their costs to employers – in the EU, and it has been rising for over 10 years. In Czechia, the inactivity and unemployment traps (taxation of people entering the labour market) are above the EU average, which discourages low-income and part-time workers from working. Adjusting labour taxes to reduce the burden on low-income earners would bring more people from these households into the labour market, including from informal or precarious work arrangements to formal and standard employment. Combining this with greater use of underutilised environmental and property taxation instruments would make the tax system more growth friendly.

(21) Czechia's overall tax revenue in relation to GDP was considerably below the EU average in 2023 (34% against the EU average of 39%). Increasing the share of taxes that are less detrimental to growth is an option to support economic growth and fiscal sustainability. Recurrent property taxes are some of the least detrimental taxes to growth, but revenue from recurrent property taxation is very low at 0.2% of GDP (against the EU average of 0.9% of GDP in 2023). Despite the slight increase in recurrent property taxes in 2024 and in the coming years as a share of GDP, the recurrent property taxation system of buildings and units is still based on property size, which leads to unequal taxation of properties of the same value and to taxation not evolving in line with property values. Implementing a property tax system based on property values aligned with market values would enable Czechia to regularly update property values. If combined with elements to protect low-income households, this would increase the efficacy of tax as a tool to mitigate increases in property prices and to put the housing stock to its most productive use. In turn, this would improve housing affordability and people's ability to move around for work, thereby supporting economic growth and further increasing revenue from recurrent property taxes. In 2024, real estate tax rates were increased by an average of around 80%. Furthermore, the possibility was expanded for municipalities to adjust tax revenues through the application of coefficients and the indexation of tax rates to inflation, and not to changes in property values, was introduced.

(22) Czechia's structural budget balance has decreased from close to balance on average over 2014-2019 to -1.7% in 2024. This was due to permanent measures such as the personal income tax cut and increases in pensions and defence spending, which were not financed by corresponding revenue growth. In 2023 and 2024, Czechia adopted legislative reforms addressing the long-running country-specific recommendation on pensions. The reforms raise the statutory retirement age to 67 by 2056, slow down the growth of newly granted pensions, reduce the maximum duration of early retirement, and tighten eligibility conditions for early retirement. These measures are projected to increase the effective retirement age and limit the increase in public pension spending in the long term by 1.9 pps. of GDP[14]. Fully implementing the recently adopted pension reforms would help mitigate ageing-related spending pressure and the resultant risks to fiscal sustainability.

(23) Risks to fiscal sustainability remain. As of 2025, working pensioners are entitled to a discount on social insurance. Supporting employability of older workers not claiming retirement pension, based on a proper cost-benefit analysis of what motivates people close to retirement to work longer, would further decrease risks to fiscal sustainability.

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[14] https://economy-finance.ec.europa.eu/publications/2024-ageing-report-economic-and-budgetary-projections-eu-member-states-2022-2070_en.

(24) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, finalising the effective implementation of the recovery and resilience plan including the REPowerEU chapter, is essential to boost Czechia's long-term competitiveness through the green and digital transitions, while ensuring social fairness. The Commission Communication NextGenerationEU – The road to 2026, adopted on 4 June 2025, clarifies the applicable timeline for the end of the Facility and provides guidance to Member States to maximise implementation by 31 August 2026, including on how to further streamline their RRPs, lays out key options to consider when revising them, and stresses the importance of careful joint planning ahead for the submission of the last payment requests in 2026. Czechia has already made progress in implementing the reforms and investments in its Recovery and Resilience Plan. To deliver on the commitments of the recovery and resilience plan by August 2026, it is essential for Czechia to accelerate the implementation of reforms and investments by addressing relevant challenges. The absorption of recovery and resilience funds is particularly constrained by limited administrative capacity at some of the implementing bodies. This is particularly visible in areas that require more expertise, such as the green and digital transitions. Absorption is also limited by the low and ineffective use of financial instruments along with insufficiently targeted grant support. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(25) The implementation of cohesion policy programmes, which encompass support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), the European Social Fund Plus (ESF+) and the Cohesion Fund (CF), has accelerated in Czechia. It is important to continue efforts to ensure the swift implementation of these programmes, while maximising their impact on the ground. Czechia is already taking action under its cohesion policy programmes to boost competitiveness and growth while enhancing social cohesion. At the same time, Czechia continues to face challenges, including those relating to boosting its innovation potential, including by investing in critical technologies and increasing pressures in the area of housing and skills shortages and mismatches. In accordance with Article 18 of Regulation (EU) 2021/1060, Czechia is required – as part of the mid-term review of the cohesion policy funds – to review each programme taking into account, among other things, the challenges identified in the 2024 country-specific recommendations. The Commission proposals adopted on 1 April 2025[15] extend the deadline for submitting an assessment – for each programme – of the outcome of the mid-term review beyond 31 March 2025. They also provide flexibilities to help speed up programme implementation and incentives for Member States to allocate cohesion policy resources to five strategic priority areas of the Union, namely competitiveness in strategic technologies, defence, housing, water resilience and energy transition, and to investments in skills in priority sectors while maintaining the focus on persons in most vulnerable situations in ESF+ programmes.

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[15] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review − COM(2025) 123 final.

(26) The Strategic Technologies for Europe Platform (STEP) provides the opportunity to invest in a key EU strategic priority by strengthening the EU's competitiveness. STEP is channelled through 11 existing EU funds. Member States can also contribute to the InvestEU Programme supporting investments in priority areas. Czechia could make optimal use of these initiatives to support the development or manufacturing of critical technologies, including clean and resource-efficient technologies.

(27) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Czechia should effectively address the remaining challenges related to decarbonisation, public administration, business environment and skills and education.

(28) Czechia has started substantial civil service reforms to improve the functioning of its civil service, including amendments to the Civil Service Acts, both on national and regional level, which brought in term limits for senior posts and more flexible recruitment. However, systemic challenges persist in attracting, retaining and developing skilled professionals, particularly in expert, managerial and digital roles. Fragmented human resource management and comparatively low public-sector wages undermine the competitiveness of the public administration as an employer. The potential impact of reforms has not been adequately monitored and it is difficult to track progress due to limited data. Strengthening the capacity of Czechia's public administration to attract, retain and develop talent is crucial to increase the effectiveness and quality of services, and in turn boost competitiveness and economic development.

(29) Although public-sector performance has remained relatively stable, gaps in strategic planning, cross-departmental coordination and evidence-informed policymaking continue to affect the quality and coherence of policies. The lack of a comprehensive framework for long-term investment planning undermines policy implementation and impact. Strengthening strategic steering and reducing departmental silos would improve policy consistency and delivery.

(30) As set in the Competitiveness Compass, all the EU, national, and local institutions must make a major effort to produce simpler rules and to accelerate the speed of administrative procedures. The Commission has set ambitious goals for reducing administrative burden: by at least 25% and by at least 35% for SMEs; and has created new tools to achieve these goals, including systematic stress test of the stock of EU legislation and enhanced stakeholders' dialogue. To match this ambition, Czechia also needs to take action. 72% of businesses consider the complexity of administrative procedures to be a problem for their company when doing business in Czechia[16].

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16 'Businesses' attitudes towards corruption in the EU' Flash Report, Eurobarometer Report (April 2024).

(31) Challenges remain in terms of the implementation capacity of the public administration. Processes such as spatial planning remain complex and slow, becoming a major constraint on the business environment, competitiveness and economic development. These are the main reasons for Czechia having the seventh smallest construction area per person of issued permits in the EU in 2023. They hold back businesses by slowing down and raising the cost of commercial development, slowing down the roll-out of high-speed digital infrastructure, raising the cost of energy due to slow modernisation of the energy infrastructure, and reducing the mobility of labour due to the inadequate supply of affordable housing. Affordability of housing is further aggravated by sub-optimal tax incentives, which fail to encourage land use, subsidise housing purchases rather than construction, and prioritise short-term rents over long-term rents. Spatial planning rules are particularly burdensome in large cities, where it can take over a decade to update an urban plan. Reform is needed to accelerate the process, especially by adjusting the competencies and differentiating planning requirements between small and large areas of construction. Such measures could significantly improve efficiency and responsiveness in urban development. On permitting, although progress has been made on the legal framework and, to some extent, on digitalisation, positive impacts are not yet visible on the ground. Further improving digitalisation and the capacity and management of construction offices could help accelerate the process.

(32) Czechia's fragmented municipal governance is a significant challenge to competitiveness as it limits administrative efficiency and the effective use of EU funding, especially by small municipalities and local stakeholders. Although a new legal framework for communities of municipalities has some scope to provide shared services and staff, uptake has been very limited. Strengthening inter-municipal cooperation, including by strengthening the uptake of the new legal framework for communities of municipalities, professionalising procurement practices and providing more support to beneficiaries (through project managers, joint service platforms and guidance) would increase the capacity and effectiveness of local administration and boost regional cohesion.

(33) Czechia has untapped potential to boost competitiveness, not least in structurally affected regions. Losses in competitiveness have been particularly visible in structurally affected regions (Karlovarský, Ústecký and Moravskoslezský regions), manifested in net outflows of young people. There is a lack of effective support to build up the administrative capacity of these regions.

(34) Czech households have a higher savings rate than the EU average, with cash and deposits accounting for 42.7% of household assets, above the EU average. Mobilising these assets to fund through the capital markets the much-needed process of decarbonisation and the digitalisation of the economy could unlock additional financing to businesses whose main sources of funding are internal firm financing and bank lending. Increasing the current share (of 6.6%) of listed shares and bonds in the mix of business funding sources could significantly boost Czechia's competitiveness and reduce the impact of inflation of household savings.

(35) Leveraging public funding remains key to mobilise private finance to support competitiveness. Czechia still has a low rate of take-up of financial instruments, such as revolving ones supported from the Cohesion Funds (2.36% against the EU average of 9%). In addition, experience with implementing financial instruments under the RRF revealed there is significant room to improve and expand the use of these instruments to incentivise private investment in the Czech economy and support the transition away from grant support. However, the National Development Bank continues to operate below its full potential with limited firepower compared to its EU peers and insufficient administrative capacity. Strengthening the National Development Bank would help unlock its potential to address market failures and lack of risk capital to boost innovation, without crowding out private financial institutions.

(36) Support for the business spin-off and start-up ecosystem, including business creation, scale-up and expansion, remains pivotal to accelerate growth and innovation. Challenges to start-ups persist as they experience difficulties in securing financing, a shortage of skilled workers and complex bureaucracy. Czech businesses still cite the complexity of administrative processes as a significant barrier to doing business (72% against the EU average of 66%), including start-ups that do not use employee stock option plans because the framework does not reflect the real needs of businesses. To improve the attractiveness and competitiveness of innovative Czech businesses, it would be helpful to increase support for start-ups and spin-offs by unlocking financing, strengthen their attractiveness to skilled workers and reduce administrative burden, in particular by optimising the framework governing employee stock options.

(37) Czechia's innovation performance continues to be held back by ineffective transfer of technology and knowledge and by weak links between academia and business. Public spending on research and development financed by businesses is still only around half of the EU average (0.024% of GDP, against the EU average of 0.050%), and has recently been falling, demonstrating the low degree of, and incentives for, cooperation between academia and business. This weighs heavily on the transfer of research results into the economy and limits Czechia's innovation capacity. This is shown, for example, by the low rate of patent applications, below the EU average (patent applications filed under the Patent Cooperation Treaty totalled 0.7 per billion euro of GDP in 2022 versus the EU average of 2.8). Measures to structurally improve and strengthen technology transfer in Czechia, aimed specifically at making technology transfer more effective and facilitating the creation of spin-offs, could help tackle this challenge.

(38) There is room to improve how public support for innovative companies is organised. Only a third of companies that are consistently engaged in R&D use indirect public support in the form of R&D tax incentives, and even fewer small and young firms use the incentives. Action to improve this should be combined with action to make the R&D tax deduction more attractive for companies and to cut red tape.

(39) Since the start of the Russian invasion of Ukraine, Czechia has tackled its substantial reliance on fossil-fuel imports from Russia by diversifying its supplies of natural gas. Nonetheless, Czechia remains highly dependent on imported fossil fuels, with coal, oil and gas making up 28.7%, 25% and 15% respectively of its energy mix in 2023. In addition, the transport sector accounts for the largest share of final energy consumption (30.9% of the total), followed by energy consumed by households (28.2%) and by industry (26.2%). The country's significant degree of dependence on these fuels leaves it exposed to price spikes, with considerable negative effects for households and energy-intensive industry. To reduce dependence on fossil fuels, it is crucial to accelerate the roll-out of renewables, with a particular focus on large-scale renewables. Accelerating investments in the decarbonisation of the heating and industrial sectors is another key element.

(40) Czechia has been reforming its legislative framework for governing the deployment of renewable energy sources, but further incentives and substantial investment are needed in order to bring stability and predictability to the market. This would also attract further private investment in renewables. Renewable energy power auctions and the use of power purchase agreements are still very limited in Czechia, with the first corporate agreement concluded in 2021. Launching power auctions and developing long-term contracts could enable the growth of larger scale renewable energy projects beyond traditional support schemes and also create opportunities for energy-intensive industries to decarbonise.

(41) The limited capacity of Czechia's distribution grid network and the need to upgrade the grid continue to hamper the swift deployment and pace of investment in renewable energy sources. Although Czechia has recently adopted reforms aiming to shorten connection queues and increase transparency, investment remain below the level needed to accommodate the connection of new renewable energy sources, increased electrification, the development of sustainable mobility and the level needed to improve fossil-free flexibility services, such as energy storage systems and the development of smart metres.
The Electricity Data Centre has initiated operations for energy sharing. The final phase, which enables the provision of flexibility services, however, faces implementation delays.

(42) Czechia's energy intensity is one of the highest in the EU, which means it would benefit from increasing energy savings by targeting deep renovations. Despite the current renovation support programmes, the final energy consumption of buildings remains high, especially in public buildings. This is in part due to the high electricity-to-gas price ratio, which encourages the use of gas for heating and disincentivises the switch to heat pumps and electrification. Stepping up action to decarbonise the heating sector and provide support to renewable heating and cooling would encourage the production of clean technologies in Czechia (e.g. heat pumps). The use of innovative financial instruments, such as energy performance contracts, could accelerate the slow rate of renovation of public buildings and underpin action by Czechia to achieve its 2030 target to reduce building energy consumption by 8% compared to 2020 levels.

(43) Competitiveness and productivity are curbed by a shortage of workers. Czechia could increase the rate of employment of women with young children, given the low rate of women employed several years after childbirth. Even if in 2024 tax credits for the inactive spouse were limited to persons caring for children up to 3 years, the tax and benefit system still dissuades low-earning parents, in particular mothers, from going back to work. High tax deductibles for non-working spouses and family benefits incentivising the parent earning less to take long periods of leave and discourage parents, in particular mothers, from working or looking for a job. Taxation on earnings for second earners was above the EU average in 2023, and above the tax wedge for single people at the same wage level. Encouraging the lower-earning parent to work or look for a job would also bring in more revenue to support the social security funds and public finances overall.

(44) The share of women, especially those with young children, on the labour market is also constrained by a lack of early childhood education and care and long-term care services. Parents of children under four face difficulties finding childcare and, as a result, the parent earning less is disincentivised from working. The gender employment gap for women between 25 and 34 was 36.1 pps. in 2024 (against an EU average of 25.2 pps.), corresponding to almost 67 000 fewer women in work than if Czechia had the EU average gender employment gap.

(45) Shortages of workers and skills mismatches remain a pressing challenge, hindering the competitiveness of the Czech economy. These challenges could be improved by easing transitions between jobs, including measures such as increasing the affordability of housing or reforming regulated professions to reduce the high barriers to professional certification. In addition, Czechia has received the EU's highest inflow per person of people displaced from Ukraine under temporary protection. Over 50% of displaced Ukrainians are working in less qualified positions than they did in Ukraine, with language reported to be a clear barrier. Furthermore, roughly 30% cite qualification recognition as a barrier to getting a better job. Simplifying the process of recognising foreign qualifications and increasing the labour market participation of underrepresented groups, including people displaced from Ukraine under temporary protection and Roma, could ease labour market tightness.

(46) Higher education participation and attainment is decreasing, which exacerbates the shortage of skilled workers. Tertiary educational attainment among 25-34-year-olds has been falling since 2021 and is the fourth lowest in the EU (33.5% vs the EU average of 44.2%), far from the EU target of 45%. Between 2016 and 2021, the number of students enrolled fell by 11.6% and dropout rates remain persistently high.

(47) High dropout rates, particularly in science, technology, engineering, and mathematics (STEM) fields, and declining enrolment in STEM programmes since 2017 illustrate systemic challenges. In 2022, only 11.9 women out of a thousand people aged 20−29 graduated in STEM fields, below the EU average of 15.1. The lack of sufficient career guidance and financial support to students are among the drivers of high dropout rates at Czech higher education institutions.

(48) Czechia has a shortage of general secondary schools and limited scope for students to move between general and specialised education pathways, limiting their options to successfully pursue tertiary education. Although student interest in tertiary educational attainment has strongly increased over the last 30 years, the number of general secondary schools has not kept pace with demand. The shortage of general secondary schools pushes students to enrol in less competitive vocational schools, leading to early specialisation. Although two thirds of people who complete vocational education and training (VET) enrol in tertiary education, their success rates are below those of students in general tracks, which contributes to consistently low tertiary educational attainment. To address these challenges, Czechia has recently announced steps to create new pathways that combine general and professional subjects and is seeking to modernise VET programmes to bring them into line with the needs of the labour market. To better prepare students who have completed secondary education for the labour market and support their transition to tertiary education, further improvements could focus on (i) expanding work-based learning opportunities, (ii) easing school-to-work transitions, (iii) improving the scope for students to move between general and vocational secondary education, (iv) increasing the capacity of general secondary schools and (v) diversifying and expanding access to tertiary education.

HEREBY RECOMMENDS that Czechia take action in 2025 and 2026 to:

1. Reinforce overall defence and security spending and readiness while ensuring debt sustainability in line with the European Council conclusions of 6 March 2025. Adhere to the maximum growth rates of net expenditure recommended by the Council on 21 January 2025, while making use of the allowance under the national escape clause for higher defence expenditure. Reduce the tax burden on low-income workers. Increase revenue from recurrent property taxes. Improve the incentives for people close to retirement to continue working.

2. In view of the applicable deadlines for the timely completion of reforms and investments under Regulation (EU) 2021/241, accelerate the implementation of the recovery and resilience plan, including the REPowerEU chapter. Accelerate the implementation of cohesion policy programmes (ERDF, JTF, ESF+, CF), building, where appropriate, on the opportunities offered by the mid-term review. Make optimal use of EU instruments, including the opportunities provided by the InvestEU programme and the Strategic Technologies for Europe Platform, to improve competitiveness.

3. Strengthen the capacity of Czechia's public administration to attract, retain and develop talent, particularly to attract people with analytical, managerial and IT skills. Strengthen strategic steering capacities to improve consistency across policies. Simplify urban planning and reduce administrative burden by improving digitalisation, capacity and the management of construction offices. Incentivise and simplify cooperation among municipal administrations. Provide support for administrative capacity building and target this support to structurally affected regions.

4. Strengthen capital markets, business access to non-bank finance and the conditions for saving, investment and innovation by promoting household investments in capital markets and by improving existing long-term savings products' effectiveness in mobilising new long-term investments. Encourage institutional investor participation in listed and unlisted shares, as well as venture capital and private equity. Increase the use of financial instruments, including by strengthening the capacity of the National Development Bank to mobilise private funding to boost competitiveness and the decarbonisation of the economy. Support the creation of start-ups and spin-offs, for example by improving legislation on employee stock option plans. Boost innovation, including by facilitating technology transfer from academia to business. Better tap the potential of R&D tax benefits to stimulate innovation in the private sector.

5. Reduce reliance on fossil fuels, notably for road transport, heating and power generation. Provide further incentives for the roll-out of large-scale renewable energy capacity, notably by running renewable power auctions and by promoting the use of long-term power purchase agreements. Increase investment in electricity grids to enhance fossil-free flexibility and enable the electrification of transport and industrial processes. Ensure the swift implementation of the full functionalities of the Electricity Data Centre. Enact measures to reduce energy consumption and the carbon intensity of the buildings sector, especially of the public building stock.

6. Lower the tax and benefit disincentives for parents to return to work and improve the supply of childcare and care services to encourage more women to enter the labour market. Strengthen the competitiveness of the economy and reduce labour shortages by addressing skills mismatches, simplifying the recognition of foreign qualifications and increasing the labour market participation of underrepresented groups. Boost educational outcomes by increasing participation in tertiary education, reducing dropout rates and providing more student support. Increase the number of students and graduates in science, technology, engineering and mathematics, especially women. Expand access to general secondary education, enable students to transition between general and vocational education, and provide more support for disadvantaged schools and pupils, including Roma.

Done at Brussels,

For the Council
The President