

## 8. State Budget

Continuing swift growth of the economy in combination with the effects of irregular drawing on the European funds led to the so far record size of the SB surplus,...

The irregularities in drawing of funds from the EU budget were essentially reflected in the results of the state budget (SB) during the year 2016. While the revenues (in cash fulfilment) were still significantly strengthened by the finishing financial flows linked to the recently completed programme period, capital expenditure on the common CR and EU projects considerably muted due to the overall low readiness of larger projects on the start of a new programme period this year. Beside these effects, the economic growth have been mirrored mainly in the revenue side of the budget more and more visibly several quarters in a row, especially via the growing collection of direct taxes.

... which arrived at 1.8% in relation to the GDP

The state budget surplus nearly doubled year-on-year in H1 2016 (to 40.6 CZK bn).<sup>1</sup> At the same time it was the best result (of this time period of the year) in the history of the CR itself. The SB balance in relation to the nominal GDP also reached a record level of +1.8% (+1.0% on a year ago). Total revenues of the SB<sup>2</sup> (+2.3%) grew exclusively thanks to the tax revenues incl. insurance (higher by 35.9 CZK bn in total) in H1.

High year-on-year growth of final consumption expenditure in the economy as well as the more intensive control measures aimed at the tax collection were reflected in the GVA collection

State wide collection of the tax most significant by weight – GVA – increased by 6% (by 4.4% at the SB level). It mirrored the stable growth rates of final consumption expenditure, both for households (2.7% nominally in H1) and government institutions (4.3%). The VAT was also affected by the more intensive control measures for tax collection, which were aimed especially at the unentitled claims and excessive VAT deductions.

The rise of the tax rates on the tobacco products stood behind the higher collection of consumption tax since the beginning of the year

The SB gained by nearly 8% more from the consumption taxes compared to H1 of the last year. This was mainly due to the growing tax collection on the tobacco products (+14.6%) supported by the increase of the tax rate.. The rate of growth of collection of this tax was not affected by a marked pre-stocking any more unlike in the previous years. The collection of weight dominant tax on the mineral oils strengthened by 4.8%. Favourable prices of automotive fuels as well as growth of demand for transportation stimulated by the economic growth contributed to a higher consumption.

The growth rate of collection of corporate taxes year-on-year has been hitting double digit numbers for already nine quarters

Among the direct taxes, the corporate taxes achieved the highest state wide collection in the absolute terms this year. They were by nearly one eighth higher for the first half-year, since they capitalised mostly from the fast growing profits of businesses in the preceding two years. However, their collection was still by 7% lower in comparison to the current peak in the boom year 2008 this year (in contrast, the collection of income taxes of natural persons from dependent activity exceeded their pre-crisis peak already by one fifth).

Taxes from income of employees from grew by the highest rate since the year 2007 in H1

State wide collection of income taxes of natural person (ITNP) from dependent activity strengthened by high 10.7%, the year-on-year growth arrived even at 13.3% in Q2 2016 itself. It fully reflected favourable situation on the labour market (i.e. growth of the average wages as well as the record number of employees). Both the development of the economy and the legislative changes<sup>3</sup> supported the collection of ITNP paid based on the tax return – the result was by 3.7 CZK bn year-on-year more favourable (after allowing for the regular refund) at the end of the half-year. The total collection advanced for the first time in the last six years into the positive values. On the contrary, the collection of ITNP from capital yields increased only very negligibly year-on-year for now. As for the other taxes, the SB

<sup>1</sup> The SB surplus doubled at the end of August compared to the data towards the end of H1 (to 81.2 CZK bn). Next to the mildly strengthening tax revenues, mainly the irregularities in the drawing on European funds contributed to this result. Transfers from the EU budget (as a consequence of exceptionally intensive last year finalisation of drawing) exceeded 140 CZK bn (they were even by 2.2 % higher year-on-year), at the same time the decline of capital expenditure kept deepening (down to 40 %, resp. 31 CZK bn).

<sup>2</sup> SB revenues are adversely impacted by the change in the budget allocation of taxes in 2016, which lowers the share of the SB on the state-wide collection approximately by 1 p.p., both for the VAT and income tax of natural persons from the dependent activity.

<sup>3</sup> It was related to setting a ceiling to the expenditure flat rate for the self-employed persons (60 % and 80 %) to the size of 2 CZK mil. On the contrary, the increase of the tax deduction for the second and further child, kindergarten fees or the reintroduction of discounts to working retirees affected the collection somewhat negatively (these changes have been effective since 2015, however as a result of the maturity of the payment of the tax, they impact its collection only in 2016).

gained a more significant resources from the real estate tax, whose swift growth (+1.1 CZK bn, similarly to the last year) proved the revival of the real estate market.

SB revenues from the EU weakened by one seventh year-on-year, but exceeded the whole-year amount anticipated by the budget already during May

The SB gained 115.5 CZK bn on the revenues from the EU in H1 (the overwhelming majority still bound to the previous programme period). Even though their size decreased year-on-year (by 14%), it already exceeded the amount anticipated by the annual budget by more than 20 CZK bn. Total net position of the CR towards the EU budget amounted to 66.6 CZK bn. It reached approximately only half of the record last year's level. Nevertheless, it was by 10 CZK bn higher against H1 2014. Mostly the lower inflow of finances from the structural funds stood behind the year-on-year weaker result this year (by nearly two thirds), on the contrary the direct payments into agriculture were falling more mildly – by less than one quarter.

Capital expenditure sank sharply (in line with the budget anticipations) year-on-year, their volume was the third lowest after year 2007

Total SB outlays fell by 0.5%. It was only the second year-on-year decline within the first half-year after year 2000. However, in contrast to year 2011, decline of this year occurred in the period of a stable economic growth and was as well anticipated by the budget. It was caused by the slump of investment, whose size attained 39.1 CZK bn and approached the level from years 2012–2013, when the public expenditure was strongly affected by the restrictive measures. Two thirds of this year's investment was related to the common programmes of the CR and the EU, they were however still connected to the programme period 2007–13 in the vast majority. The reason was a lower overall readiness of larger (transport) projects at the beginning of new programme period.<sup>4</sup> Total investment has shared in the total state expenditure by 6.4% so far.

Allocation of the SB investment aimed at the development projects in the new programme period stays very low for now

Expenditure on pensions grew the fastest in the last five years, however thanks to a strong growth of the collection of insurance (+5.2%) the pension account deficit kept shrinking

Rate of growth of current SB expenditure (2.1%) had similar pace as recorded in the last five years. The social benefits were traditionally instrumental in the higher expenditure (by 10 CZK bn year-on-year). More than three quarters were directed to pensions, which grew by 4.8%, the fastest in the last five years. The effect of the one-time February allowance (1 200 CZK) beyond the standard pension adjustment (valid again since January 2015) and partially also the growing number of retirees (+0.7%, after three years of stagnation) were in play here. The pension account deficit (the difference between the revenues and expenditure on pensions from the SB) amounted to 11.2 CZK bn in H1 and was again more favourable year-on-year, already the fifth time in a row.

Expenditure on other social benefits has been rising already a fourth year in a row, mainly due to the impact of the sickness benefits and partially also the social care benefits (for long-term seriously sick)...

The stated expended 57.6 CZK bn for other social benefits (i.e. excluding pensions), by 1.9% more year-on-year. The economic growth had a differentiated effect, it was overshadowed by legislative changes for some types of benefits. Further, the paid out unemployment benefits were reduced (-3%), but by a much slower rate than on a previous year, since the number of recipients of this benefit stagnated, in contrast to all registered job applicants (-15%). On the contrary, the year-on-year decline deepened for the material deprivation benefits (from last year's -4.7% to -11.6%). The state social support benefits (significant from the point of view of volume) stagnated. The long-term growth of the social care benefits and mainly the sickness benefits (by 9.2%) continued. This was due to the legislative measures (reintroduced sickness payments already from the 15<sup>th</sup> day), the growth of incapacity to work as well as higher drawing of the maternity benefits. Even though the expenditure on sickness benefits reached a maximum after H1 2009 this year, they were still by 750 CZK mil lower than the volume of the collected insurance.

...on the contrary the fall of expenditure on the material deprivation benefits deepened

Fall of net expenditure on the state debt halted after two years, their size (23.8 CZK bn) was still the third lowest since H1 2008

Expenditure on the wages of state employees was expanding (despite the growth of employment and wage tariffs) by slight 3.2%. A high last year basis, possibly in part reflecting also the expenditure associated with the preparation of the new Service act (which brings new rules for public administration employees), stood behind the milder growth. Non-investment transfers to the regional budgets, which

<sup>4</sup> Situation has not changed much during the vacation period either. All capital expenditure of the SB reached 46.5 CZK bn in the first eight months of 2016. Only 8.4 CZK bn were bound to the EU new programme period (resp. 16.2 bn after calculating also the current expenditure).



are significant by volume, strengthened by 3.7%, mostly representing the funds for the regional education system. State saved somewhat only on the payments to the EU budget (4.5 CZK bn).

Stabilization of the size of the total state debt continued, lasted already 13 quarters in a row

Net expenditure on the state debt (i.e. after calculation the revenues of the state debt chapter) did not fall any more in contrast to the previous two years. The size of the total state debt amounted to 1 691.3 CZK bn at the end of H1, it strengthened by 1.7% year-on-year (its size did not grow any more during the Q2 itself). Higher borrowing activity of the state given the favourable situation on the financial markets and the spreading of the planned repayments of bonds within the year were reflected in the mild growth of the debt. The volume of Czech bonds held by foreign investors gained pace. Non-residents held already by 367 CZK bn at the end of June, resp. 26% of the value of all bonds denominated in Czech Koruna.

Relative size of debt of the government institutions sector was falling exclusively thanks to the strong growth of GDP

Consolidated gross debt of the whole sector of government institutions (including also the local budgets or the social security funds) reached according to the up-to-date data of the CZSO the size 1 857.9 CZK bn at the end of Q1 2016<sup>5</sup> and it amounted to 40.4% in relation to GDP (it was by 1.5 p.p. higher in the same period of the preceding year). The reduction of the relative level of debt was exclusively the result of the growth of the nominal GDP, since the absolute level of indebtedness increased (by 22.5 CZK bn).

The Czech Republic was the eight least indebted country in the EU at the beginning of the year 2016, the declining trend of relative indebtedness was apparent already since Q2 2015 in the EU

Budget of the government institutions reached a mild deficit of 8.1 CZK bn in Q1 2016 (in the accrual expression)<sup>6</sup>, when the surplus of the local government institutions did not manage to compensate the deeper deficit of the central government institutions. The proportion of the total government sector debt to GDP was the eighth lowest within the EU (Denmark, Sweden, Lithuania or Romania were in a similar position) in the Czech Republic (at the end of Q1 2016). Relative debt lowered in half of the EU states compared to the last year's Q1, however by a faster pace only in Ireland, which nevertheless recorded a double indebtedness compared to the Czech Republic at the beginning of the year 2016. Very high indebtedness rate prevailed in Greece (176% of GDP). It was mildly expanding also in the economically stagnating Finland in the last two years.

Chart 19 State-wide collections of tax revenues (y/y in %) and state budget balance (in CZK bn)

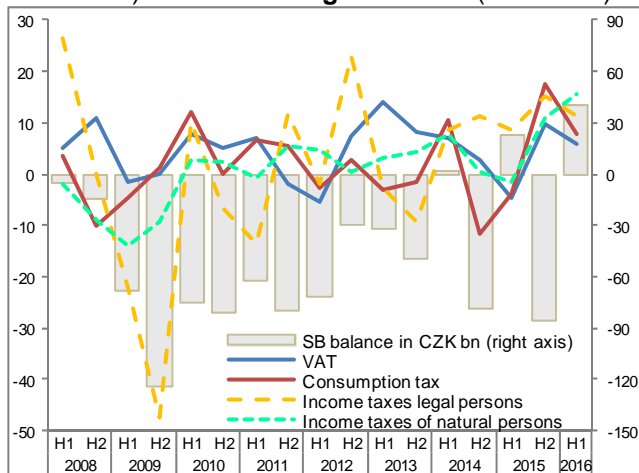
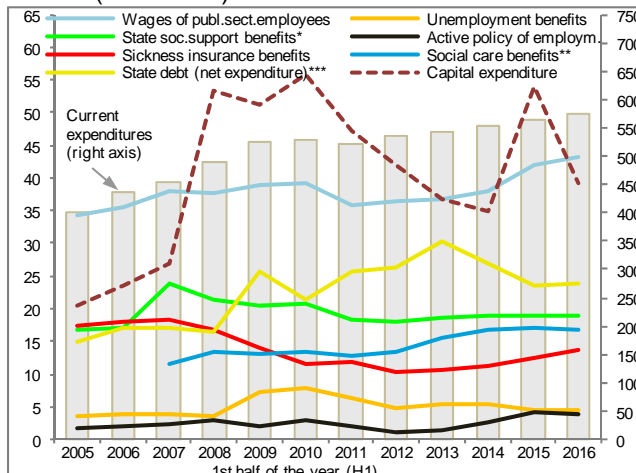


Chart 20 Selected state budget expenditures (in CZK bn)



\*\* including the foster care benefits

\*\* material deprivation assistance benefits, disability benefits, contribution to care based on Act on State Social Support.

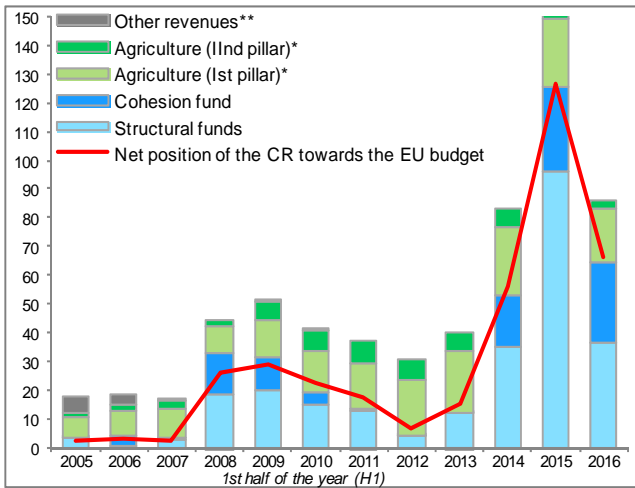
\*\*\* expenditure calculations also include the revenues in chapter on State Debt

Source: MF CR, MLSA

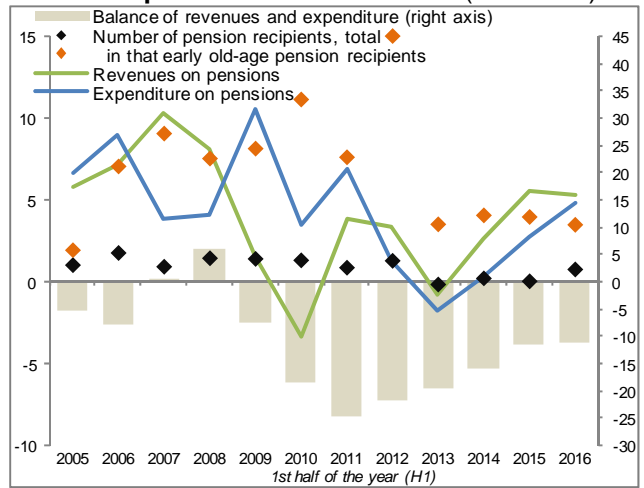
<sup>5</sup> Preliminary data regarding the debt and deficit of the government institutions sector for Q2 will be published by the CZSO on 3rd October 2016, by Eurostat then on 24th October.

<sup>6</sup> Indicators of the budget balance and government institutions debt are based on the accrual principle required by the methodology ESA2010 and Manual on Government Deficit and Debt. According to the accrual principle, the revenues and expenditure are assigned to the period, to which they relate by type, i.e. regardless of the period of the actual realisation of the cash flow (as in the case of cash fulfilment).

**Chart 21 Structure of the CR revenues from the EU budget, total net position (in CZK bn)**



**Chart 22 Number of pension recipients, revenues and expenditure on pensions from SB (y/y, in %) and pension account balance (in CZK bn)**



\* 1st pillar includes funds for direct payments, market measures and vet. measures, IInd pillar resources for development of rural areas and fishing.

\*\* Pre-accession tools, internal policies, compensation payments.

Source: MF, CSSA

