

8. State Budget

The state budget (SB) was driven to the record surplus by the income from the EU (mostly due to strong completion of drawing on funds in the year 2015) accompanied by the effects of continuing economic growth last year.

The state budget (SB) ended according to the cash fulfilment in surplus in the amount of 61.8 CZK bn in 2016 (it was a deficit of 62.8 bn in 2015). The budget surplus was last achieved in the history of the independent CR in the period of the years 1993–1995. The irregularities in the drawing on European funds at the turn of the EU programme periods were majorly reflected in the last year's result. On the income side (157.8 CZK bn), it presented for the most part funds still bound to the expiring programme period (2007–2013), while among the investment expenditure of the SB (84.7 bn) the lower total readiness of projects on the start of the new programme period had an impact. The continuing expansion of the economy also played a role in the last year SB balance, when all the tax incomes (excluding insurance) strengthened by 7.5%¹ year-on-year and were by 22.3 CZK bn higher in comparison to the budget anticipations (i.e. the approved budget). The SB balance in relation to the nominal GDP arrived at +1.3% last year and was nearly double compared to the so far record year 1994.

High year-on-year growth of total final consumption expenditure was reflected in the VAT collection.

State wide VAT collection strengthened by 5.4% last year. Even though the year-on-year rate of growth of the collection (of this most significant tax by weight) nearly doubled compared to the preceding year, its last year's collection – in contrast to all other taxes significant in volume – stayed mildly (by 0.8%) behind the budget anticipations. Higher collection reflected the nominal growth of final consumption expenditure (by 3.5% for households in, by 3.4% for government institutions).

Taxes on tobacco products and taxes on mineral oils both contributed equally to the higher collection of consumption taxes year-on-year.

Income inflow from the consumption taxes to the SB was by 5.2% higher year-on-year. Both stronger collection of taxes on tobacco products (+7%, driven mostly by the increase of the tax rate) and the higher income from the tax on the mineral oils, whose collection grew by 4.7% year-on-year, were behind this rise. It was caused by the growing consumption of motor gasoline as well as the diesel oil² stimulated by the favourable prices of automotive fuels (especially in the first half of the year) as well as the long-term growth of demand for transportation with the continuing economic expansion.

Collection of corporate taxes rose the fastest since the peak year 2008, benefited mainly from the strengthening profits of businesses in the years 2014 and 2015.

State wide collection of the corporate taxes continued to grow by a swift pace. It further accelerated to 11.7% in 2016 (from 11.4% in 2015) and it exceeded the budget anticipations by nearly one tenth (14.5 CZK bn). In contrast to other types of taxes, it was not significantly affected by the legislative effects in the last five years and more clearly thus reflected the favourable development of the profit rate of businesses after the year 2013. Despite of this development, the last year's collection of taxes (164.7 bn) still hovered one tenth below its pre-crisis maximum from the year 2008³.

Collection of ITNP from the dependent activity grew the most since the year 2007 due to a favourable condition of the labour market, the collection of taxes from self-employed natural persons also increased...

Year-on-year rate of growth of the state-wide collection of income taxes of natural persons (ITNP) more than doubled (to 11.7%), primarily due to the tax payments from the dependent activity. Record number of employed persons as well as the continuing reduction of the number of unemployed contributed to this development, as well as the strengthening wage dynamics in most branches⁴. The collection of income taxes of natural persons (ITNP) based on the tax returns significantly increased in the last year (to nearly 7 bn, the highest collection since the year 2010), which was associated not only with the profitability of the self-

¹ State wide collection of tax income (i.e. at the level of all public budgets) increased even by 8.4% compared to year 2015. Tax income of the SB itself were negatively affected by the change of the budget distribution scheme of taxes last year, when the proportion of the SB on the state-wide collection decreased roughly by 1 p.p., both for the VAT and the income taxes of natural persons (ITNP) from dependent activity.

² Total consumption of diesel oil increased by 4.0% from January till November 2016 (in case of motor gasoline by 1.7%). Due to the lowering of support of green and high percentage biofuels in transport (since year 2016) it can be assumed, that part of the consumption transferred to more taxed automotive fuels. Consumer prices of automotive fuels hovered the lowest since the deep recession (2009) in eleven months of the last year.

³ The sharp year-on-year fall of collection (by more than one third) in the crisis year 2009 was the reason, the lowering of the tax rate from 21% to 19% in the period of years 2010 and 2011 also had an effect to a lesser extent.

⁴ State-wide collection of ITNP from dependent activity was negatively impacted by the legislative changes – it was especially the further tax deductions on second and further child in the year-on-year comparison. It however represented only a marginal effect with respect to the growth of the economy.

...on the contrary, the dynamics for ITNP from capital yields was modest and remained tightly behind the budget anticipations.

employed natural persons but also with the limitation of the size of expense rates. The double-digit growth of the collection of tax from the property acquisition continued last year similarly to the year 2015, indicating the further revival of the real estate market due to the growing disposable income of households as well as the prevailing low interest rates.

Record depth of the fall of total SB expenditure due to year-on-year slump of investment, but a modest growth of current expenditure as well.

Total SB expenditure decreased by 6.0% last year. It represented the deepest year-on-year fall of expenditure in the era of the independent CR. Sharp, however expected slump of investment (by 52% year-on-year) was not compensated by a corresponding growth of the current expenditure – these strengthened by 1.2% (the least in the last four years), when the vast majority of current expenditure (incl. pensions or other social benefits) did not fulfil the budget anticipations.

Share of investment on all SB expenditures dropped below 7% last year, taking into account the extraordinary year 2015 it however fully fits into the long-term development.

Sharp fall of the capital outlays (by 91 CZK bn) was linked to the extraordinarily high basis of the year 2015 and also the anticipated slower drawing of funds on common projects of the CR and the EU on the start of the new programme period⁵. Mild acceleration of the investment flow towards the end of the last year ensured meeting the whole year amount anticipated by the SB. The proportion of investment on total budget expenditure fell to record 6.9% last year. If we however took into account also the year 2015, then a similar proportion (for whole period of 2015-2016) would not deviate from the long-term level in any way in this two year period⁶.

Moderate growth of expenditure on pensions combined with the dynamic growth of collection of compulsory insurance led to the lowest pension account deficit in the last eight years.

Full 45% of current expenditure were directed to social benefits last year, the dominant part was traditionally formed by the expenditure on pensions. These also thanks to a one-off February contribution (in the total size of 3.5 CZK bn) strengthened by 1.0% year-on-year. The year-on-year dynamics was however stronger (2.4%) in 2015, since it reflected the higher expenditure in connection to the return to the traditional adjustment scheme of pensions⁷. Mild increase of the number of pensioners (+0.3%) also manifested in the last year's volume of expenditure on pensions. The number of persons with a permanently shortened old-age pension grew more dynamically, their proportion of all recipients of old age pension crossed 25% for the first time last year. The pension account deficit (difference between incomes and expenditure on pensions from the SB) reached 16.5 CZK bn and it shrank by more than one half compared to the year 2015.

Expenditure on other social benefits (without pensions) were by 2.7% higher year-on-year, mostly due to higher sickness benefits.

Volume of other social benefits (without pensions) was growing more dynamically than the expenditure on pensions themselves last year in contrast to the year 2015. Higher drawing of sickness insurance benefits stood primarily behind this development (by 8.9%), caused by the growth of sickness (in all regions) as well as more intensive drawing of the maternity benefit. Even though the expenditure on sickness benefits grew already fourth year in a row, they were still lower than the volume of collected insurance payments last year (by 2.1 CZK bn, by 5.5 bn in the year 2012). Social care benefits also slightly increased (by 2%). It was a consequence of the across-the-board increase of the contribution to care benefits (since August by 10%), because the material deprivation assistance benefits were by one eighth lower year-on-year (even by 18% for the two years). The volume significant benefits of state social support stagnated (around 37.5 bn, already third year in a row), when the lower volume of paid out child benefits was compensated by slightly higher housing benefits, parental benefits as well as the foster care benefits. Despite significant improvement on the labour market and also the decrease of the number of registered job applicants (by 72 thousand at the end of December year-on-year), the volume of the unemployment benefits reduced only by 0.7% last year (number of persons with the right to claim support fell only by 5.3 thousand at the same time).

Continuing notable fall of the material deprivation benefits evidenced the improving financial situations of households.

⁵ 54.3 CZK bn was spent in 2016 on current as well as capital expenditure for common CR and EU programmes (excluding the common agricultural policy) according to the preliminary data (the budget expectation was 70 bn).

⁶ The share of investment on the SB expenditure was on average 10.2% during the period 2015–2016, similarly to the preceding decade (2005–2014).

⁷ Starting January 2015, the full adjustment of pensions returned. They again fully reflect with the current adjustment scheme the increase of the consumer prices and further 1/3 of the increase of the real wage.



Lower drawing of expenditure on non-investment purchases and further reduction of net expenditure on state debt.

Expenditure on wages of state employees similarly to the non-investment transfers to the regional budgets significant in volume (especially to regional education) increased by 5% in 2016, in both cases however it represented lower rates of growth than in the previous year. Budget savings were achieved for non-investment purchases and expenditure on state debt. Net expenditure on state debt dropped last year already for the third year in a row (to 40.7 CZK bn). The improving SB balance (and connected lower borrowing need of the state), as well as the favourable conditions on the markets with government bonds both play a role here.

Total amount of the state debt lowered after three years of stabilisation in the year 2016, both the internal and external indebtedness was reduced.

While the total size of the state debt increased by 21.7 CZK bn during the Q1, the trend turned in the remaining part of the year. The debt lowered by 3.6% for the whole last year (to 1613 CZK bn), the most since the inception of the independent CR. It mirrored the reduction of the inner indebtedness (by 45.8 bn), however the crown value of the external debt was also lower (by 13.8 bn). The external debt comprised 16.7% of the total debt at the end of the year, which represented the lowest proportion since the beginning of the year 2008. Decrease of the total debt was associated with the higher volume of planned repayments concentrated into the second half of the year. The falling borrowing need of the state also had a positive effect. The state tried to make use of the negative interest rates in the year 2016 – 57% of the value of newly issued bonds thus displayed a maturity up to five years and the volume of sales of state bonds with a negative yield reached 145.7 bn. The growth of the volume of Czech bonds held by the foreign investors further fastened. It represented already 424 CZK bn at the end of December 2016, resp. 31.6% of the value of all crown bonds (it was 14.5% two years ago)⁸.

Value of debt of the whole sector of government institutions lowered quarter-on-quarter already second time in a row, it amounted to 1813 crowns at the end of Q3 2016

Consolidated gross debt of the whole sector of government institutions⁹ reached the size of 1 813 CZK bn based on the newest CZSO data at the end of Q3 2016 and it arrived at 38.7% in relation to the GDP (it was by 1.9 p.p. higher in the same period of the previous year). The swift growth of the nominal GDP stood behind the year-on-year lowering of the relative level of the debt last year, but the decrease of the absolute size of the debt to a lesser extent as well (by 15.6 CZK bn). The Czech Republic was the seventh less indebted EU country last year, only Estonia, Luxembourg and Bulgaria recorded significantly lower relative debt at the end Q3. The indebtedness fell in 17 EU states in comparison to Q3 2015 (the most in Ireland from 85.6% to 77.1% of the GDP). From the seven most hit states¹⁰ only Italy however managed to reduce its indebtedness (by 1.4 p.p.). Out of the largest EU economies, Germany was the most successful in this respect, when it also thanks to the budget surpluses pushed the indebtedness below the 70% boundary (the lowest since Q1 2009).

Only three EU states achieved a notably lower indebtedness in relation of debt to the GDP than in the CR.

All subsectors of government institutions achieved more favourable budget balance for the three last year quarters.

Budget of the government institutions ended in the positive balance in the amount of 41.3 CZK bn in the CR for Q1 to Q3 2016 (in the accrual expression)¹¹. Especially the local government institutions contributed to the more favourable result year-on-year (by 38.4 bn), their high surplus (51.8 bn) was mainly connected with the restriction of the investment activity. Deficit of the central government institutions reduced by nearly one half year-on-year (to 17 bn), health insurance companies achieved a more favourable budget result as well.

⁸ Inflow of the speculative capital in connection with the nearing end of the exchange rate commitment of the CNB at the beginning of 2017 accelerated. Non-residents owned Czech bonds already in the amount of 538.8 CZK bn at the end of January, resp. 38.7% of value of all crown bonds.

⁹ Debt of the sector of government institutions includes apart from the central government institutions also the budget of the regional governments or health insurance companies. Preliminary data regarding the debt and deficit of the government institutions sector for the whole year 2016 will be published by the CZSO on 4th April 2017 (by Eurostat then on 24th April).

¹⁰ States, where the debt of the government institution sector exceeded 95% of GDP last year (Greece, Portugal, Italy, Cyprus, Belgium, Spain and France).

¹¹ Indicators of the budget balance and the government institutions debt are based on the accrual principle. According to this principle, incomes and expenditures are assigned to the period, to which they are connected by type, i.e. regardless of the period of occurrence of the cash flow (as it is in case of the cash fulfilment).

Chart 19 **State wide collection of tax income (y/y in %) and state budget balance (in CZK bn)**

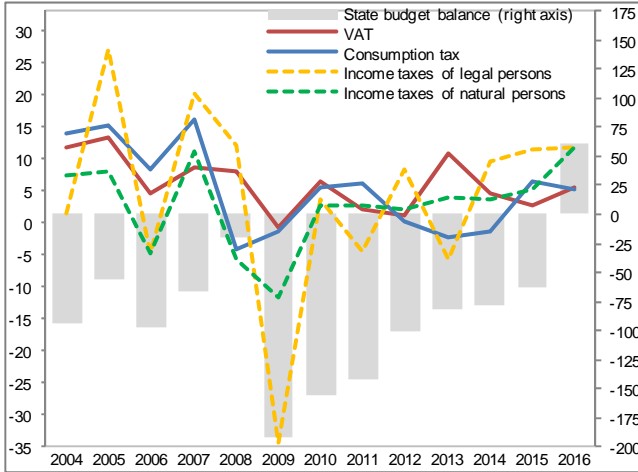
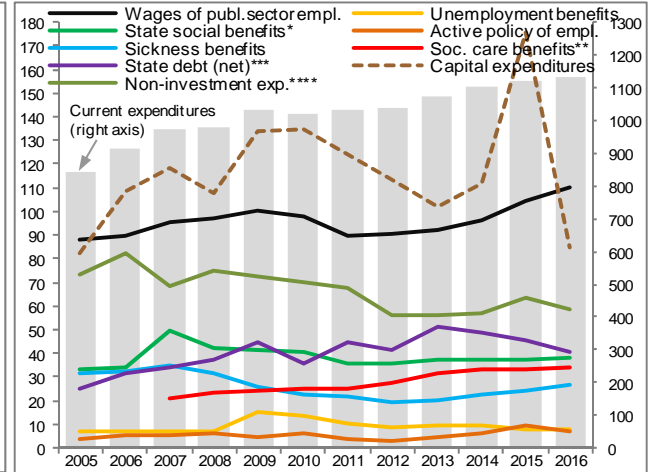


Chart 20 **Selected state budget expenditures (in CZK bn)**



*including the foster care benefits, ** material deprivation assistance benefits, disability benefits, contribution to care based on Act on State Social Support, *** expenditures also include the income of the chapter State debt
**** excluding interest and other financial costs of state debt

Source: MF CR, MLSA

Chart 21 **State debt of the CR according to means of financing (in CZK bn) and share of CZK bonds held by non-residents (in %)**

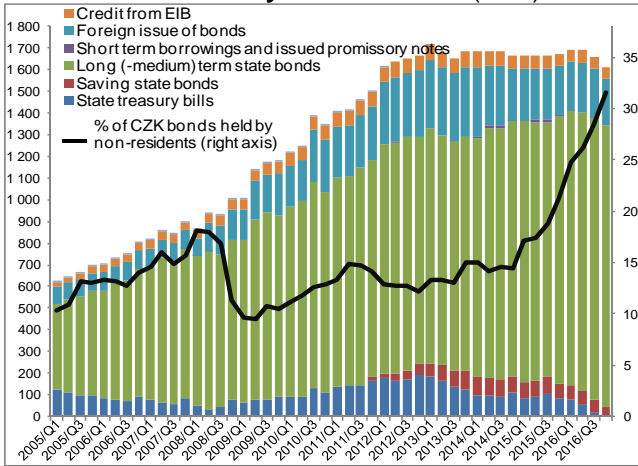
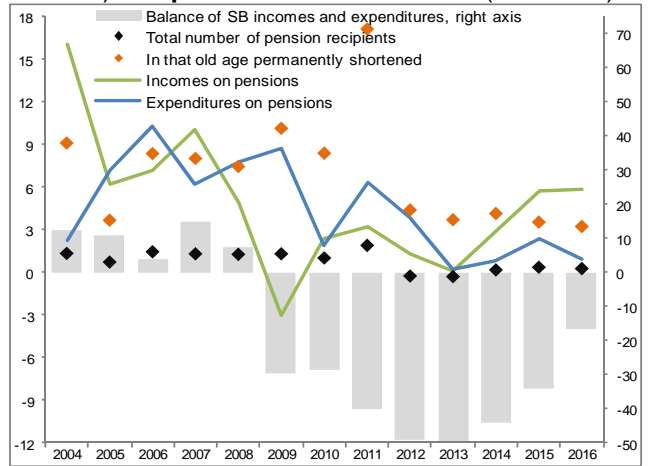


Chart 22 **Number of pension recipients, incomes and expenditures on pensions from the SB (y/y in %) and pension account balance (in CZK bn)**



Source: MF, CSSA

