

## 8. State Budget

Strengthening economic growth supported by a record drawing of resources from the European funds catapulted the state budget to the lowest deficit after year 2008

The strengthening economic growth accompanied by the intensive finalisation of drawing of funds from the EU budget helped to keep the trend of declining state budget (SB) deficits in 2015. It ended (based on cash fulfilment) in deficit of 62.8 CZK bn, which was the fourth best result after 2000. The actual deficit was visibly better than the budget anticipations (similarly to the previous two years). Deepening irregularities on both the revenue and outlay side caused, that the SB fell into a more notable deficits only in the last quarter of the year. The SB balance (forming the key part of a deficit or surplus of the government institution sector) amounted to -1.4% in relation to nominal GDP in 2015 (-1.8% a year ago) and it belonged (together with year 2008) to the lowest in the new millennium.

Even though the year-on-year dynamics of the state-wide VAT collection (+2.8%) was also due to the effect of the legislative measures the lowest in the last three years, still it exceeded the budget anticipations

Both transfers from the EU and all tax revenues (higher by nearly 50 CZK bn) contributed to the growth of the total SB revenues (by 8.9% year-on-year) by an equal amount. The swift pace of the economy was to a growing extent reflected in the tax revenue collection, including the indirect taxes, whose year-on-year dynamics was blurred by an artificially raised basis at the beginning of the year.<sup>1</sup> The collection of the weight dominant VAT increased by 2.8% for the whole year 2015. The effect of the strong final consumption expenditure throughout the economy was partly dampened by the introduction of the second lowered VAT rate, falling prices of fuels and also by the payment of the temporarily excessive VAT deductions.

The year-on-year dynamics of consumption tax collection the fastest in the last eight years, especially thanks to the growing rates of taxes on tobacco products

The state-wide collection of all consumption taxes grew the fastest (+6.5%) after year 2007, thanks to the tax on the tobacco products, whose collection increased by one seventh higher year-on-year and (according to the cash fulfilment) returned to a continual course for the first time after year 2011. The collection of the dominant (by weight) tax on mineral oils strengthened by 3.3% in 2015, mainly the consumption of diesel oil expanded. Low prices of automotive fuel stimulated the demand (incl. the transit transport), the strengthening economy was also accompanied by the growth of private as well as freight transportation. On the contrary the re-introduction of tax reliefs (so called green fuel) had a slight negative effect.

State-wide collection of the corporate taxes grew the most since the business cycle peak in 2008

Rising profits of the businesses were gradually transformed into increasing growth rates of corporate tax collection (+9.7% in 2014, +11.4% a year later). On the contrary, the collection of income taxes of natural persons remained (similarly to years 2013 and 2014) below the level of budget anticipations, when it grew by 4% (similar rate as in 2014). The legislative measures (increase of the tax relief on second and further child, "kindergarten fee", re-introduction the basic tax relief for working pensioners) partially subdued the positive impact of higher employment as well as gradual wage growth acceleration. Even though the state-wide collection of corporate taxes grew the fastest in last seven years in 2015 (+11,4 %), it still lagged by nearly one fifth against its pre-crisis peak (year 2008). Apart from the impacts of the recession on the tax collection (the highest in 2009, but also in years 2011 and 2013), the lowering of the tax rates also played a role. The collection of taxes from employees was already by 7.7% higher compared to its pre-crisis peak (year 2007).

Larger collection of taxes from employees was prevented by the widening of tax reliefs and partially also the modest wage growth especially in the first half of the year

More than one fifth of the CR revenues from the EU budget eventuated in the last year during the period 2007–2015

The expected intensive finalisation of drawing of resources from the EU budget fundamentally influenced both the revenue as well as outlay side of the budget. The CR gained in total nearly 194 CZK bn in 2015, which represented more than one fifth of the received funds for the period 2007–2015. Nearly 57% of revenues were associated with the structural funds in 2015, which also participated the most on the fastened drawing completion (they were by 53 CZK bn higher year-on-year, by 23 CZK bn for the cohesion funds). After accounting for the payments into the EU budget, the net position of the CR arrived at nearly 152 CZK bn, twice as much as in 2014.

<sup>1</sup> With respect to the consumption tax on tobacco products, the higher collection from the beginning of year 2014 was connected with the intensive pre-stocking of traders at the end of year 2013 for the reason of subsequent increase of rates. As of 1.12.2014, another increase of the consumer tax rates occurred for the tobacco products, but was supplemented also by the regulation of the pre-stocking. Higher VAT basis was associated with the temporary deferring of payment of the part of excessive deductions at the beginning of year 2014 (in the amount of 8.7 CZK bn) for the "non-settled" VAT payers. Amount of 1.8 CZK bn was still being deferred (by government authorities) at the end of December 2014.

Dynamics of the SB expenditure growth increased its pace to the highest level after 2006

Total expenditures of the SB accelerated to 7.1% year-on-year, they grew by nearly double pace compared to year 2014. Especially the investment expenditure caused it, by 58% higher year-on-year. 83% of SB capital outlays were direct to co-financing of common CR and EU programmes. It was especially the Transport Operational Programme (41.4 CZK bn, by 27.9 CZK bn more year-on-year) and further the domains of entrepreneurship, innovations, environment and also the regional operation programmes. Investment constituted a record 13.6% of all SB outlays, when its share oscillated only slightly above 10% in years of the business cycle peak.

Nearly one seventh of the state budget outlays directed to investment in 2015

Pension account deficit lowered already second time in a row and achieved its best result in the last five years in 2015

The growing social benefits (by 10.5 CZK bn) participated from one half on the higher current expenditures (by 1.9%). Nearly four fifths of social outlays were expended on pensions, whose size was influenced by a repeated transfer to a previous indexation scheme and to partly also by intergenerational exchange of the pensioners. The number of pension recipients was moderately increasing (from 0.2% in 2014 to 0.4% in the following year), exclusively due to the higher number of old-age pensioners. Even though the growth of the expenditure on pensions was the highest in the last three years (by 2.4% year-on-year) this year, the pension account deficit (the difference between revenues and expenditure on pensions from the SB) kept declining (to 35 CZK bn) thanks to the dynamic growth of the collection of the insurance (by 5.2%, the highest after 2008).

Sickness benefits expenditure reached the highest absolute amount after year 2009, still they were by more than 3 CZK bn lower than the volume of collected insurance

Especially the outlays on sickness insurance (by 9%) were increasing among the social benefits (other than pensions). It was caused by the legislative measures (renewed payment of sickness benefits already from the 15th day) and also the growth of sickness rate. The weight most dominant state social support benefits in total stagnated. Only the foster care benefits (by one eighth year-on-year), maternity grant and housing benefits (by 3.6%) grew within this sector. Social care benefits also stagnated, when a higher expenditure on care (based on the Social Services Act) was compensated by 7% drop of the material need benefits. The favourable situation on the labour market also led to a marked fall of the size of paid out unemployment benefits (by one tenth compared to year 2014, they fell even by 45% against the year of the deepest recession). Only one quarter of persons registered in the labour offices was receiving the unemployment benefits in December 2015 (their share slightly increased by 2.5 p.p. year-on-year). Simultaneously, the outlays on the active policy of employment markedly strengthened (thanks to the EU funds), they were by more than one half higher for Q1 to Q3 2015 year-on year and they even exceeded the resources on the passive employment policy after a long time.

State social support benefits in total stagnated year-on-year, similarly to the social care benefits

Expenditure on wages and other payments for work fastened to 7.8%, they were however only by 4% higher against the year 2009

The retreat from the former restrictive measures stood also behind the rise of the current SB expenditures. This was also reflected in the higher non-investment transfers to regional budgets (e.g. on teachers' wages or contribution to state administration in municipalities) as well as in the growth of expenditure on wages of state employees (by 7.8%, partially also due to the preparation for the new Public Servants Act, but also due to higher wages in defence or the judiciary). Expenditure on non-investment purchases was also higher year-on-year.

Expenditure on state debt were declining already second year in a row, in accumulation by 8%

The SB saved on the payments to the EU budget as well as the expenditure on state debt (-2.7 CZK bn) similarly to the last year. The state managed to sell its medium term bonds on the primary market with negative interest rates by the end of summer for the first time in history.

Size of the state debt was stabilised in the last nine quarters

The stabilisation of the state debt continued. Its size reached even 1 673 CZK bn according to the MF at the end of the year 2015 and increased by 0.6% year-on-year (after fall in the preceding year by 1.2%). It happened due to the development in Q4 itself, when the total debt rose by 10 CZK bn. State utilised the favourable situation on the financial markets, when it borrowed with a negative yield. The external debt share on the total indebtedness was 17% at the end of 2015 (the least since the beginning of 2008). The volume of the Czech bonds kept by foreign investors increased by nearly one half during the year 2015 and amounted to 295 CZK bn at the end of Q4.

Debt of the government institution sector relative to

The debt of the whole government institution sector (accounting for among other things also the budget of regions or social security funds) reached according to the



GDP lowered during the first three quarters of 2015, similarly to the majority of EU countries

up-to-date data of the CZSO the size of 1831.3 CZK bn at the end of Q3 2015<sup>2</sup> and it was 41.4% in relation to GDP (42.7% then at the end of 2014). The drop of the relative level of the government institution debt is the result of both the growth of the nominal GDP and the stabilisation of the nominal level of the state debt, which comprises the dominant part of the total debt of the government institutions. The relative size of the government institution sector debt was the seventh lowest among the EU countries in the CR at the end of Q3 2015 (e.g. Denmark or Sweden also had a similar position to the CR). The relative indebtedness lowered in most EU countries since the beginning of 2015 (the most in Ireland – from 107.5% to 99.4%), on the contrary it increased by more than 3 p.p. in Slovenia (to 84.1%).

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

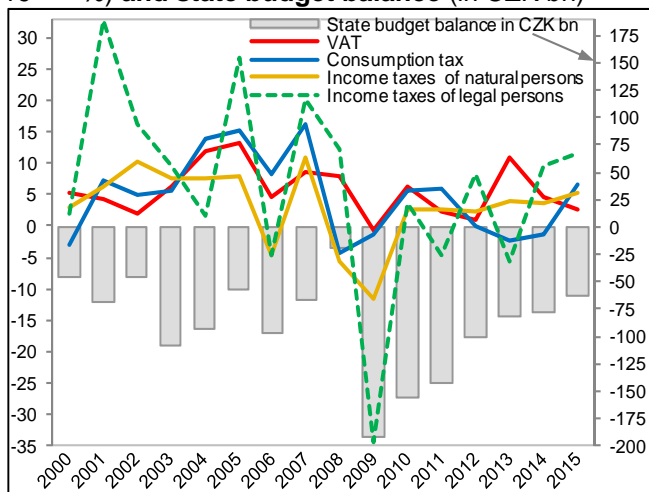
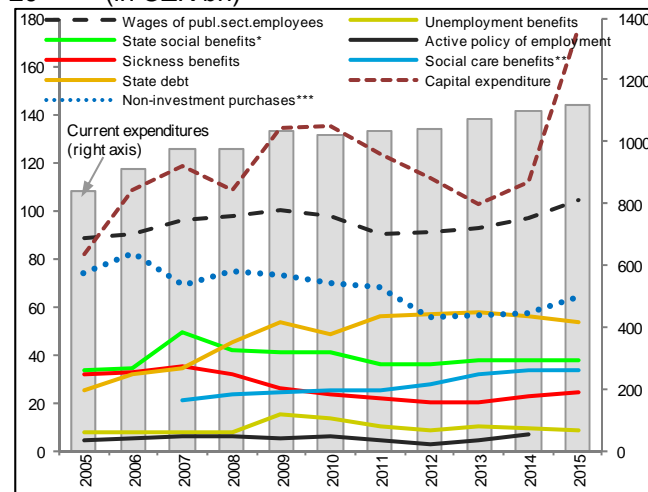


Chart 20 Selected state budget expenditures (in CZK bn)



\*including the foster care benefits

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

\*\*\* excluding interest and other Financial costs

Source: MF, MLSA

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

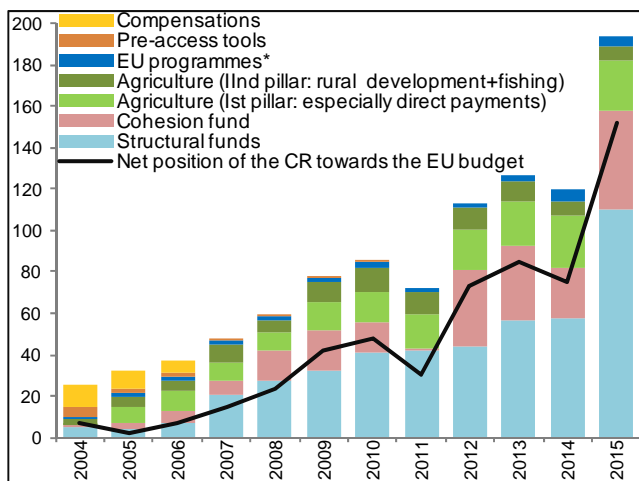
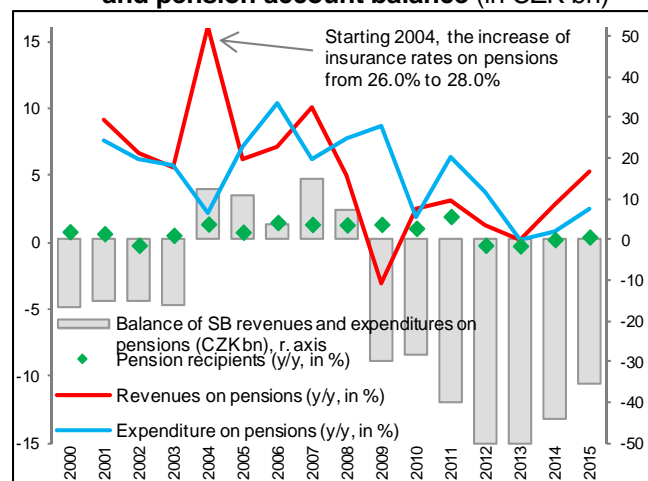


Chart 22 Revenues and expenditures on pensions from the State budget (y/y, in %) and pension account balance (in CZK bn)



\*include programmes directly governed by the Commission (Horizon 2020, Tool for interconnection of Europe, Erasmus+)

Source: MF, CSSA

<sup>2</sup> The data regarding the debt and deficit of the government institution sector for Q4 2015 will be published by the CZSO on 1st April 2016. Simultaneously, the previous data will also be revised.