

## 8. State Budget

State budget surplus for the first time since 2008 in H1...

Trend towards continuing stabilisation of public budget has also proved during the year 2014. At the end of Q2, the state budget finished (based on cash fulfilment) in surplus of 1.4 bn crowns, which was the highest in the last eight years, and it improved in relation to nominal GDP to +0.1 % (from last year's -1.7 %, resp. record -4.1 % in H1 2010). The budget has been pulled out of deficit by revenues (higher by nearly 40 bn crowns year-on-year), which more than adequately compensated the restrained growth of total expenditures (+1.1 %).

...driven by the growth of all main revenue components...

Effort to complete drawing of remaining funds at the end of program period „pushed“ the revenues from the EU to historical maximum

So far the highest revenues from the EU (in H1: 84 bn crowns) historically and further also the extraordinary revenue of the chapter Czech Telecommunication Office from the auction of frequency bands for high speed mobile network LTE (8.5 bn crowns) contributed to the strengthening of total revenues (year-on-year +7 %) from more than one third. The increased collection of VAT as well as consumption taxes were evenly reflected in the higher tax revenues (+25 bn crowns), the collection of direct taxes then also to a lesser extent. The state-wide collection of dominant by weight VAT added 7 % year-on-year (while the budget anticipated stagnation compared to last year collection). Both the gradual revival of private consumption and the measures against the tax evasions and more prudent approach to excessive VAT deduction pay out, are reflected in the improved collection.

VAT collection remains above the level of budget anticipation

Higher collection of consumption taxes significant by volume is considerably affected by the legislative changes

All important groups of consumption taxes were on the contrary affected by the change of legislation<sup>1</sup>. The state budget gained from the most significant consumption tax – tax on mineral oils, despite the weaker growth of sales at petrol stations, by 7 % more year-on-year. The higher collection of tax on tobacco product by more than one fifth was affected by the intensive prestocking of traders at the end of year 2013<sup>2</sup>. The significance of „solar taxes“ gradually dissipates for the state budget due to legislative changes.

Collection of corporate tax bounced off from the record low level of the previous three years

The state wide collection of the corporate tax strengthened by 8.4 % in H1 year-on-year, when it was falling in the same period of the three preceding years. The collection was influenced especially by the economic situation of large companies and their restructuring in 2013. On the contrary, the physical person income taxes (PPIT) from dependent activity remained due to a more modest growth (+4.7 %) the only more significant budget item of the state, whose collection does not fulfil the budget anticipation this year. The so far rather subdued growth of both wages and employment is projected into the rates of growth of the collection. Still, the state wide collection of taxes from employees hovered 13 % above the level of top of boom (H1 2008) in H1 2014, on the contrary it was nearly by one quarter lower for corporations (it was dampened next to the impacts of recession on profits of companies also by the repeated lowering of the tax rate). The collection from PPIT from capital income increased by more than one tenth also due to the volume of bank deposits year-on-year. The collection of PPIT from self-employed also progresses favourably, especially as a result of cancellation of some tax reliefs when using capital expenditure allowances.

Prevailing uncertainty on the labour market so far prevents a higher growth of collection of physical person income tax ...

...which as the only more significant income item remained below the level of last year fulfilment in H1 2014

Investment was falling already fourth year in a row and reached 45 % of the level in H1 2010

Mild growth of total expenditure (+6,2 bn crowns) was driven only by current expenditure year-on-year (+1.5 %), the capital expenditure continued in decline already fourth year in a row. This year's fall of investment<sup>3</sup> was milder in contrast to the preceding years (and in comparison to year 2013) as well as anticipated by the budget. The lower anticipation of investment is connected to the decreasing need to cofinance the projects covered from the revenues from the EU associated with the

<sup>1</sup> The increase of rates for consumption tax on tobacco products from 1.1. (it was also realised in the same period in the previous year); cancelling the right to tax return on mineral oils used for agricultural primary production (so called „green fuel“) for tax on mineral fuels; lowering of rates from 26 % to 10 % (from 28 % to 11 % resp.) for tax payments on „solar systems“ accompanied at the same time by lengthening the payment for equipment introduced to operation during the year 2010.

<sup>2</sup> The collection of these taxes planned for whole year of 2014 was already fulfilled from 35 % only for first this year's month (from 29 %, also due to prestocking in last year's January). The effect of prestocking will be gradually subduing during the year and the more long-term trends of tobacco consumption will be more apparent apart from the higher rate in the total collection. The collection was already higher by less than one tenth by the end of August 2014 year-on-year.

<sup>3</sup> The size of capital expenditure (50.8 bn crowns) was also higher by 5.7 % during the first eight months of 2014.

finishing programming period, partially also by the transfer of funds (8 bn crowns) to non-investment transfers (repair and maintenance of the rails). The investment shared in overall state expenditure by 5.3 % this year, by more than one half below the level of years 2008-10, but still more than in period 2006-7 (4.5 %).

Stagnating expenditure on pensions reflects the lower rate of adjustment as well as demographic trends

Expenditure on pensions the most significant by volume (in line with the budget anticipations) stagnated year-on-year. The number of recipients mostly influences the size of expenditure on pensions given the lower rate of adjustment, this number in fact stagnating eight quarters in a row. Adverse last year's development for collection of social insurance on pensions halted, when it strengthened by 2.4 % year-on-year. The pension account deficit lowered to 16 bn crowns according to the preliminary data in H1 2014 (by 3.5 bn crowns year-on-year), when it reached the best result in the last four years.

Mild improvement of pension account due to revival of insurance collection

Expenditure of other social benefits were higher apart from the unemployment benefits year-on-year, however below the level of budget anticipations

The state expended by 3.5 % more on other social benefits (even though their drawing was with respect to the approved budget year-on-year lower). The resources for the unemployment benefits somewhat declined in line with the situation on the labour market (-1.5 %), however the state spent more on other benefits – especially the social care allowances (mostly the aid in material hardship and care allowance), the sick benefits as well as significant by volume state social support (+1.2 %). Expenditure on all social benefits (including also pensions) cut from the budget 41 %, (two years ago 42 %).

Long-term trend of growth of expenditure on state debt halted thanks also to the favourable development of interest rates in H1 2014

The legislatively amended higher payments for state insures and subsidies to the education system significant by volume as well as expenditure on wages of state employees (+ 3.3 %) contributed to the growth of current expenditure (+8 bn crowns). The state on the contrary saved on the non-investment purchases above the frame of the budget anticipations and also for expenditure connected to state debt, which fell for the first time since 2010 year-on-year.

Net position of the CR towards the EU budget was the highest in history in H1 2014

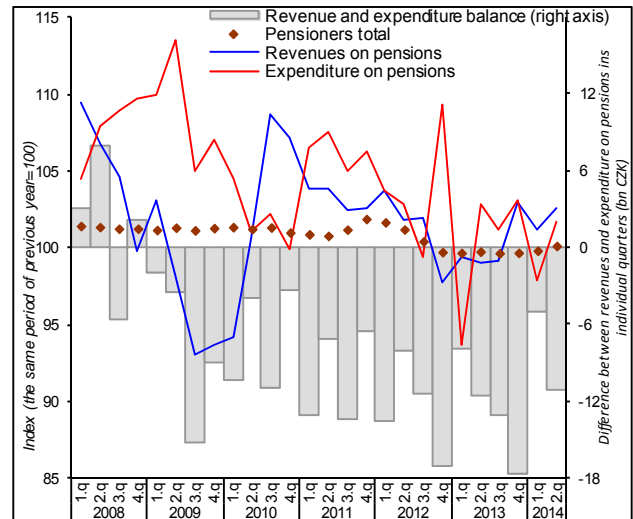
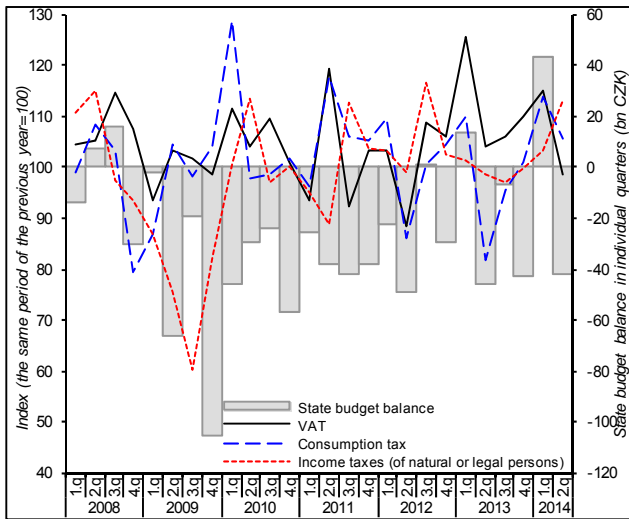
Even despite a mild increase in payments to the EU budget (+1.2 bn crowns) the intensive drawing of all funds from the EU was reflected in further strengthening of positive position of the CR towards the EU budget. It arrived at record 56.4 bn crowns for H1 2014. The positive balance of the CR in relation to the European budget reached nearly 390 bn crowns since the accession to the EU till the half of year 2014 (given the total revenues of nearly 760 bn crowns). Especially the faster drawing of funds from the Structural and Cohesion Funds stayed behind the markedly higher balance. Direct payments (from Common agricultural policy) constituted more than one quarter of total revenues in H1 2014.

The size of state debt stagnated also due to repayment of foreign bonds in Q1

The overall state debt has not changed in first half year and it arrived to 1683 bn crowns at the end of June. Nearly four fifths of the total debt belonged to internal indebtedness (it increased by 53 bn crowns since the beginning of the year). Both the repayments of foreign bonds and an absence of new borrowing (during the whole this year's half year) favourably impacted the development of the external debt.

Chart 21 **State-wide collection of tax revenues and state budget balance development**

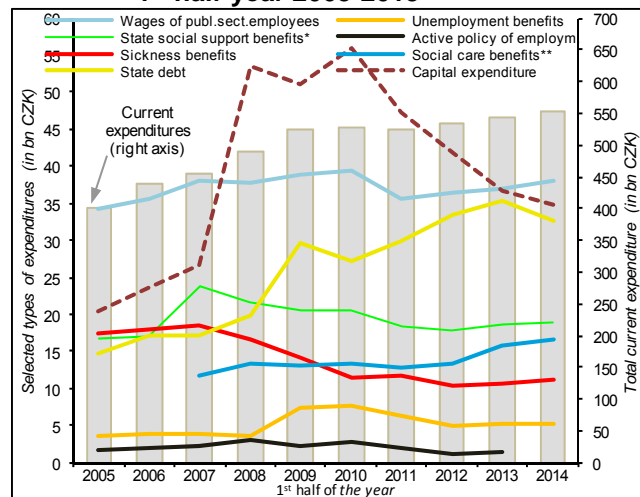
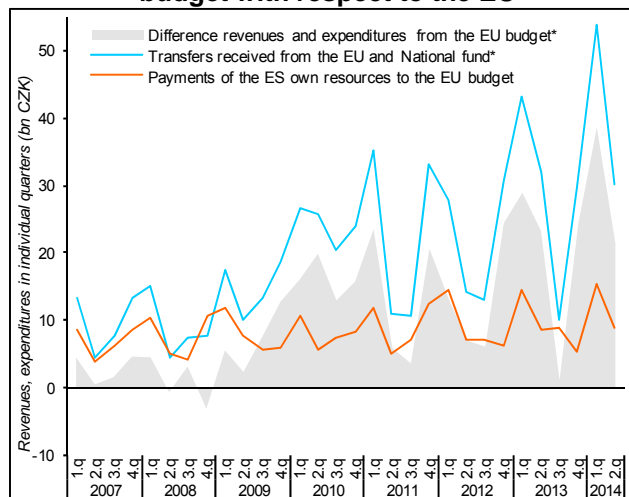
Chart 22 **Pension account balance and number of pensioners development**



Source: MF CR, ČSSA

Chart 23 Revenues and expenditures of the state budget with respect to the EU

Chart 24 Selected state budget expenditures in 1<sup>st</sup> half-year 2005-2013



\*only the funds to cover expenditure on Common agricultural policy under management of Ministry of Agriculture are included out of transfers received from the EU

\* Foster care benefits and grants are also included  
\*\* Include: Material need benefits, Benefits for persons with disabilities, Care benefits (under the Act on Social Services)

Source: MF CR

Sources of data in the whole analysis: CZSO, MF CR, CNB, Eurostat, CZSO calculations.

Latest information from the CZSO and CNB given in this report has been dated the 15th September 2014.