Key fiscal challenges from the Czech perspective

THE CZECH AND SLOVAK ECONOMIES:
17 YEARS AFTER

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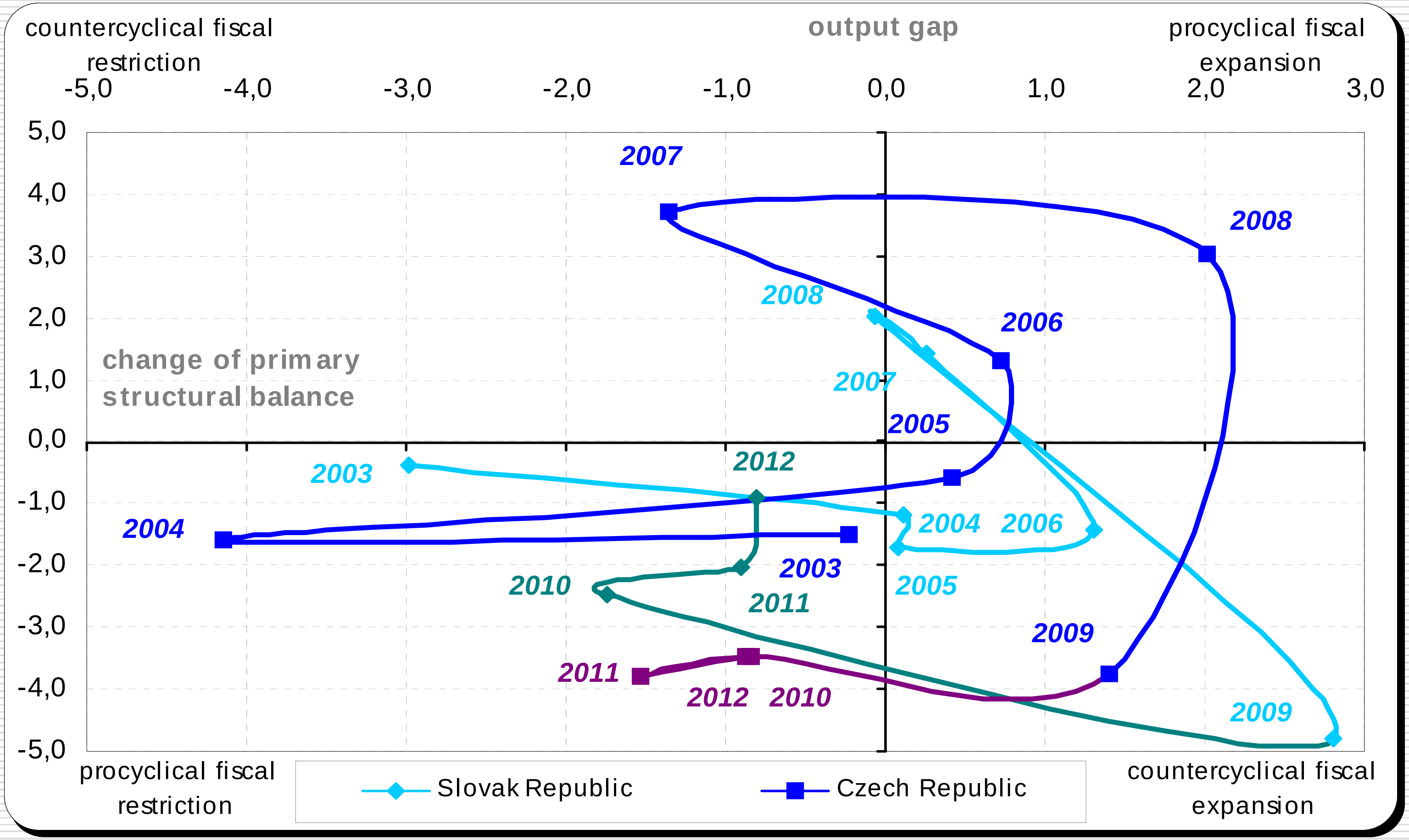
Fiscal stance in years 2003 – 2010 and medium-term outlook



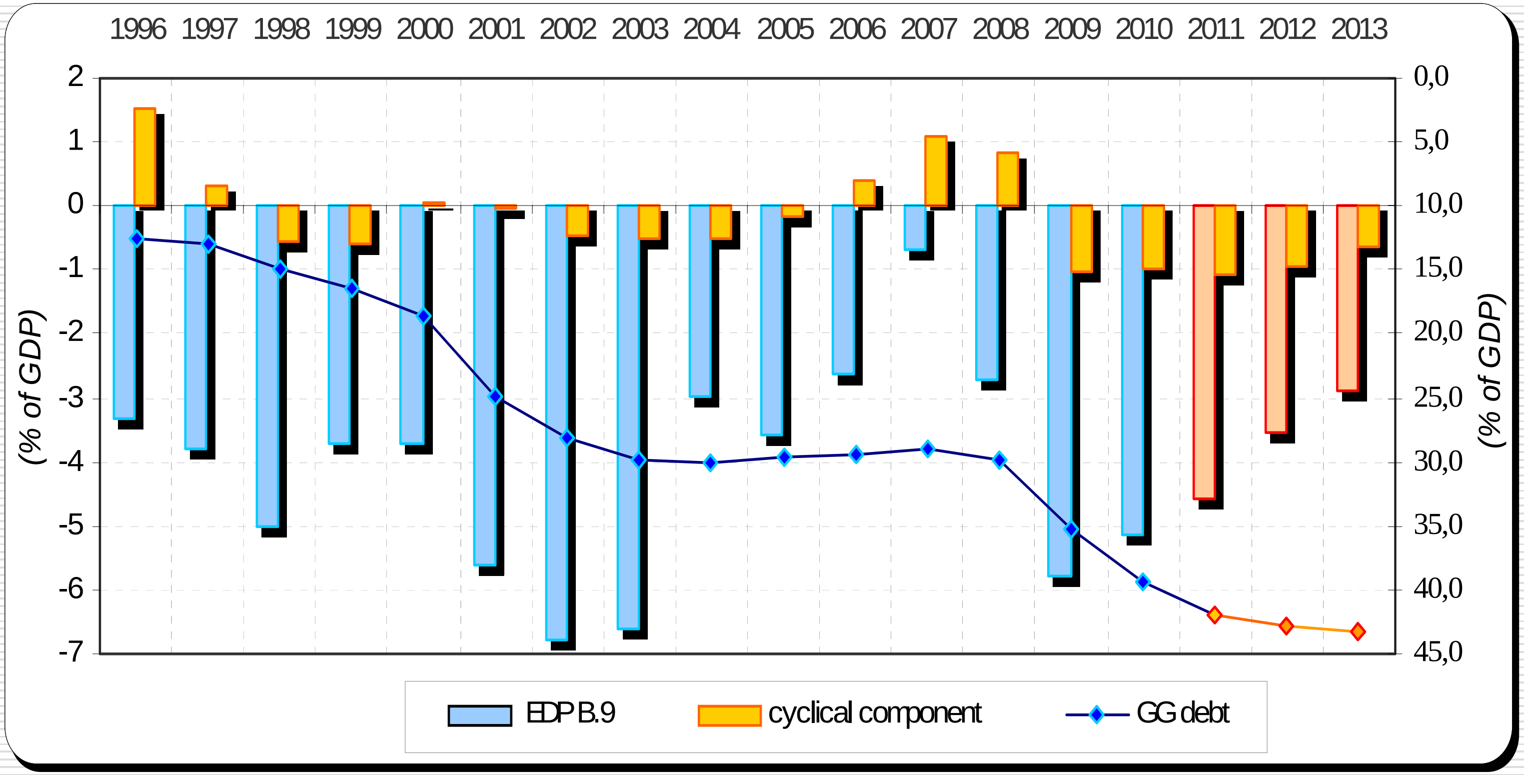
Current fiscal policy and consolidation strategy

- **excessive deficit procedure** initiated in December 2009 after strong worsening of fiscal position during crises
  - The Council of the EU recommended to reduce the ratio of the GG deficit to GDP below the 3% reference value by 2013 (average annual structural effort 1 % of GDP).
- **consolidation strategy** in compliance with the above-mentioned requirements
  - the Government has slightly tightened fiscal objectives (4,6 % of GDP in 2011; 3,5 % of GDP in 2012 and 2,9 % of GDP in 2013) and specified the objective of achieving balanced GG finances in 2016 (conditional)

Quality of public finance 2009

Tax revenue	**18,8**	**Intermediate consumption**	**6,6**
Direct taxes	7,4	**Compensation of employees**	**8,1**
Current taxes on income, wealth etc.	7,4	**Social transfers**	**19,9**
PIT	3,6	**Property income** *(mainly interests)*	**1,3**
CIT	3,6	**Subsidies**	**2,1**
Capital taxes	0,0	**Other current transfers**	**1,6**
Indirect taxes *(taxes on production and imports)*	11,4	**Gross fixed capital formation**	**5,2**
VAT	7,0	**Capital transfers**	**2,3**
Excise taxes	3,8	**Others**	**-1,1**
Social contributions	**15,4**		
Property income	**0,9**		
Other	**5,1**		
Total revenue	**40,1**	**Total expenditure**	**45,9**
Tax burden (%of GDP)	**34,5**	**GG deficit**	**-5,8**

Deficit & Debt

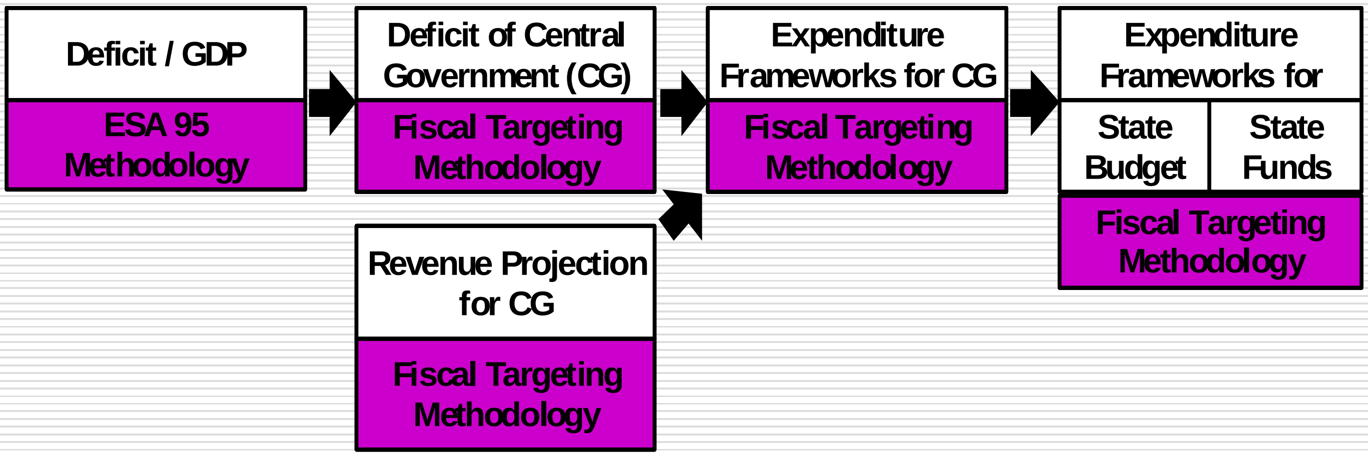


Consolidation measures 2011

	Change in balance
REVENUE	
VAT - parametric changes	0,2
CIT - removed 50 % tax allowance related to employment of disabled employees	0,2
PIT - technical modifications	6,6
of which: 50% witholding tax on building savings	*4,5*
Social security contributions	12,9
of which: retaining 2010 ceiling of SSC assessment base	*3,1*
retaining 2010 SSC rate	*9,8*
Total	**19,9**
EXPENDITURE	
Reduction in public sector wages (excl. teachers)	13,3
Social expenditures	12,6
Reduction in non-mandatory current and capital expenditures	13,3
Expenditures of general treasury	11,1
Expenditures of other budget chapters	10,9
Increase in R&D support	-0,6
Increase of wages in education	-2,1
Total	**58,5**

Fiscal targeting

- prepared in 2003 effective from 2004
- comprising the MT GG deficit path, MT CG expenditure framework and MT budgetary outlook (state budget + state extra-budgetary funds´ budgets);
- the rules for amending and up-dating of MTEF are comprised in the law on budgetary rules);
- multi-annual fiscal planning covers next 3 years (on rolling bases) in line with the horizon of updated SGP programs



Fiscal rules and budget framework

- compliance with the SGP reference values on deficit and debt is ensured just implicitly by full consistency between the national budgetary targets and the SGP programs;
- Under the SGP, the country is committed to adhere to the MTO for its budgetary position of „close to balance or in surplus“
- Czech fiscal targeting is complex, effectiveness depends heavily on the political willingness to respect the spirit rather then the numerical values;
  - **and additional tax revenues were not always used for debt reduction.**
- **Possible improvements**
  - ***Improving public scrutiny and monitoring***
  - ***Reducing the complexity of the MTEF settings and procedures***
  - ***Strengthening the enforceability***
  - ***Improve the transparency – budgetary documentation***

Long-term sustainability

- Last projection results – EPC (AWG) report
- Show increase mainly in pensions and health care expenditure mainly due to changes in population structure
  - Pensions: 7,8% → 11,0%
  - Health care: 6,2% → 8,4%
- Parametric changes in pensions (July 2008)
  - Higher retirement age
  - Changes in disability pensions

  » improvement of more than 3pp in 2050
- However sustainability gap remains high

Current efforts

- Pension expert group
- Main tasks
  - Update pension projections
  - Formulate recommendations to pension reform
- Main pension reform principles
  - Diversification of the pension system
  - Fiscal sustainability of the pension system
  - Intergenerational distribution of burdens
  - Increasing the equivalence of the pension

Pension expert group – proposals

- I. pillar
  - Increase in retirement age – reach equal statutory age for men and women
  - Gradually switch to price indexation
  - Changes in widows'/widowers' pensions
  - Decrease in contribution rate 28% → 23%, lower incomes should be counterbalanced by unification of VAT (19%)
  - Decrease in contribution ceilings (3times average wage)
  - Introduction of funded pillar

Introduction of funded pillar

- **Option I.**
  - I. pillar: PAYG 20pp out of 23%
  - II. pillar: remaining 3pp out of 23%
    - Compulsory for people younger than 40
    - Payouts only in lifetime annuity
  - III. pillar: keeping the state subsidy
- **Option II. (minority)**
  - I. pillar: PAYG with parametric changes (contribution rate 23%)
  - II. pillar: 3% state subsidy if policy holder contributes 3%
    - Voluntary
    - Payouts only in lifetime annuity with minor exceptions
- **Political decision is needed**

Key fiscal challenges

1. **Making national fiscal rules more effective**

   Reduction of structural deficit

2. **Improvement of transparency and public understanding of fiscal framework for policy formulation and execution**
3. **Fiscal sustainability of public finances**

Thank you for your attention!