

8. State Budget

Expanding economic growth assisted the state budget to reach the second most favourable balance after year 1996.

The state budget (SB)¹ ended in 2017 in mild deficit (6.2 CZK bn). The favourable result from the preceding year (+61.8 bn) was not repeated, it was markedly affected by the completion of incoming payments from the EU budget tied to the ended programme period. Still, the last year's result was the second best after year 1996. Still the SB was achieving mild surpluses for the most of the year 2017, only the accelerated drawing of investment as well as some current expenditure towards the end of the year² drew it into deficit. The achieved deficit was by 53.8 CZK bn lower in contrast to the approved budget (even by 132 bn in year 2016). SB was affected by both the expanding economic growth and the slower commencement of the drawing of the European funds³ throughout the whole last year. SB balance, comprising the key component of the deficit or surplus of the sector of the government institution budget, arrived at +0.1% in relation to the nominal GDP last year (+1.3% a year before).

Total SB revenues lowered for the first time in four years. The swift growth of the tax income including insurance was not enough to offset the sharp fall of the resources from the EU budget.

Total SB revenues lowered by 0.6% last year. It occurred for the first time since 2012, when the domestic economy was gripped by recession. The sharp decline of the income from the EU budget stood exclusively behind the last year's result (by 82 CZK bn year-on-year, to 77 bn), which was simultaneously by 21 bn deeper than the budget anticipations. The anticipation was on the contrary exceeded for all more volume significant tax revenues. State-wide collection of all tax revenues (incl. insurance) grew by 6.9% last year and approached the value from year 2016 (+7.2%, the highest after year 2007). Rate of growth of tax revenues weakened in the second half of the last year, especially due to the less favourable collection of the corporate taxes.

VAT contributed to the growth of the tax revenues by nearly one half last year, driven mostly by the strengthening expenditures on final households as well as government institutions consumption.

While the high collection of the corporate taxes drove the growth of the SB tax revenues (excluding insurance) in both years 2015 and 2016, on the contrary it was VAT last year, which contributed to the growth by nearly one half. VAT collection strengthened by 8.3⁴ year-on-year, at the level of all public budgets then by 9.1% (by 5.4% the year before). The accelerated growth was caused especially by the development in Q2. The transfer of some activities from the grey economy due to recent measures introduced on the side of the tax collection also contributed to this result. Still, the economic growth mirrored also in the final consumption expenditures – which increased in nominal terms for households year-on-year by 6.5%, for government institutions by 5.0% in 2017, continued to represent the key factor behind the higher collection of VAT.

Collection of consumer tax on mineral oils increased thanks to the higher freight transport. Collection of tax on tobacco products was supported by the January increase of rate of this tax.

The SB received by 2.9% more from all consumer taxes year-on-year in 2017. The collection of two most significant subgroups – tax on mineral oils and tax on the tobacco products strengthened by a similar pace. Growing freight transportation had a positive effect in the weight dominant tax on the mineral oils, especially the consumption of the diesel fuel and jet fuel was growing. Year-on-year rate of growth of the retails sales for fuels nearly doubled during 2017 (from 3.4% in Q1 to 6.6% in Q4). These influences overtook the impact of the instruction of the so called green fuel also for the animal primary production, which in contrast mildly subdued the collection of tax. With respect to the collection of tax on tobacco products, especially the increased tax rate since January 2017 stood behind its growth.

Collection of corporate tax grew by the weakest pace for the last four years, among other things due to the strengthening wage costs

Speed of the collection of the corporate tax was weakening during 2017 and the state-wide collection was lower compared to the same period of the last year already in Q3. It concerned the first year-on-year fall since the end of year 2013. Thanks to a higher collection in Q4, the yearly budget anticipations for this tax was fulfilled. Its collection was by 3.6% higher year-on-year, however it was the weakest growth in the last four

¹ Unless stated otherwise, all data related to the state budget are sourced from the data of the Ministry of Finance on the cash fulfilment.

² The balance was +26.5 CZK bn in total for the first ten months of 2017. The capital outlays increased during November and December (by 30 CZK bn to 81.6 bn). Rate of growth of expenditure on the wages of state employees also accelerated, similarly to the non-investment outlays to business entities or state funds.

³ According to the calculations of the MF, the SB balance adjusted on both income and expenditure side for the resources on programmes from the EU budget and Financial mechanisms (EEA and the Norway Grants, Swiss – Czech Cooperation Programme) arrived at -1.3 CZK bn in 2017 (-13.6 bn the year before).

⁴ The proportion of the SB on the state-wide VAT revenue fell from 70.25% to 69.68% due to the change of the budget appropriations of taxes to the benefit of municipalities starting 1. 1. 2017. Reciprocally, the percentage share of the tax revenue – from the tax returns on income taxes of natural persons was amended.



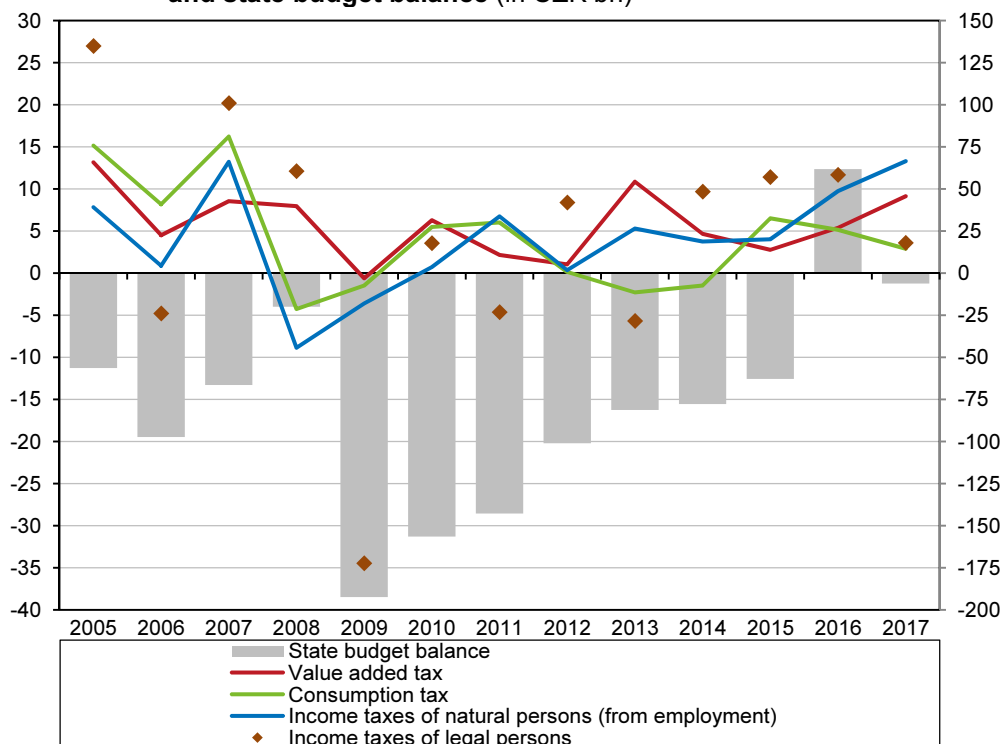
of firms.

Record level of employment, heightening growth of the average wages as well as the increase of the level of the minimum wage increased dynamics of the growth of the collection of income taxes of natural persons from employment.

years. The mildly falling profitability of businesses from years 2016 (and partially also 2017) already started to show to a higher extent, mostly due to the intensifying wage costs. Last year's collection still did not reach the level from the peak of the business cycle of the last decade, partially also because of the mild reduction of the tax rates.

In contrast, with respect to the collection of the income tax of natural persons (ITNP) from employment, the development of the labour market was still favourable. Its state-wide collection strengthened for already a third year in a row (up to last year's +13.3%) and it tightly exceeded the record year-on-year growth from the expansion year of 2007. Expanding economy also stimulated the business activity, which showed also in the higher collection of the ITNP from the self-employment (by 11.2% to 7.6 CZK bn). Collection of this tax grew already third year in a row. Collection of ITNP from capital revenues arrived at 16 CZK bn last year. It was the only more significant tax by volume, where the state collected less last year. Not only the prevailing low interest rates on deposits had an impact here, but especially the legislative change associated with the tax exemption for the retirement entitlement of the defence forces.

Chart 19 State wide collection of tax income (year-on-year in %) and state budget balance (in CZK bn)



Source: MF CR

Current expenditures contributed exclusively to the increase of the SB expenditures and grew the fastest in the last eight years.

„Failing to complete the drawing “of investment in relation to the budget anticipations deepened to 22 CZK bn last year.

Total SB expenditures grew by 4.9% last year to near 1 280 CZK bn. Similarly to year 2016, the current expenditures contributed exclusively to their growth, their rate of growth was the highest in the last eight years (+5.5%). Capital expenditures again fell despite the low comparative basis last year (-3.1%). While the drawing of investment stayed only tightly behind the budget anticipations in year 2016, this difference consisted of more than 22 CZK bn already last year. Their drawing recorded more considerable irregularities⁵ during the year. The volume of investment completed by means of common programmes of the EU and CR (from the programme period 2014–2020) attained 36.9 CZK bn, doubled year-on-year. Nearly one half from this volume was financed with the assistance of the operational programme (OP) Transportation, one fifth then via the OP Environment. All expenditures to finance the common EU and CR programmes (incl. current outlays) arrived at 91.1 CZK bn last year and practically stagnated in comparison to year 2016. Just under 55% of all SB capital expenditures were directed solely to the national projects and thus did not have any relation to the EU. The volume of such assigned investment

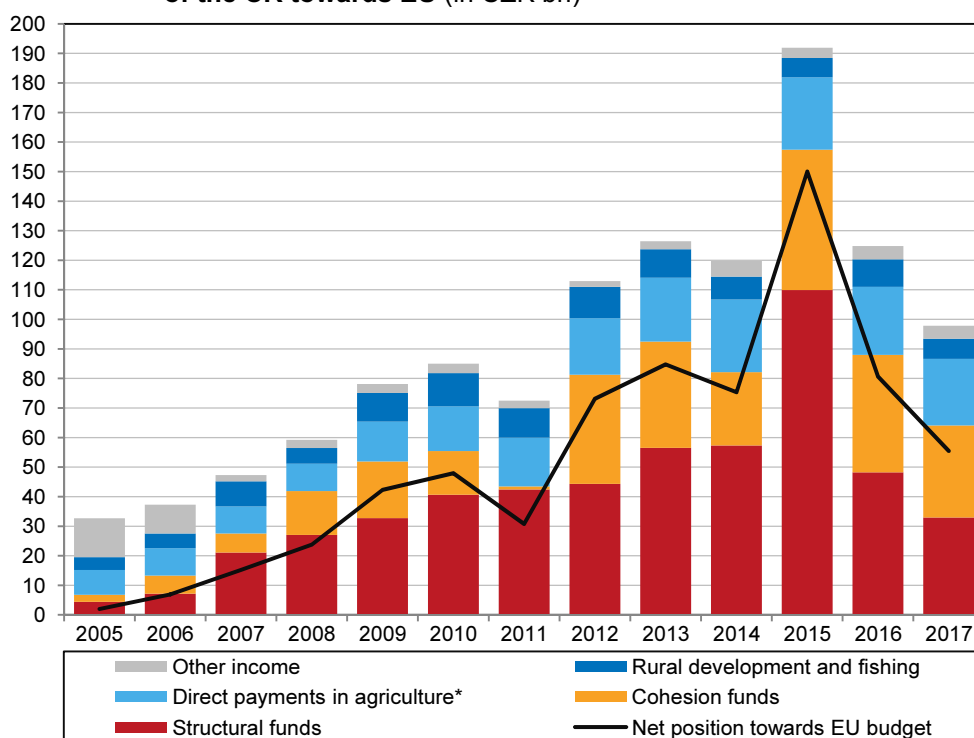
⁵ Nearly one half of the yearly volume of investment was drawn in the last quarter. Further one quarter then in Q3 2017.

(44 CZK bn) stagnated year-on-year, it was however by nearly one half larger compared to year 2015. The proportion of investment on total SB expenditures was falling already second year in a row and comprised mere 6.4%, which was the least since year 1998.

Positive balance of the CR towards the EU budget shrank to a six-year minimum. The weaker drawing of the structural funds, including among other the projects hard on investment preparation were the cause.

Drawing of the SB investment intended to the European projects is with a certain delay evident in the development of the position of the CR towards the EU budget. Even though the CR acquired in “net” from the EU nearly 98 CZK bn last year, it was the least in the last six years. It was associated with the deeper reduction of the reimbursed funds in the area of the structural funds. Their last year’s amount (33 CZK bn) nevertheless slightly increased the level from years 2007 and 2008, resp. from the commencement of the preceding programme period. Drawing of funds meant for direct payment in agriculture or the rural development on the contrary functioned relatively continually in the recent years. The total payment of the CR into the EU budget also remains stable. In the last five years, it fluctuated around 43 CZK bn per year.

Chart 20 Structure of the CR income from the EU budget and net position of the CR towards EU (in CZK bn)



* Includes also the market operations and veterinary measures.

Source: MF CR

Mainly higher expenditures on wages of employees in areas with the state dominance and on the pension adjustment drove the growth of the current expenditures.

Non-investment transfers to the public budgets on the regional level, whose growth accelerated to 13.4% (from 4.6% in 2016) participated the most on the higher SB current expenditures (by 62.6 CZK bn) year-on-year last year. These expenditures especially reflected the growth of earnings of employees in the regional education⁶. The weight dominant item of social benefits also shared in the current expenditures in one quarter, its increase (+16.9 bn) was affected primarily by the pension adjustment. The rate of growth of expenditures on the wages of state employees nearly doubled (to 9.2%), mainly thanks to the increase of the wage tariffs. The non-investment transfers to contributory organizations also recorded high dynamics (+13.8%), including e.g. universities or the research agencies. The volume of non-investment transfers to the business entities also increased by nearly one tenth (to 48.3 CZK bn). These transfers are linked to a significant extent to the support of the sustainable sources of energy.

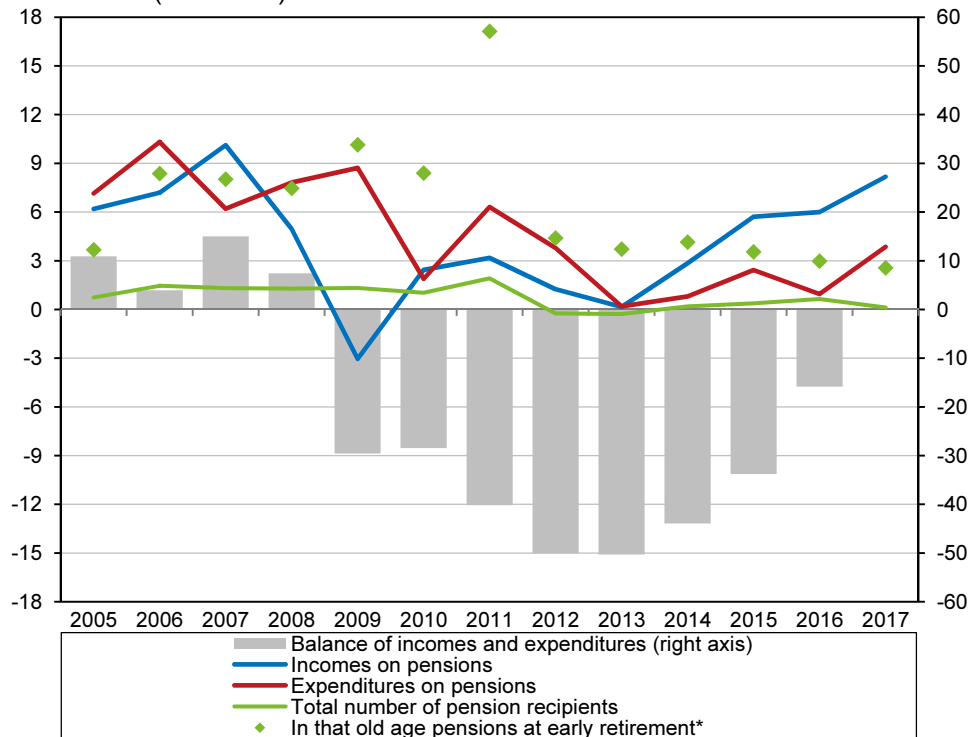
⁶ As of 1st September 2016, the wages were raised to teachers (+8%), but also non-educational employees (+5%) – their wages were also raised starting 1st July 2017 (by further 9.4%). Wages then rose also to the educational employees (+15%) as of 1st November 2017.



Dynamical growth of the collection of insurance together with the minimal addition to the number of pensioners led to the marked improvement of the pension account balance. It broke free from the deficit for the first time in nine years.

41.4% of all SB expenditures were aimed at the social benefits last year (by 0.7 p.p. less year-on-year). Full 78% of expenditures on social benefits were directed to pensions, where the state expended by 3.9% more year-on-year (by 0.9% in 2016). The impact of the new legislative amendment allowing to increase pensions above the level of the standard adjustment was projected in the growing pace of expenditures. On the contrary the number of all pension recipients (2.896 mil persons) expanded only slightly (+0.1%). Apart from the demographic effects, it was also connected to the favourable situation on the labour market and consequent "lower demand" for early retirement (year-on-year relative addition of persons with the permanently shortened pension was the weakest in the last four years last year). Record level of employment accompanied by the strengthening wage growth supported the dynamic collection of insurance (+8.2%, the highest after 2007). Rate of growth of insurance on pensions kept growing during the year 2017 (it was 6.6% year-on-year in Q1, it attacked 10% towards the end of the year). These tendencies resulted in the considerable improvement of the pension account balance⁷, which was by nearly 16 bn more favourable year-on-year and attained +0.1 CZK bn. Pension account thus extracted itself from the deficit for the first time since the end of expansion phase of the last decade.

Chart 21 Pension recipients, income and expenditure on pensions from the state budget (year-on-year in %) and pension account balance (in CZK bn)



* Old age pension income awarded before the pension age is reached and shortened for the earliness is for the whole time period of the drawing the benefit. Source: MF CR, CSSA

Rate of growth of other social benefits reduced last year and thus increased markedly slower than expenditures on pensions.

Rate of growth of the SB expenditures on other social benefits (apart from pensions) reached 1.3% and it lowered to one half compared to year 2016. The impact on the economic growth of the household income is still more evident. State expended less especially on the material deprivation assistance benefits (year-on-year by one fifth, by 35% in three years, resp. 3.9 CZK bn), where both the weight dominant allowance for living and supplement for housing significantly shrank. State social support benefits fell by 1.3%, whose growth lasting the four preceding years thus halted. Mainly the lower volume of the supplements for housing and child allowances were behind this development. Mild growth of the foster care benefits as well as the weight dominant group of the parent benefits (this benefit is not linked to the income of the family and its development thus more suggest the mild growth of the natality in the recent years) worked in the opposite direction. Smaller savings were achieved with the

Higher incomes of household from employment led to the reduction of

⁷ It is expressed as the difference between revenues and expenditure on the pensions from the SB (based on preliminary data).

expenditures on material deprivation or state social support.

unemployment support (4.9% year-on-year, by 19% in the three years, resp. 1.8 CZK bn). Increase of the relative representation of the frictional component of unemployment as well the strengthening rising of wages stood in the background (with the impact on the size of the paid-out benefits)⁸. On the contrary, the growth of the sickness benefits continued already for the fifth year (by 7.8% in 2017)⁹. It was connected both to the stronger drawing of the maternity benefits due to the slightly higher birth rate and mainly to the larger volume of sickness benefits (+7.7%) as a result of both increased sickness rate and growing number of persons with health insurance. The SB spent 25.1 CZK bn on the care benefits (for persons on long term sickness leave), by 9.0% more year-on-year¹⁰.

Size of the state debt substantially fluctuated during the year 2017. The expectations linked to the termination of the regime of forex interventions manifested. State was selling bonds for negative yield in a higher extent.

Net expenditures on the state debt equalled 39.8 CZK bn in year 2017. They declined (even though by a slower pace) already for the fourth year in a row – in total they were thus by 21.9% lower. Lower interest rates on the market with the state bonds were behind the cut in the first half of the year and also the weaker borrowing need of the state (due to the improving SB balance). State debt considerably fluctuated during the year 2017¹¹ and it was 1 625 CZK bn at the end of December, by 0.7% more year-on-year. While the internal indebtedness mildly increased (+27 bn), the CZK value of the external debt sank already third year in a row, since the state met its borrowing need exclusively on the domestic market. The external debt thus shared by 15.6% on the total state indebtedness and within Q4, it represented the lowest share in the last ten years. The volume as well as the share of the koruna bonds held by the non-residents markedly fell in connection to the outflow of the speculative capital in Q4 2017 (from 51.4% to 41.6%), and it thus returned to the value from the beginning of the year.

Rate of indebtedness of the whole sector of the government institutions attained 35.1% of GDP in Q3, it lowered by nearly one tenth year-on-year.

Consolidated debt of the whole sector of the government institutions (reflecting also the budget of the regional municipalities or health insurance companies) attained according to the up-to-date data of the CZSO size 1 739 CZK bn at the end of Q3 2017¹². The rate of indebtedness was 35.1% of GDP and fell by 3.1 p.p. year-on-year, which was the similar result of both reduction of the absolute size of the debt and the growth of the nominal GDP. Apart from the central government institutions, the local government institutions also significantly participated on the reduction of the absolute size of the debt. The government institutions administered the surplus of 84 CZK bn in Q1 to 3 2017 (50 CZK bn the year before). All government subsectors showed positive balance, as well as its year-on-year enlargement. Central government institutions contributed to the increase of the total surplus the most.

⁸ Even though the total number of unemployed registered with the LO fell by more than 100 thousand, the number of persons with the right to claim support was lower only by 17.3 thousand year-on-year at the end of December 2017. The long-term unemployed succeeded to find a job in a higher extent. The number of applicants with the right to the unemployment support thus mildly increased to 30.5% (from 27.0% last year). The average monthly size of the unemployment support was 6 969 CZK at the end of year 2017, 6 457 CZK the year before.

⁹ The difference between the revenues and expenditures in the area of the health insurance remained according to the data of the MLSA positive (+3.1 CZK bn) in 2017 as a result of the strong growth of the collection of insurance (+10.7%).

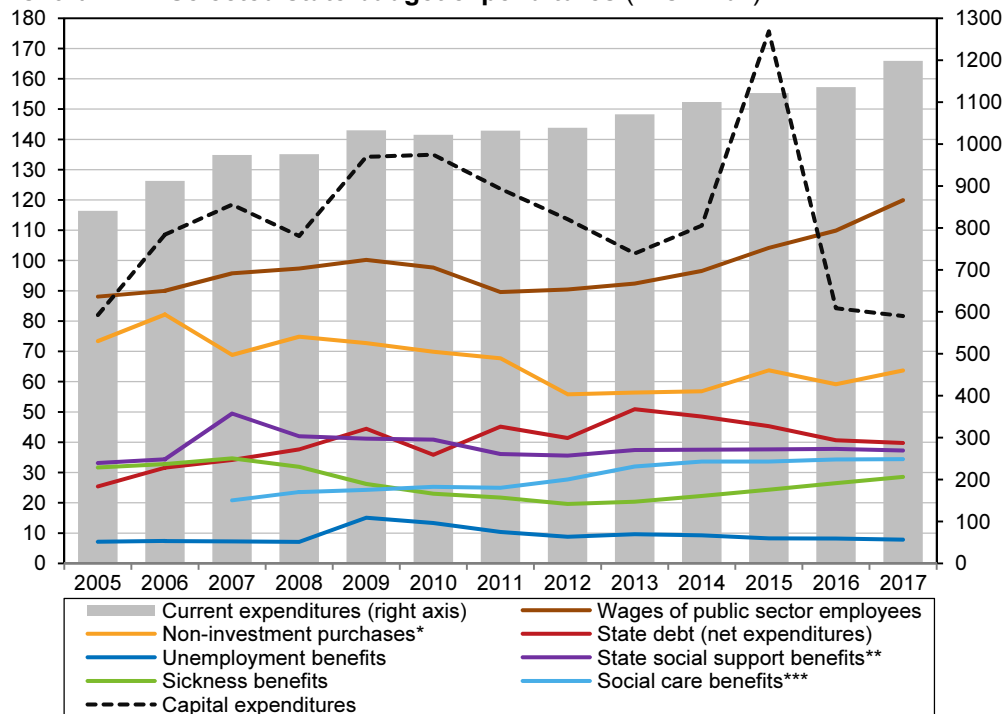
¹⁰ Acceleration of the rate of growth was caused mainly by the legislative amendment, which raised the contribution in all grades of dependence by 10% as of 1. 8. 2016.

¹¹ The debt hiked to 1 789 CZK bn during Q1 and recorded the fastest quarter-on-quarter growth since year 2010 (+11%). This short-term increase was connected to the specific situation on the bond market due to the expectations associated with the termination of the regime of forex interventions. State bonds were sold for the negative yield in the value of 493 CZK bn in 2017, which brought additional revenues into the state budget in the amount of 1.2 bn. The proportion of the state debt, which does not carry any interest costs, rose from 12.0% to 15.2% during the year 2017.

¹² The CZSO will publish the preliminary data regarding to debt and deficit of the government institutions sector for the whole year 2017 on 4th April 2018, Eurostat then on 24th April 2018.



Chart 22 Selected state budget expenditures (in CZK bn)



* Include mainly expenditure on the purchase of services (IT, rents), expenditure on water, fuel and energy purchases, expenditure on material purchase, expenditure on repairs and maintenance. On the other hand, interests, guarantees and other financial outlays on the state debt are excluded.
 ** including the foster care benefits
 *** Material deprivation assistance benefits, Benefits for people with disabilities, Care benefits (based on Act on State Social Support)

Source: MF CR, MLSA

CR was the fourth relatively least indebted EU country.

Tendency to lower the relative indebtedness is apparent on the level of the whole EU since the half of 2015 nevertheless it occurred only very gradually till now.

The CR was the fourth relatively least indebted country of the EU at the end of Q3 2017 (with the distance behind Estonia, Luxembourg and Bulgaria). It was the best position since the accession of the CR into the EU. The indebtedness rate did not significantly decrease – in contrast to the CR – in the EU since the end of the last recession. It fell by exactly 3 p.p. in the last three years, by mere 0.4 p.p. against Q3 2016 (to 82.5% of GDP). 24 countries of the Union signalled the year-on-year reduction of the indebtedness (19 the year before). The position of the most indebted economies however improved only marginally. In Italy and France, troubled by high unemployment, the indebtedness rate even increased (by 2, resp. 1 p.p. year-on-year). Only one third of the euro area members fulfilled the Maastricht debt criterion (60% of GDP), in that from the core countries (EU15) only Luxembourg and Netherlands. Only Germany, Sweden and Malta managed to decrease their indebtedness to the level close to the pre-crisis year 2008 so far.