# 8. State Budget

State Budget returned to deficit last year. Its balance was the worst in the last four years, but better than in the business cycle peak in the last decade.

State Budget (SB)[1] recorded a deficit of 28.5 CZK bn in year 2019 and thus achieved the weakest result in the last four years. The depth of the deficit was however at the same time considerably lower (by 56 bn) in comparison to the average for the business cycle peak period in the previous decade (2003 till 2007). Mainly the swift growth of both the current and investment outlays and further also the mild slowdown of dynamics of collection of some weight-significant taxes due to the easing of economic growth stood behind the fall of the balance from year 2018 (by 31.5 bn). Balance of flows in relation to the EU budget [2] also had an effect to a lower extent.

Mostly non-tax and capital income drove the growth of total SB revenues. The total tax collection including insurance gradually reflected the slowdown of economic growth.

Year-on-year growth of the SB revenues (by 8.5% and by 119.3 CZK bn resp.) was from more than one third saturated by higher non-tax and capital incomes and transfers last year, which was the result of stronger inflow of funds from the EU budget (+6.7 CZK bn), planned one-off transfer from the privatisation account (18.0 bn) as well as higher incomes from the sale of emission allowances. Collection of insurance on social security also contributed to the larger total budget revenues by one third (+7.5%), tax incomes played nearly similar role (+4.9%). Collection of both these components however slightly lagged behind the budget anticipations, because the economic slowdown became evident especially in the second part of the year. The tax collection increased at the level of all public budgets (without insurance) by the weakest pace in the last four years (by 5.4% year-on-year, by 5.0% in H2 itself).

Rate of growth of the state-wide VAT collection markedly slowed down and ended behind the budgetary target.

SB revenues from the tax holding the largest weight – VAT – increased by 4.4% last year and similarly to year 2018 it did not meet the budgetary target. It follows from the state-wide collection, which eliminates the effect of changes in budgetary determination of the tax, that the growth rate of the VAT collection was falling last year already second year in a row and it also lagged behind the dynamics of growth of the nominal final consumption expenditures of both households and government institution.

Lower collection of the consumption tax on the tobacco products was for the major part offset by higher collection of tax on mineral oils.

Collection of all consumption taxes in line with the budgetary target decreased only very little year-on-year in 2019 (by 0.2%). This decrease was nearly exclusively affected by weaker collection of tax on the tobacco products (-4.9%), whose collection was except for fluctuations due to the pre-stocking adversely affected mainly by the fact, that the tariff of this tax was not increased last year for the first time since year 2011. Collection of the consumption tax holding the most significant weight – on mineral oils – went up by 2.7%. Higher transport work manifested especially in the passenger transport, which resulted in higher consumption of the diesel fuel, petrol and especially the kerosene[3].

Dynamics of the collection of income tax of natural persons still featured double digit figures despite a mild slowdown.

Volume of collection of corporate tax overtook the level from the business cycle peak in

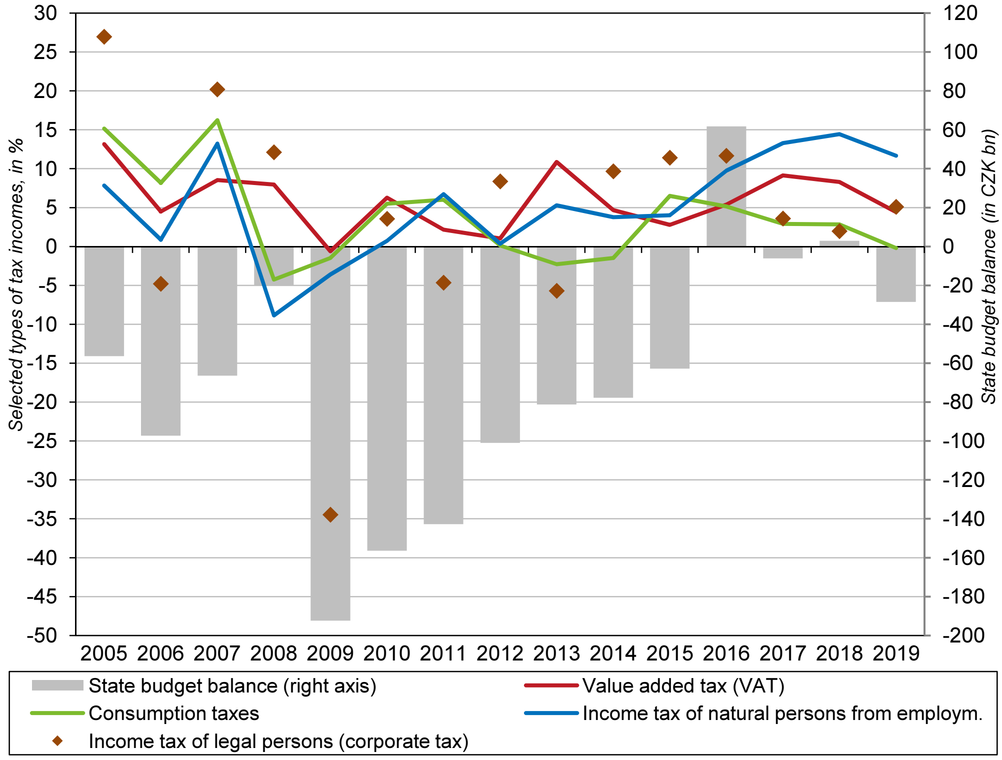
Growth of collection of direct taxes was driven the most by the income tax of natural persons already third year in a row. Its collection at the level of all public budgets rose by 11.7% year-on-year (the rates moved between 13 and 15% in both years 2017 and 2018). This slowdown is linked to the weaker dynamics of employment as well as mild moderation of growth of averages wages, which were observed especially in the second half of the last year. Other direct taxes also recorded a brisk double-digit growth in 2019 – for natural persons from tax return declaration or capital gains. The strong domestic demand associated mainly with the higher purchasing power of households still played a role here. Statewide collection of corporate tax, following the weaker dynamics influence

[1] Unless stated otherwise, all data related to the state budget stem from the data of the Ministry of Finance regarding the cash fulfilment.
[2] According to the MF calculations, the SB adjusted for funds on programmes and projects from the EU budget and Financial mechanisms (EEA and Norway Funds, Swiss – Czech Cooperation Programme), which were pre-financed from the SB and subsequently paid for from the EU budget and financial mechanisms, ended in 27.7 CZK bn in 2019, by 24.2 bn deeper year-on-year.
[3] According to the CZSO data, the consumption of diesel (including biofuels) increased by 0.7% year-on-year, diesel fuel by 1.5% and kerosene by 3.9% in 2019. The consumption pace was weaker, in case of both diesel and petrol a very mild year-on-year decrease was recorded (by 0.2% and by 0.5% resp.) in Q4 itself.

the last decade for the first time.

mostly by strengthening wage costs in years 2017 and 2018, increased by 5.1% year-on-year last year. The absolute size of the collection exceeded the pre-crisis level for the first time (year 2008)[4]. Still the last year´s collection stayed slightly behind the budgetary target, similarly as the total income tax of natural persons.

**Chart 16 State wide collection of selected tax incomes** (year-on-year in %) **and state budget balance** (in CZK bn, annual cumulation)




Source: MF CR

Growth rate of the SB expenditures was further rising and climbed up to 10.8%.

Rate of growth of total SB expenditures has been expanding already third year in a row and it hiked up to 10.8%[5] in 2019, which was maximum for the last two decades. Both current (+128 CZK bn) and capital (+23 bn) expenditures contributed to the growth last year similarly to year 2018. Strengthening of investment (by 19.6%) was from more than one half connected to higher transfer to the state fund of the transport infrastructure. Half of all SB investment was directed on the common CR and EU projects (68.5 CZK bn )[6]. Their year-on-year growth was relatively small (+8.5%), since considerable acceleration of drawing of euro funds already occurred during the year 2018. In contrast, investment realised without the participation of the EU funds and the financial mechanisms strengthened nearly by one third last year (to 70.8 CZK bn), still they slightly fell behind the budgetary target (unlike the "European investment"). Proportion of investment on total SB expenditures mildly rose to 9.0% and arrived at four-year maximum. Nevertheless, their weight was oscillating between 10 and 12% in years 2006 to 2011.

Volume of capital expenditures increased by one fifth, mainly thanks to investments on projects without the EU participation.

Current expenditures were stimulated by higher expenditures on social benefits as well as wages of public sector

Current expenditures of the SB strengthened by one tenth year-on-year last year. Traditionally mainly the higher expenditures on social benefits stood behind this development (+8.2% and +46 CZK bn resp.). Purchasing power of households was also stimulated by strengthening expenditures on the regional education (+20 bn), especially

[4] For income taxes of natural persons, the pre-crisis maximum (from year 2007) was exceeded already in year 2015.
[5] This above-standard high rate of growth of expenditure growth also reflected the (neutral from the view of the total budget) transfer of 18.6 CZK bn connected to the budget surplus of the pension insurance system for year 2018 (from chapter General Treasury Administration Chapter into chapter Operation of State Financial Assets). Without this transfer, the year-on-year rate of growth of expenditures would be 9.4%.
[6] Total expenditures to finance common EU and CR programmes totalled 140.4 CZK bn last year and strengthened by one eighth year-on-year. This item also includes the non-investment expenditures (e.g. on direct payments to farmers).

employees. Expenditures on non-investment purchases and the state debt had the opposite effect.

on the wages of employees[7]. Higher expenditures on wages of public administration employees at the central level had a similar effect (+7.1% and +10 bn resp.). Transfers to state funds recorded double-digit growth (especially into the area of agriculture and transportation), non-profit and similar organisations. On the contrary the funds of non-investment purchases and connected outlays decreased by 3% (purchase of services, material, water, energies etc.), net expenditures on the state debt also decreased by an identical pace (to 39.6 CZK bn)[8].

Rate of growth of expenditures on pension insurance benefits rose the most after year 2009.

Share of SB expenditures aimed at all social benefits has been falling for a third year in a row. It amounted to 38.8% last year (42.1% in year 2016). Nearly four fifths of these expenditures were allocated on pensions. Their growth rate nearly doubled last year compared to year 2018 (to 8.7%), higher rate was last recorded in year 2009. Given the stagnation of the total number of persons receiving pension (including old-age pensioners), the effect of legislative amendments was fully evident[9].

Rate of growth of collection of contributions on pension insurance fell year-on-year. Balance of the pension account remained in mild surplus for a second year in a row.

Still very favourable situation on the labour market led among other things to the growth of the economic activity of persons near the end of the productive age as well as seniors. It was also positively reflected in the growth of incomes flowing into the system of pension insurance contributions or lower use of early retirement[10]. Despite of this development the year-on-year rate of growth of collected insurance on pensions for the first time after year 2013 slackened year-on-year last year (to 7.8%, from 10.1% in year 2018). It corresponded to the more notable slowdown of the employment growth in the economy as well as the mild decrease of dynamics of the average wages. Pension account balance[11] thus very mildly worsened year-on-year in 2019 and remained positive already second year in a row (+16.4 CZK bn).

Mainly higher drawing of sickness insurance benefits and also strengthening of expenditures for citizens with disabilities contributed to the growth of non-pension social benefits.

Growth of expenditures on other social benefits (excluding pensions) accelerated last year for second year in a row and hit a six-year maximum (+6.4%). Higher state expenditures were for the overwhelming part connected to the sickness insurance benefits (+14.5%[12], the drawing doubled in the last eight years) and also to the benefits for persons with disabilities including care benefits (higher by one eight year-on-ear, by one half in six years). Expenditures on state social support on the contrary decreased by 3.3%, these expenditures rather stagnated so far since the end of the last recession. Only peripheral by volume foster care support strengthened last year among the partial benefits of the state social support. Both volume of all income-tested benefits, e.g. child allowances or housing benefits (by 10% and by 8% resp.) and weight dominant parental allowances (by 2%) decreased. The volume of material deprivation assistance benefits went also down due to the improved financial situation of households (by 18% year-on-year, by 61% in the five years). The fall of unemployment benefits halted after five years last year (+8.0%). Effect of the growth of the average size of support manifested (thanks to recent wage acceleration in the economy), number of unemployed eligible for support however stagnated year-on-year.

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[7] It was mainly related to the year-on-year rise of the volume of resource on the wages of pedagogical (+15%) and non-pedagogical employees (+10%).

[8] It is the budget balance of the chapter State debt. These expenditures increased year-on-year for the last six years only in year 2018 (by 2.4%).

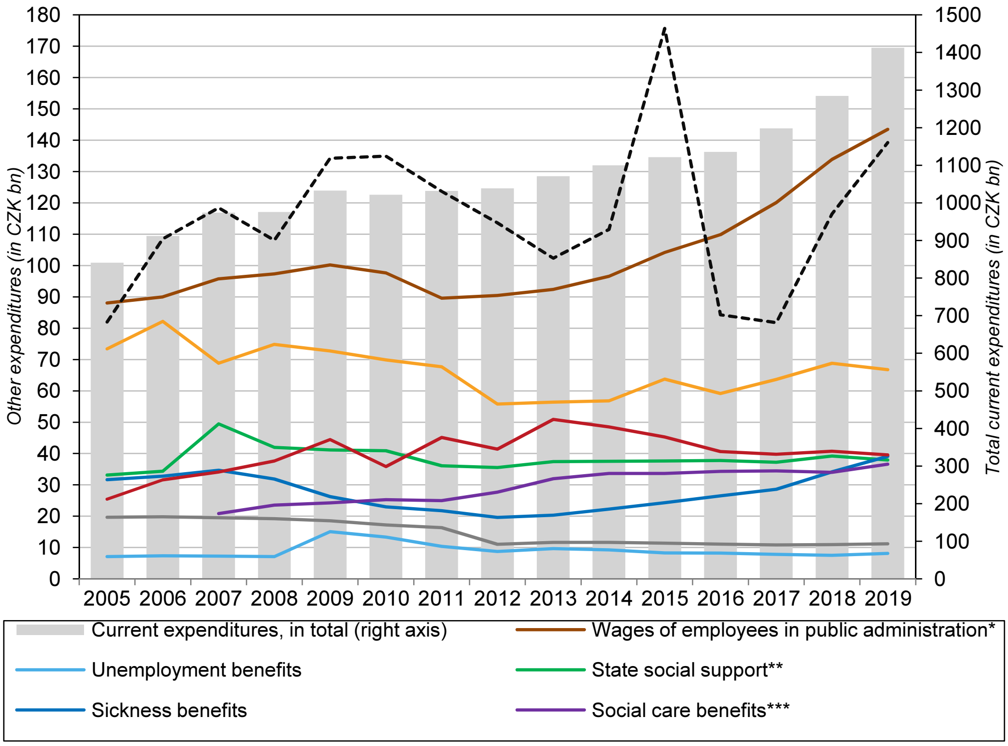
[9] It concerned the increase of the basic pension assessment from 9% to 10% of the average wage, percentage pension assessment by 3.4% and further the increase of 1 000 CZK for pension recipients, who reached the age of 85 years. Pension adjustment mechanism further since year 2018 fully reflects the impact of the consumer price growth (altern. the growth of the living costs of pensioners) and one half of the growth of real wages in the economy is also taken into account.

[10] Year-on-year growth of the number of recipients of permanently reduced pension (due to its earlier acquisition) amounted to 1.9% in Q4 2019, this rate continuously decreases after year 2014. Ratio of early pensioners to all old-age pension recipients reached 26.6% in the CR (with significant regional variations).

[11] Expressed as the difference between revenues and expenditures on pensions from the SB. Expenditures on administration of the pension insurance system are included in the expenditures (they arrived at 6.3 CZK bn based on the MF data in 2019).

[12] Prevailing growth of the temporary incapacity for work stood behind it. Daily assessment basis of this benefit was also raised (derived among other things from the size of previous earnings). Growth of the volume of paid out sickness benefits was also partially affected by higher drawing of maternity benefits last year (+7.4%).

**Chart 17 Selected expenditures of the state budget** (in CZK bn, annual cumulation)




*Covers expenditures on salaries in central government institutions. Does not include e.g. wage costs of regional education.
**Also includes the foster care benefits.
***Includes Material deprivation assistance benefits, Benefits for people with disabilities, Care benefits based on Act on State Social Support.
****Contains mainly expenditures on purchase of services, materials, energies or other services (e.g. expenditures on repairs and maintenance).
*****Corresponds to the balance of the budget chapter State debt.
Source: MF CR, MLSA

Size of debt remains stabilised already the seventh year. Medium- and long-term state bonds issued on the domestic market prevail as the dominant debt instrument.

At the end of year 2019, the state debt reached 1 640 CZK bn, its growth only negligible year-on-year (by 1.1%). The size of the debt stays stable already seventh year. In the last four years, certain seasonal development is repeated – the value of debt rises at the beginning of the year and a gradual reduction occurs under the effect of repayments in its second half. State practiced its borrowing operations only on the domestic market last year, which was reflected in further decrease of the koruna value of the foreign debt (by 13.9%). It shared in the total state debt by 12.4%, the least since the end of year 2004. Medium and long-term state bonds (issued on the domestic market) comprised more than six seventh of the total debt. Financial institutions remain the key holder of the koruna state bonds – with mild dominance of insurance companies and pension funds (29.5%) over other entities formed mainly by banks and investment funds (25,2%). Non-residents held 40.5% of the debt, their proportion in contrast to previous years remained stable during the year. Weight of households thanks to the new product offer to citizens (Bond of the Republic) strengthened, it was still below average compared to the EU states (1.1%).

Indebtedness rate of the government institution sector fell to ten-year minimum.

Budget balance remained positive for the fourth year in a row, the size of surplus however narrowed.

Debt of the whole sector of government institutions (including apart from central local government institutions or health insurance companies as well) totalled according to the CZSO data size of 1 740 CZK bn at the end of year 2019 and the indebtedness rates summed 30.8% of GDP (ten-year minimum). It decreased by 14.1 p.p. in the last six years, only in year 2019 then by 1.8 p.p. (exclusively due to the growing nominal GDP, since the absolute size of the debt rose by 5.8 CZK bn). Budget balance of the government institution sector was 15.4 CZK bn and +0.3% resp. of GDP last year. Surplus was achieved already for the fourth time in a row, its size was however only one third compared to year 2018. Primarily the worsening at central government institutions manifested, where the balance fell by 40.7 CZK bn (to -31.7 bn, four-year minimum). Health insurance companies lowered the budget surplus by one third year-on-year, on the contrary the local government institutions

The economic slowdown during the year 2019 was also mirrored in the dynamics of some significant tax incomes.

(formed mainly by regions and municipalities) improved their positive result by one half (to 36.0 bn). The surplus on the local level was achieved with simultaneous growth of investment, which was a positive factor[13]. Decelerated economic growth during the year 2019 manifested on the fiscal level by weakening dynamics of the tax incomes (mainly the current taxes on income and social contributions). It led to the worsening budget balance of the whole sector of government institutions – while in Q1 it amounted to +1.0% of GDP seasonally adjusted, it dived to -0.3% at the end of the year and presented the first deficit in the last five years.

The CR kept the position of the fourth relatively least indebted economy of the EU.

Gradual trend of lowering the indebtedness rate is apparent in the EU after year 2014. Situation in the most hit economies however was not improving much.

Debt of the whole sector of government institutions was 32.0% of GDP in the CR according to the latest data at the end of Q3 2019[14]. The CR thus held a position of the fourth the relatively least indebted EU country – with a larger distance behind Estonia (9.2%), Luxembourg (20.2%) and Bulgaria (20.6%) and simultaneously with a minimal lead ahead of further five states (Denmark, Sweden, Romania, Lithuania and Latvia). The indebtedness rate dropped by 1.9 p.p. year-on-year exclusively due to the nominal GDP growth in the CR year-on-year, more than in the euro area (-1.0) as well as the EU (-1,3). Indebtedness rate has been shrinking in the EU as well as the euro area already fifth year in a row, the reduction pace however failed to accelerate despite long-term economic growth. This is mainly connected to the fact, that the government institutions sector in the EU countries was still showing negative budget balance, which was not declining in the last quarters anymore[15]. Indebtedness rate lowered in three quarters of Union states in Q3 2019 year-on-year, a moderate increase however manifested among others also in some highly indebted economies (to 137.3% of GDP in Italy and to 100.5% in France). Indebtedness below 60% of GDP was observed only in near one half of the euro area members, in that out of core countries (EU15) only in Luxembourg, Netherlands and Finland. Only Germany and Malta succeeded in decreasing their indebtedness rate below the level from the business cycle peak period of 2006 to 2008 so far. Only Sweden was also approaching tightly this level, the CR was still exceeding it by more than 5 p.p.

[13] Gross fixed capital formation climbed by 3.4% in year 2019 to record 120.4 CZK bn. Volume of investment enlarged third year in a row.
[14] Preliminary data regarding the debt and deficit of the sector of government institutions for the whole yea 2019 for all EU states will be published by Eurostat on 3rd April 2020.
[15] Balance was moving in the range of -0.7% to -0.9% of GDP (after seasonal adjustment) during the three quarters of 2019. The balance at the same time reduced down to -0.5% in Q2 2018, which was the level close to the best result from the business cycle peak of the last decade. Among larger Union economies, only Germany (+1.7% of GDP) and Netherlands (+2.1%) succeeded in having surplus in Q1-Q 3 2019.