Public finance consolidation in the Czech Republic

Aleš Rod

Project EU Hidden Triggers

Webinar, 22nd May, 2015

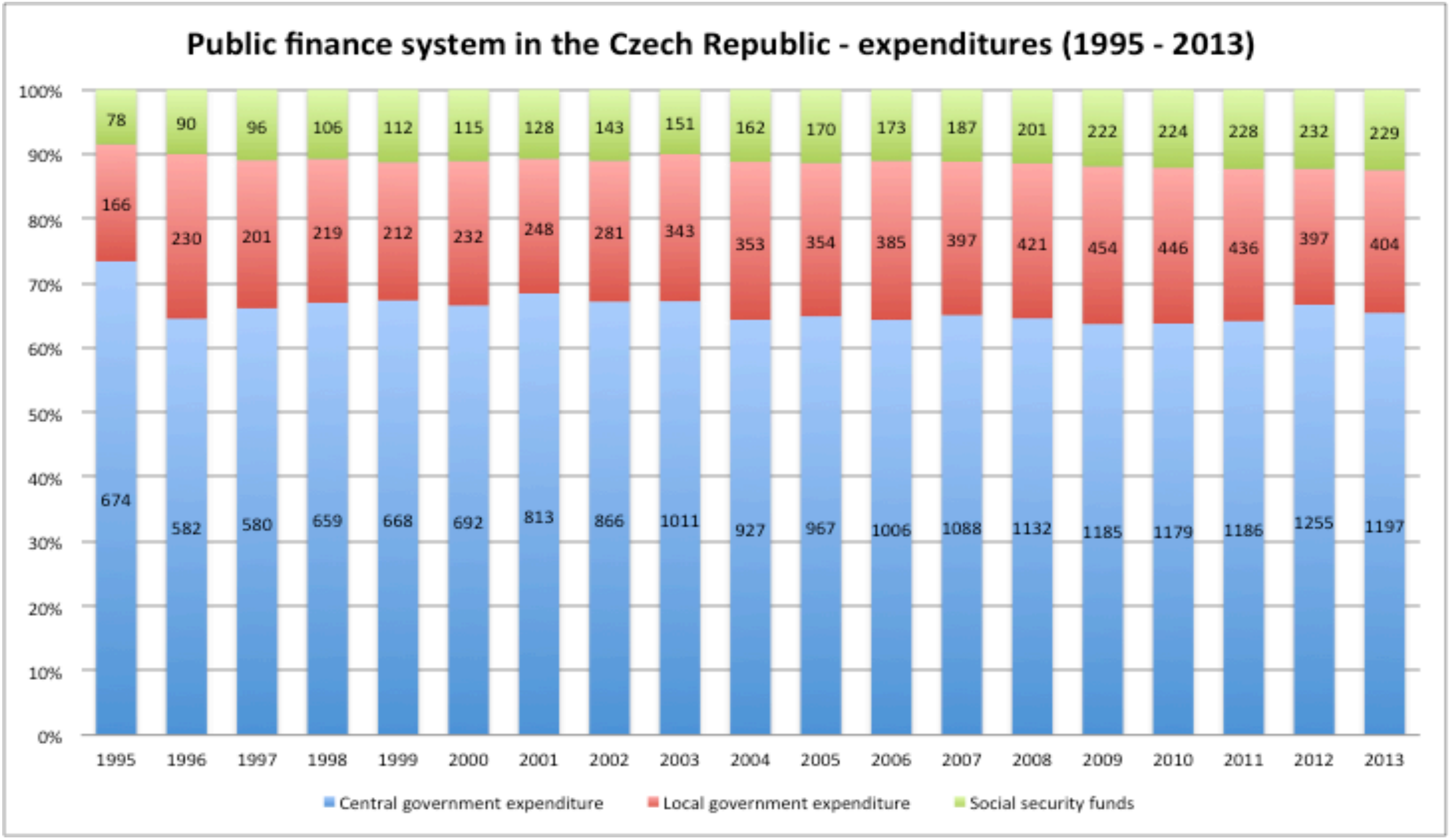
cета

Visegrad Fund

Public finance in the Czech Republic

- Centralization
  - state budget + budgets of local governments and municipalities + extrabudgetary funds
- Individualization
  - each institution has own budgetary chapter with own sovereign revenues and expenditures
- Preparation in advance
  - next year budget + binding Y+3 and general Y+5

Main element: central government

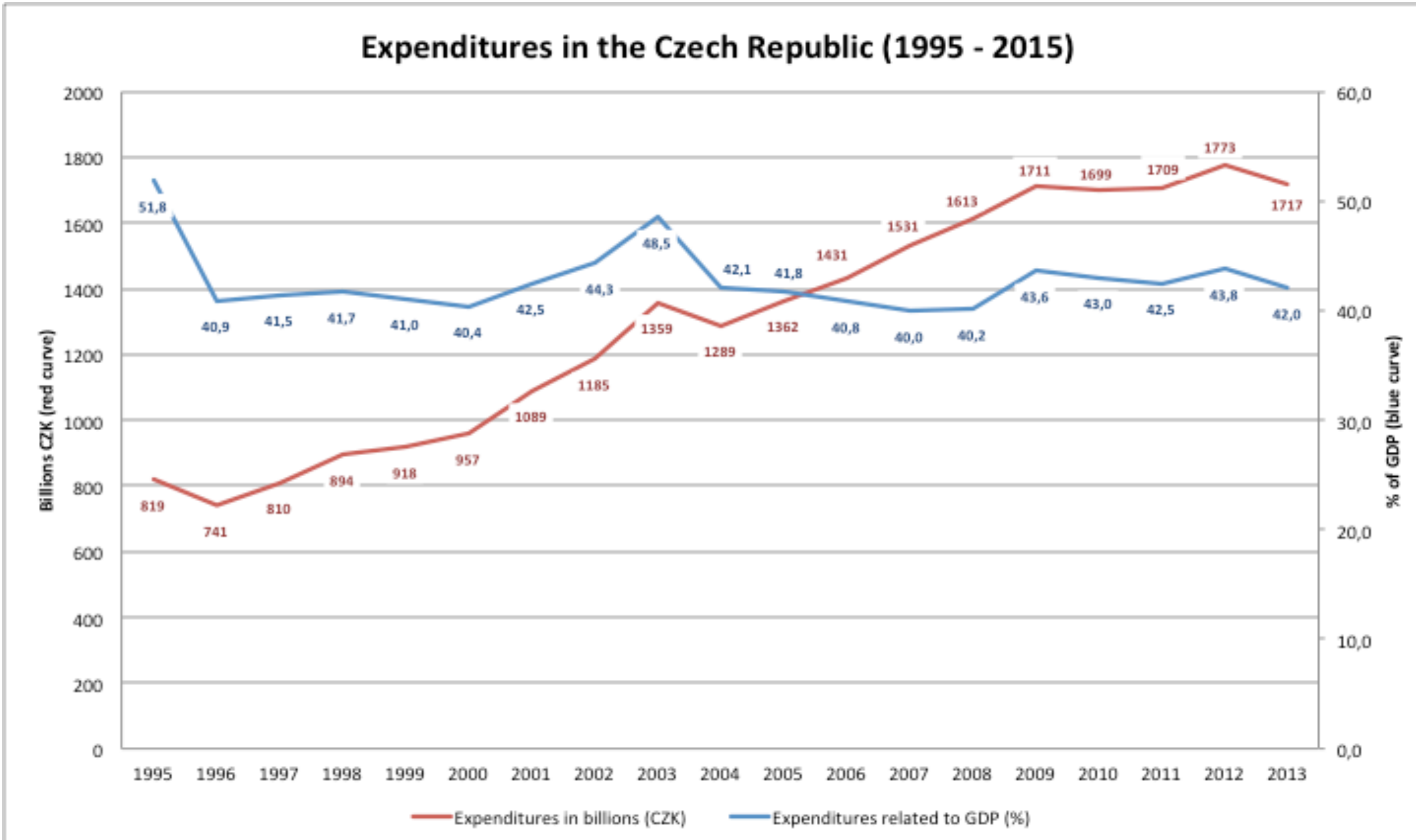


Shape of public finance

Expenditures

- Early transition was linked to extraordinary expenses, but beside this, expenditures averagely rose by 4 % (annually)
- The volume of expenditure rose more than twice to the level 62 bln. EUR (2014)
- Relative numbers: 40 – 45 % of GDP
- Low level of compensation of employees
- High level of mandatory expenditures (limited reaction on economic shocks)

General government expenditures



International comparison

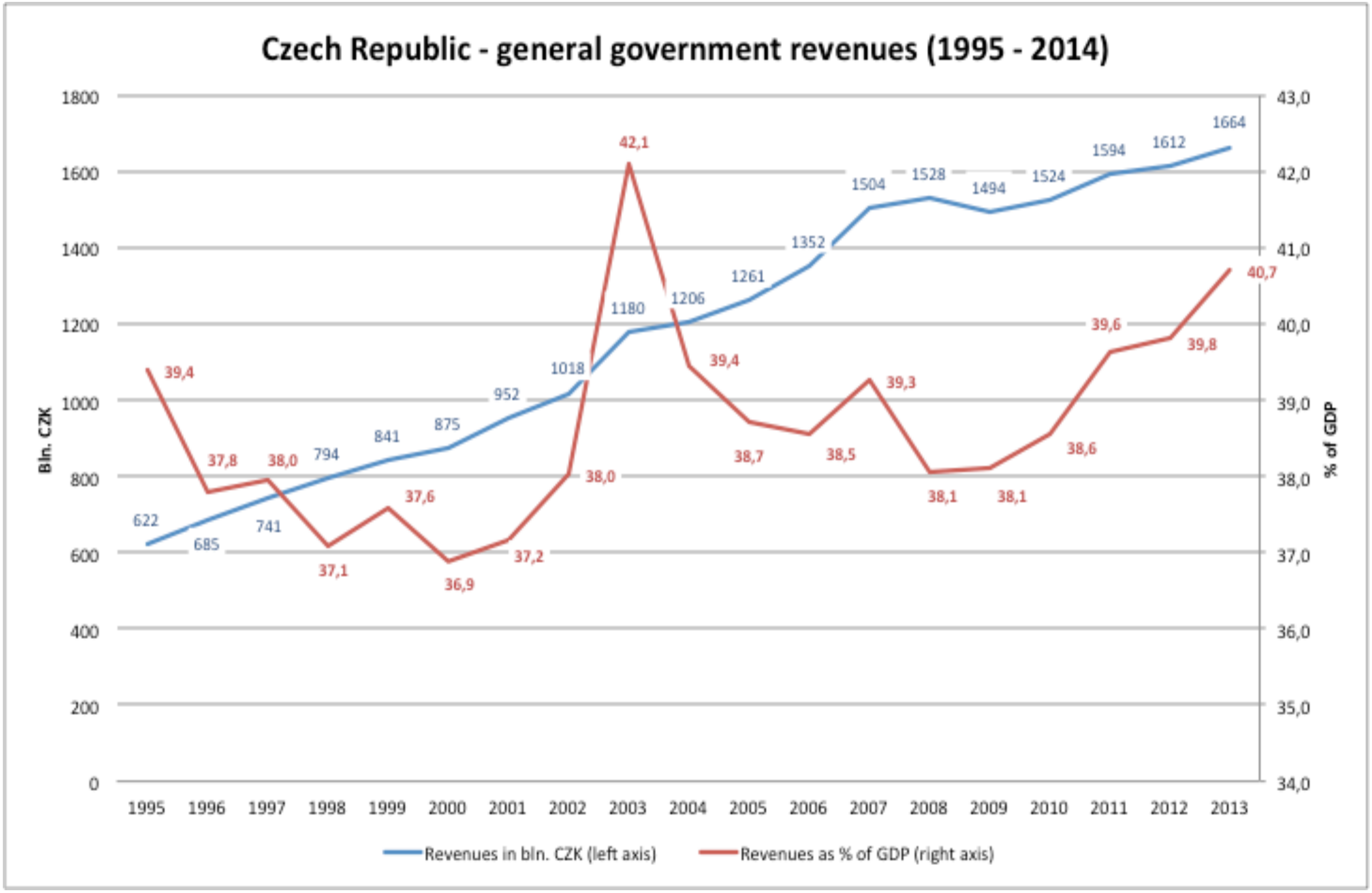
Public expenditures / GDP	2006	2007	2008	2009	2010	2011	2012	2013	2014
EU28	45,6	44,9	46,5	50,3	50,0	48,5	49,0	48,6	48,1
EA	46,0	45,3	46,5	50,6	50,5	49,0	49,6	49,5	49,1
Czech Republic	40,8	40,0	40,2	43,6	43,0	42,4	43,8	41,9	42,0
Germany	44,6	42,7	43,5	47,4	47,2	44,6	44,2	44,3	43,9
Hungary	51,9	50,2	48,9	50,8	49,8	49,9	48,7	49,8	50,1
Poland	44,7	43,1	44,4	45,2	45,9	43,9	42,9	42,2	41,8
Slovakia	38,5	36,1	36,7	43,8	42,0	40,6	40,2	41,0	41,8

- The second lowest outlays among V4 countries

Revenues

- Revenues consists of 9 main elements
  - Social contributions: 37 % of total
  - Taxes on production and imports: 32 % of total
  - Taxes on income and wealth: 17 % of total
- Annual increase (avg: +5.7 %), trend of revenues/GDP ratio rises as well
- Problems: taxation of labor, complicated system, tax exceptions, inefficient collection

General government revenues



International comparison

Revenues / GDP	2006	2007	2008	2009	2010	2011	2012	2013	2014
EU28	44,0	44,0	44,0	43,6	43,6	44,0	44,7	45,4	45,2
EA	44,6	44,7	44,4	44,4	44,3	44,9	46,0	46,6	46,7
Czech Republic	38,5	39,3	38,1	38,1	38,6	39,7	39,9	40,8	40,1
Germany	43,0	43,1	43,5	44,4	43,1	43,7	44,3	44,5	44,6
Hungary	42,5	45,2	45,3	46,2	45,2	44,4	46,4	47,3	47,6
Poland	41,1	41,2	40,8	37,9	38,2	39,0	39,2	38,2	38,6
Slovakia	34,9	34,1	34,3	35,9	34,5	36,4	36,0	38,4	38,9

- Slovakia – the lowest average level of revenues
- All countries with the exception of Hungary below EU and EA averages

Deficits and debts

Debt / GDP	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Czech Republic	28,5	28,0	27,9	27,8	28,7	34,1	38,2	39,9	44,6	45,0	42,6
Hungary	58,8	60,8	65,0	65,9	71,9	78,2	80,9	81,0	78,5	77,3	76,9
Poland	45,3	46,7	47,1	44,2	46,6	49,8	53,6	54,8	54,4	55,7	50,1
Slovakia	40,6	33,8	30,7	29,8	28,2	36,0	40,9	43,4	52,1	54,6	53,6

- No country reported annual net lending (surplus of public finance), average deficit was -4.7 % of GDP
- Problem: a rapid increase of indebtedness
  - Most significant example: Czech Republic

Consolidation – the case from 2010

- Since the 1st day of its existence, the 2010 government coalition presents itself like:
  - ***Center-right government (For a minimal state)***
  - ***Fiscally responsible (We must cut, not to tax)***
  - ***Liberal and market-oriented (No regulation, no penalty to work or success, we will let you breathe***
- During negotiations in 1st year of election period, this rule of fiscal policy adjustment has been agreed:

Cuts vs. new taxes = 2:1

Expenditures

Expenditure cuts

- **2010-2012**
  - 2010: cuts 15 billion CZK
  - 2011: cuts 58,5 billion CZK
  - 2012: cuts 100,1 billion CZK
- **2013-2014**
  - 2013: 96,4 billion CZK
  - 2014: 115 billion CZK

- ***List of main measures***
  - *Binding for budget planning*
  - *Simplification of bureaucracy (no duplicity)*
  - *Modification of pension valorization system*
  - *Reduction of some social transfers and benefits*
  - *Limitation of subsidies for renewable energy*

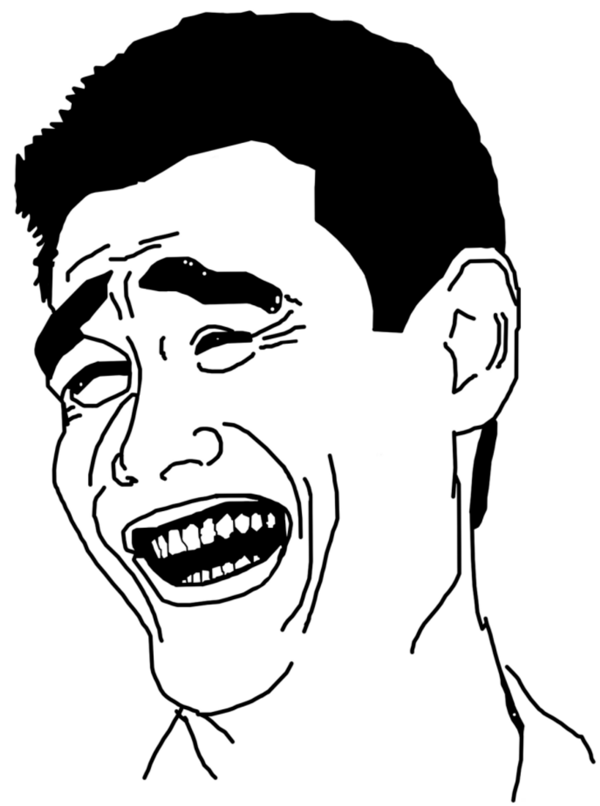
- The fact is that cuts equal low percentage points of total government outlays
- Regardless cuts, some expenditure chapters eventually rose
- Behind this measures, there is parallel activity creating roots for another expenditures (new agendas, new EU programs with co-financing, new space for corruption and inefficiency)

Revenues

List of tax increases

- Brand new "flood tax" 1200 CZK/year
- 15 % income tax on interests from building savings
- Income tax for pensioners with high pensions (4x average wage)
- No tax deduction for working pensioners
- 50 % tax for state benefit at building savings product
- Annual highway fee 1500 CZK
- Toll increase by 25 %
- Rise of excise tax for cigarettes and tobacco
- Brand new excise tax for LPG used as fuel
- Low rate of VAT to 14 %, and to 15%
- 32% tax from emission allowance
- Upper rate of VAT will increase to 21 %
- Excise tax from wine
- No tax deduction for entrepreneurs
- 22 % income tax for "rich" people
- No maximal health insurance contribution for people with high income
- Higher real estate transfer tax (from 3 to 4 %)

List of tax cuts



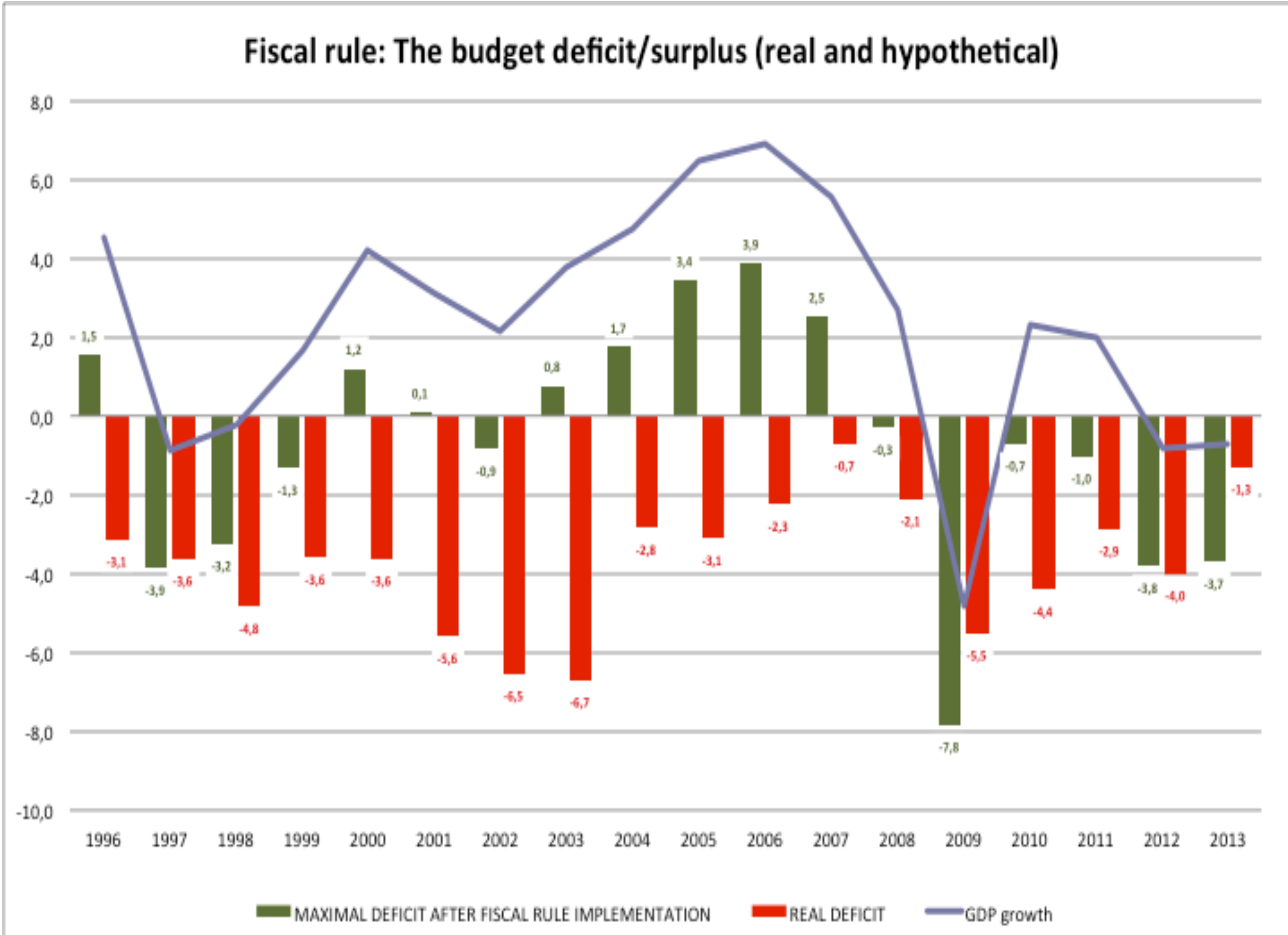
Unfortunately, the actual fiscal situation is too far from expected pre-election promises

Solutions?

1. **EFFICIENCY: *"Not to substitute inefficient tax collection by new taxes"***
    - *Excise taxes (alcohol, fuels, cigarettes, tobacco)*
    - *VAT (especially mineral oils and fuels)*
    - *Laffer's effect consideration*
2. **BARRIERS: *"To tie hands of politicians, not of taxpayers nor entrepreneurs"***
    - Fiscal rules (autopilot)
    - Simplification of tax legislation
    - Less bureaucracy

=> RESULTS

- ***to limit public expenditures***
- ***to stop indebtedness***
- ***to create barriers for spontaneous growth of bureaucracy***



Fiscal rule: The budget deficit/surplus (real and hypothetical)
8,0
6,0
4,0
2,0
0,0
-2,0
-4,0
-6,0
-8,0
-10,0
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
1,5
-3,1
-3,9
-3,6
-3,2
-4,8
-1,3
-3,6
1,2
-3,6
0,1
-5,6
-0,9
-6,5
0,8
-6,7
1,7
-2,8
3,4
-3,1
3,9
-2,3
2,5
-0,7
-0,3
-2,1
-7,8
-5,5
-0,7
-4,4
-1,0
-2,9
-3,8
-4,0
-3,7
-1,3
MAXIMAL DEFICIT AFTER FISCAL RULE IMPLEMENTATION
REAL DEFICIT
GDP growth

Conclusions and recommendations

1. Asymmetry between bureaucrats and politicians (B>>>P) generates an insuperable barrier for spontaneous reduction of the public sector.
2. The only way how to consolidate is through legislative tiding hands of politicians and bureaucrats (the harder the better).
3. Consolidation of public finance is not doable without strong opinion leaders, who covers back of government.

Thank you for your attention!