Addendum to an updated Convergence Programme (November 2008)

1 Introduction

This addendum summarizes measures adopted and elaborated by the Czech Republic in response to the economic slowdown. It is elaborated in accordance with the European Economic Recovery Plan, as agreed by the European Council on 11 and 12 December 2008. This plan calls for a fiscal stimulus introduced both at the individual Member States and the European institutions level in an amount of approximately 1.5 % of EU GDP. This effort should help the economies to adjust better to the current unfavourable conditions.

2 Fiscal Policy Set-Up in the Czech Republic for 2009

State budget for 2009 was approved with a planned deficit of CZK 38 billion. Nevertheless, in reaction to worsening economic outlook, the below mentioned measures have already been adopted during the preparation of the 2009 state budget and discussions in the Chamber of Deputies of the Parliament.

The Chamber of Deputies invited the government to prepare three scenarios of the general government deficit development with respect to the envisaged GDP growth dynamics, because the revenues of public budgets are based – taken from the present standpoint – on relatively optimistic growth expectations (see Convergence Programme).

In February 2009, the Ministry of Finance will submit to the government an updated macroeconomic forecast. In conformity with these documents, and especially regarding an updated level of envisaged general government deficits, the government will decide about the possible need to adopt the further steps in a budgetary area.

3 Measures Taken in Line with the European Economic Recovery Plan

The Czech Republic puts stress on fiscal discipline. With respect to the challenges of ageing population, there is not much space for increasing the indebtedness of a country. The Czech Republic faces one of the fastest ageing in Europe, and therefore it must implement the pension and health care reform. Both reforms can be relatively costly in fiscal terms, depending on the selected variant. At the same time, the Czech Republic will aspire for euro area entry and thus fiscal discipline is of paramount importance.

A persisting structural deficit in public budgets is another specific feature of the Czech fiscal situation. In 2007, at the peak of the economic cycle, it reached around 1.3% of GDP. Estimates from October 2008 for 2008 and 2009 point to a minor deterioration of this structural deficit to 1.5% of GDP for both years.

In the light of this national context, the main role will be played by automatic stabilizers and medium-term expenditure ceilings. Therefore, the following strategy was adopted as a response to the worsening economic outlook in the EU and to the European Economic Recovery Plan.

1. Lowering of taxes and social insurance contribution and direct assistance to the households

    - Additional increase of public sector wages by **CZK 2.7 billion** in comparison with the planned amount.

    - Decrease in social insurance contribution paid by employees by 1.5 p.p. Expected budgetary impact is approximately **CZK 18.4 billion.**

2. Increase in public expenditures

    - One-off increase in capital of the Czech Export Bank, the Export Guarantee and Insurance Corporation, the Czech-Moravian Guarantee and Development Bank totalling an amount of **CZK 2 billion.** *All these institutions are focused on the support of business in the CR.*

    - Increase in capital of the Support and Guarantee Agricultural and Forestry Fund by **CZK 300 million**. The core activities of this body consist in subsidizing interests of business credits in the field of agriculture, forestry, water management and industry, and also financial support of insurance in these areas.
    - Allocation of **CZK 600 million** for investment incentives for projects of technology centres.
    - Support of EU funds co-financing aimed at projects improving environment in an amount of **CZK 500 million** (in the framework of the Financial Perspective from 2004-2006).
    - Allocation of **CZK 14.4 billion** for construction and modernization of infrastructure within the State Fund for Transport Infrastructure**.**

Czech Export Bank is a specialised banking institution for state support of export by the provision and financing of export credits.
Export Guarantee and Insurance Corporation is a state export credit agency issuing credits for exports of goods and services from the Czech Republic against political and commercial risks. It provides insurance services to all exporters of Czech goods and services regardless of their size, legal form or volume of insured exports.
Czech-Moravian Guarantee and Development Bank provides assistance to small and medium sized businesses, infrastructure projects and other segments of the economy in need of public support. It focuses especially on support for small and medium sized businesses by a form of guarantees and favourable loans using public resources of the state budget, regions and structural funds. Moreover, it supports the owners of residential prefabricated “panel“ buildings during their regeneration and renovation, and grants favourable loans to water management projects.

3. Improving the functionality of the sickness insurance system
    - Reduction in sickness insurance premiums paid by the employers by 1 p. p., while simultaneously shifting the obligation to pay the sickness benefits for two weeks to the employers. The change is aimed at decreasing the use of sickness leave which seems to be significantly higher in the context of other European countries.