

# 5 Quality of Public Finances – Revenues and Expenditures

## 5.1 General Government Revenues

In 2008, the total tax revenues collected by the general government sector are developing approximately as forecasted. Value added tax (VAT) collection is slightly worse due to, in particular, a more substantial slowdown of spending on final consumption expenditures than expected. In contrast, revenues from direct taxes are higher than expected.

The share of indirect taxes (the item “taxes on production and imports”) in GDP continues to increase and should rise from 10.9% in 2007 to around 11.2% of GDP in 2008. The main factor has been the increase in the reduced VAT rate from 5% to 9% effective from 1 January 2008, with the impact being felt particularly in the categories of food, construction work for social housing, housing services, and regular public transport. Within excise taxes, from the beginning of 2008 the tax rate on tobacco products has been increased, and, in the context of initiating the environmental tax reform, the introduction of a tax on electricity, natural gas and solid fuels also increased the revenues from indirect taxes.

In comparison with the aforementioned growth in the share of indirect taxes in GDP, a direct income taxes as a proportion of GDP will gradually decline over the period 2008–2010, dropping from 9.3% of GDP in 2007 to an expected level of 8.1% of GDP by 2010. In addition to introducing a flat personal income tax (PIT) rate of 15% and reducing the corporate income tax (CIT) rate from 24% to 21% in 2008, there will be a further gradual reduction in the CIT rate in accordance with the approved legislation: to 20% in 2009 and further to 19% in 2010. Another reduction in tax rates is not expected in 2011, and the share of current income taxes will show moderate growth of 0.1 percentage points year-on-year.

Similar to income taxes, also the share of social contributions paid on the part of employees and employers will fall. From 2008, a ceiling was introduced for the annual assessment base for social and health insurance premiums amounting to four times the average annual wage in the national economy. From the start of 2009, the premium rates for sickness insurance and the contribution to the national employment policy will be reduced. With respect to employees, the premium rates will be lowered by a total of 1.5 percentage points, while, as regards employers, in accordance with the new Act on Sickness Insurance already approved, the rate will be lowered by 1.0 percentage point.<sup>10</sup> Reducing social contributions with respect to employees compensates for an originally planned drop in the PIT rate. The PIT rate will be kept at the present rate of 15%, even though its reduction to 12.5% was approved in 2007. An additional counterbalance to the said drop in government revenues due to the reduction in the sickness insurance premium will be represented on the expenditures side by the positive impact of an employer’s obligation to pay sickness benefits during the first 14 days of an employee’s illness, which also enters into effect from 1 January 2009 under the new Act on Sickness Insurance (for more information, see last year’s CP update). From 2010, in accordance with this Act, another drop in the rate of the premium paid on the side of employers, by 0.9 percentage points, is planned.

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<sup>10</sup> The impacts of the new Act on Sickness Insurance were described, quantified and included in the outlook in the previous CP update and thus are no longer contained in the boxes or tables of this section.

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Overall, social contributions in proportion to GDP can be expected to drop from 16.3% in 2007 to approximately 15.2% in 2010.

The item “property income” shows a decline after 2008 due to the unforeseen recurrence of this year’s record dividends. Within the category “other”, a gradual rise can be traced due to grant revenues from the EU budget.

The total tax quota shows a constant decline over time. From values of 36.6% and 35.7% of GDP for 2007 and 2008, respectively, it will gradually fall to a value of around 33.7% of GDP by 2011 (see Table 5.1).

**Table 5.1: General government revenues**

% of GDP	ESA code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
			(1)	(2)	(2)	(2)
<b>Components of revenues</b>						
<b>Total taxes</b>		<b>20,2</b>	<b>19,5</b>	<b>19,4</b>	<b>18,9</b>	<b>18,6</b>
Taxes on production and imports	D.2	10,9	11,2	11,1	10,8	10,4
Current taxes on income, wealth etc.	D.5	9,3	8,3	8,3	8,1	8,2
Capital taxes	D.91	0,0	0,0	0,0	0,0	0,0
<b>Social contributions</b>	<b>D.61</b>	<b>16,3</b>	<b>16,2</b>	<b>15,7</b>	<b>15,3</b>	<b>15,1</b>
Property income	D.4	0,8	1,0	0,8	0,7	0,5
<b>Other</b>		<b>4,3</b>	<b>4,4</b>	<b>4,6</b>	<b>4,7</b>	<b>4,8</b>
<b>Total revenue</b>	<b>TR</b>	<b>41,7</b>	<b>41,0</b>	<b>40,6</b>	<b>39,6</b>	<b>39,0</b>
<b>p.m.: Tax burden</b>		<b>36,6</b>	<b>35,7</b>	<b>35,1</b>	<b>34,2</b>	<b>33,7</b>

(1) Prediction.

(2) Outlook.

Sources: Czech Statistical Office (2007), Ministry of Finance.

### Box 5.1: Changes in taxation

#### Corporate income tax

In 2008, the restriction on the deductibility of financial costs, which had been introduced in the 2007 reform, was abolished. In addition, the CIT base was reduced through an exemption for so-called service fees collected by companies operating fixed-odds betting. In 2008, the impact of these measures on CIT will be approximately CZK -2 billion, with an expected impact in the following years of approximately CZK -2.2 billion.

#### Personal income tax

The government decided to abandon its original plan to reduce the PIT rate from 15% to 12.5% as of 1 January 2009. The rate will remain at the level of 15%. In comparison with the original outlook, the positive impact for general government revenues is estimated at CZK 10 billion per year.

#### Reduction in social insurance premium rates

From 2009, in response to the maintaining the PIT rate, the social insurance rate for employees will be lowered by 1.5 percentage points. This constitutes a zero-adjustment to the premium rate for employees for sickness insurance and for the contribution to the state employment policy. The total premium rate for pension insurance, sickness insurance and contribution to the state employment policy will thus be reduced from 33% to 31.5%. For self-employed individuals, the rate will be lowered by 0.4 percentage points. This measure will reduce government revenues by ca CZK 18.4 billion in 2009, by a further CZK 19.1 billion in 2010, and finally by CZK 20.3 billion in 2011.

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The impacts of active tax policy measures are summarised in Table 5.2

**Table 5.2: The impact of revenue measures<sup>1</sup>**

CZK bn	Year 2008	Year 2009	Year 2010	Year 2011
Maintaining the PIT rate at the level of 15% instead of planned decrease to 12.5%	-	10,0	10,0	10,0
Adjustment of the CIT base	-2,2	-2,4	-2,4	-2,4
Decrease in the rate of social contributions paid by employees by 1.5 pp	-	-18,4	-19,1	-20,3
<b>Total impact on revenue</b>	<b>-2,2</b>	<b>-10,8</b>	<b>-11,5</b>	<b>-12,7</b>
<b>Total impact on revenue (% of GDP)</b>	<b>-0,1</b>	<b>-0,3</b>	<b>-0,3</b>	<b>-0,3</b>

<sup>1</sup>The impacts in Section 5 are expressed in comparison with no-policy-change scenarios (i.e. they are cumulative).

Source: Ministry of Finance.

### 5.2 General Government Expenditures

Owing to austerity measures in the area of social outlays and a moderate increase in government consumption, total general government expenditures declined as a percent of GDP. This share has shown a constant decreasing trend since 2004 and should gradually decrease further from 42.6% in 2007 to 40.2% of GDP in 2011.

Social transfers are a key component of mandatory general government expenditures and recorded a year-on-year drop from 18.2% of GDP in 2007 to approximately 17.8% of GDP in 2008, due particularly to a decrease in monetary payments for social benefits.

The share of interest payment expenditures should also begin to show a decreasing trend due to the anticipated modest drop in interest rates and the declining share of debt relative to GDP.

Gross fixed capital formation shows an increasing tendency, which can be attributed especially to the gradual increase in funds drawn from the EU budget. In comparison with the development anticipated for the period 2008–2011, growth in gross fixed capital was very low in 2007 and recorded an unfavourable shift in the structure of general government expenditures, particularly towards social expenditures. An attempt to reverse this negative trend in 2008 in the form of savings measures in the social area (described in more detail in the previous CP update) should result in returning social transfers to a lower level. Sufficient space will thereby be created within the approved expenditure limits for targeted growth oriented general government expenditure investments. Acceleration in investment activity is nevertheless critically dependent on the realisation of projects co-financed through EU funds, which carry with them a large volume of domestic resources intended for national financing and pre-financing.

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**Table 5.3: General government expenditures**

% of GDP	ESA code	Year 2007	Year 2008 (1)	Year 2009 (2)	Year 2010 (2)	Year 2011 (2)
<b>Components of expenditures</b>						
<b>Compensation of employees</b>	<b>D.1</b>	<b>7,6</b>	<b>7,3</b>	<b>7,1</b>	<b>6,9</b>	<b>6,8</b>
<b>Intermediate consumption</b>	<b>P.2</b>	<b>6,2</b>	<b>6,0</b>	<b>5,6</b>	<b>5,1</b>	<b>4,8</b>
<b>Social transfers</b>		<b>18,2</b>	<b>17,8</b>	<b>17,9</b>	<b>17,5</b>	<b>17,0</b>
Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	5,3	5,3	5,4	5,4	5,3
Social transfers other than in kind	D.62	12,9	12,4	12,4	12,1	11,8
<b>Interest expenditure</b>	<b>EDP D.41</b>	<b>1,2</b>	<b>1,3</b>	<b>1,3</b>	<b>1,2</b>	<b>1,1</b>
<b>Subsidies</b>	<b>D.3</b>	<b>1,8</b>	<b>1,8</b>	<b>1,8</b>	<b>1,7</b>	<b>1,7</b>
<b>Gross fixed capital formation</b>	<b>P.51</b>	<b>4,7</b>	<b>4,8</b>	<b>5,2</b>	<b>5,3</b>	<b>5,4</b>
<b>Other</b>		<b>3,0</b>	<b>3,2</b>	<b>3,4</b>	<b>3,4</b>	<b>3,5</b>
<b>Total expenditures</b>	<b>TE</b>	<b>42,6</b>	<b>42,2</b>	<b>42,2</b>	<b>41,1</b>	<b>40,2</b>
<b>p.m.: Government consumption (nominal)</b>	<b>P.3</b>	<b>20,4</b>	<b>19,8</b>	<b>19,4</b>	<b>18,6</b>	<b>17,8</b>

(1) Prediction.

(2) Outlook.

Sources: Czech Statistical Office (2007), Ministry of Finance.

### Box 5.2: Changes in social expenditures

#### Extraordinary pension indexation

In April 2008, an amendment to the Act on Pension Insurance was approved that newly establishes a government obligation to index pensions if the increase in prices reaches the 5% mark (previously, the limit under the law was 10%). For this reason, in 2008, an extraordinary indexation of pensions was carried out with a one-off increase in government expenditures of CZK 6.7 billion, effective from 1 August 2008.

#### Payment of sickness insurance benefits

A provision on the non-payment of sickness benefits for the first three days of sick leave was abolished (i.e. the exclusion period, defined in last year's CP update) based on a decision of the Constitutional Court. During the period from 1 June 2008 to 31 August 2008, therefore, benefits will also be paid for the first 3 days in the amount of 60% of the assessment base. From 1 September 2008 to 31 December 2008, under the new regulation adopted in a shortened legislative process, sickness benefits will be paid for these days in the amount of 25% of the assessment base. From 1 January 2009, a new Act on Sickness Insurance will come into effect (see last year's CP for its parameters). As compared to original expectations, this development resulted in a negative impact on public outlays amounting to CZK 1.2 billion in 2008.

#### Changes in payments from public health insurance

Expenditures from public health insurance will be affected by an increase in the financing of emergency services (strengthening the role of their financing from health insurance), the inclusion of vaccinations into payments from public health insurance (transfer of competences from the state) and, by contrast, the removal of company preventive health care from financing through public health insurance (transfer of obligation to the employer) and the financing of post-mortem examinations from outside of health care facilities (transfer of payment obligation to regions). The positive impact on government outlays is estimated at about CZK 160 million, stemming from expected changes due to legal amendments that should come into effect in 2009.

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**Table 5.4: The impact of expenditure measures<sup>1</sup>**

CZK bn	Year 2008	Year 2009	Year 2010	Year 2011
Reduction of the inflation limit for one-off indexation of pensions (one-off indexation as at 1 August 2008)	6,7	-	-	-
Parametrical changes in the pay-as-you-go pension system	-	-	-0,4	-0,8
Adjustments of sick benefits following the decision of the Constitutional Court (impact during 1 September–31 December 2008)	1,2	-	-	-
Other adjustments in social expenditures	0,1	-0,3	-0,3	-0,3
Changes in public health insurance	-	-0,2	-0,2	-0,2
<b>Total impact on expenditures</b>	<b>8,0</b>	<b>-0,5</b>	<b>-0,9</b>	<b>-1,3</b>
<b>Total impact on expenditures (% of GDP)</b>	<b>0,2</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>

<sup>1</sup>The impacts in Chapter 5 are expressed in comparison with no-policy-change scenarios (i.e. they are cumulative).

Source: Ministry of Finance.

The individual types of government expenditure in proportion to GDP are shown in Table 5.5.

**Table 5.5: General government expenditures by function**

% of GDP	ESA code	Year 2002	Year 2003	Year 2004	Year 2005	Year 2006
1. General public services	1	5,0	5,2	5,0	5,5	5,0
2. Defence	2	1,6	1,9	1,4	1,6	1,2
3. Public order and safety	3	2,1	2,2	2,2	2,2	2,2
4. Economic affairs	4	8,6	8,4	7,5	7,0	7,0
5. Environmental protection	5	1,0	1,2	1,1	1,2	1,2
6. Housing and community amenities	6	0,7	1,3	1,0	1,4	1,2
7. Health	7	6,3	6,4	7,4	7,2	7,2
8. Recreation, culture and religion	8	1,3	1,3	1,2	1,2	1,3
9. Education	9	5,2	5,2	4,8	4,8	5,0
10. Social protection	10	14,5	14,3	13,6	12,8	12,6
<b>Total expenditure</b>	<b>TE</b>	<b>46,3</b>	<b>47,3</b>	<b>45,1</b>	<b>44,9</b>	<b>43,8</b>

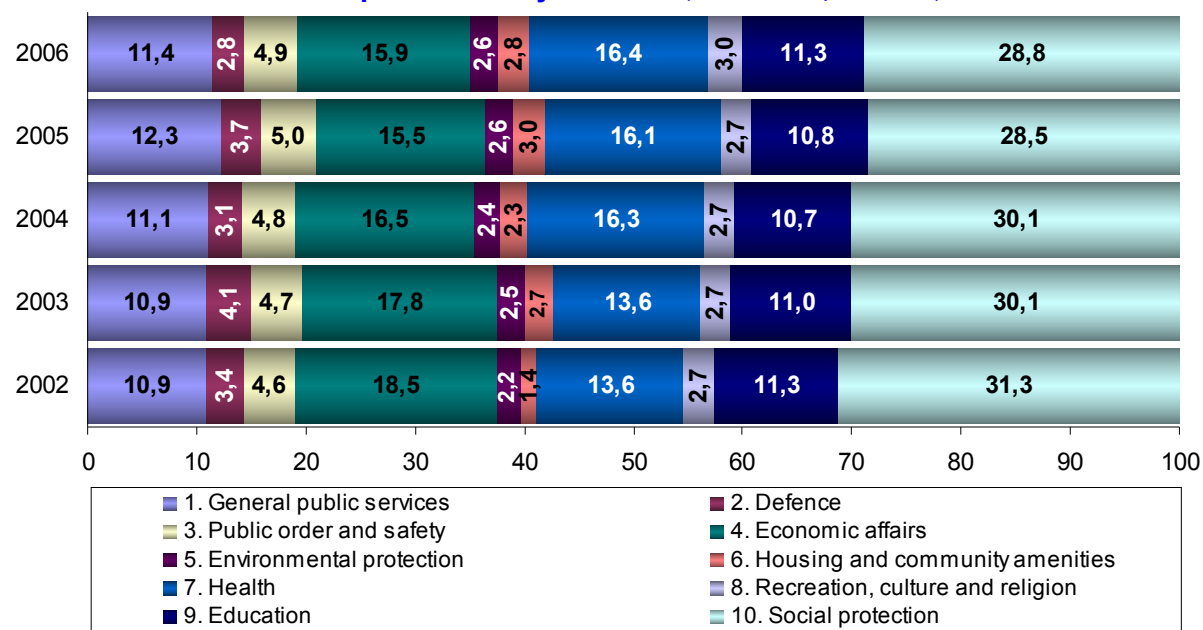
Note: Total expenditures do not correspond precisely to the current version of the yearly national accounts. This is due to the different periodicity for publishing the main aggregates of the annual national accounts (every half year in April and October) and the expenditures of general government institutions by function (once a year in December).

Source: Czech Statistical Office.

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Chart 5.1 presents the structure of the outlays of general government institutions by function (COFOG). A decrease is evident in the share for economic affairs and that of defence. In contrast, the opposite trend was recorded for health, i.e. an increasing share in total general government expenditures.

**Chart 5.1: Government expenditures by function** (% of total expenditures)



Source: Czech Statistical Office.