6 Sustainability of Public Finances

6.1 The Government's Strategy

Long-term sustainability is one of the weak spots of public finances. The most serious risk is the expected demographic development, which will somewhat dramatically increase the share of persons of retirement age in the working population over the next several decades. The government is continuously engaged in the issue of an ageing population and its impact on the long-term sustainability of public finances.

The pension system

The approach to resolving the pension system issue has been divided into three phases. The proposal of measures for the first phase was approved in the summer of 2008 and contains stabilising parametric adjustments to the current pay-as-you-go scheme. The main adjustments include continuing to increase the retirement age at the current rate progressively to 65 years of age,[11] coordinating the age for entitlement to "permanent" widow's or widower's pension based on retirement age, and converting full disability pension into retirement pension at the age of 65. It was also agreed to extend the minimum insurance period and to limit its compensatory periods, the current definition of disability was modified, and a special reserve account for pension reform was created (see Box 6.1 for more details).

The second prepared phase will involve separating the assets of shareholders and clients in the voluntary supplementary pension insurance scheme and additional adjustments geared to increasing the motivation of clients and the participation of employers in supporting supplementary pension insurance. A guarantee of minimum income for pensioners in the amount of the minimum subsistence level will also be introduced.

During the third phase, an additional savings pillar for the pension system is being considered that either would be based on a scheme to "opt out" of the state pay-as-you-go system at a certain level or would become an obligatory pillar from a certain time.

The health care system

The health care system reform has also been divided into several phases. The first phase, which was launched in 2007 and incorporated into the set of measures for stabilising public finances, was described in detail in last year's CP update. In 2008, certain partial adjustments were approved for the system of service charges (see Box 6.1). Certain measures are being considered to take effect from 1 January 2009. These include exempting children under six from doctor's fees and reducing the annual limit for selected fees and supplementary payments for medication for children under 15 from CZK 5,000 to CZK 3,000.

Currently, there are proposals in the legislative process for acts containing specific system changes aimed at, among others, clarifying health care terminology, strengthening fair

[11] The age limit of 65 applies for men and women with a maximum one child. The age limit for women according to the number of children remains differentiated: the target limit is 64 for women with two children, 63 with three children and 62 with four or more children.

competition among health service providers by establishing uniform conditions for providing these services, clarifying the positions of the provider and the patient and their mutual relationships (particularly with the goal of strengthening the interests and rights of the patient), and increasing the quality of care and the safety of the patient through greater and more effective monitoring and inspection. Another part of the newly prepared legislation aimed at developing the public health insurance system, clarifying the insured person's entitlements from the insurance system (including to establish limits on the availability of care), positioning and regulating of health insurance companies with the goal of their more transparent functioning and greater responsibility of the management, and strengthening supervision over the operating performance of health insurance companies and the fulfilment of their obligations to insured persons is already prepared and awaits the start of the legislative process. The specific solutions under consideration here probably will be reflected in laws beginning from 1 January 2010 at the earliest.

The goal of the reform laws is to increase competition among insurance service providers as well as health insurance companies through the use of market mechanisms. The financing and provision of health care should thereby be made more effective.

Box 6.1: Adjustments to the health care and pension systems

The health care system

A law partially adjusting the system of service charges has been in effect since 1 September 2008. Institutional care for newborns (from birth until released from hospital) and organ donors has been exempted from a service charge. This partial adjustment of the obligation pertains to a small circle of people.

The pension system

In the first stage of pension reform, it was agreed to continue in the process of gradually increasing the retirement age. The retirement age for insurees born after 1968 will be 65 for men and women who have raised no more than one child. For women born after 1968 who have raised 2, 3, or 4 or more children, the retirement age will be 64, 63, and 62, respectively. In accordance with the extension of the retirement age, the age limit for entitlement to a "permanent" widow/widower's pension also is increased in the final phase to 61, while the age limit for entitlement to retirement pension for a shorter term of insurance is increased in the final phase to 70. Another measure is the change of disability pensions to retirement pensions upon reaching 65 years of age, with effect from 2010.

Another measure is gradual extension of the required insurance period for entitlement to retirement pension from 25 to 35 years (including compensatory insurance periods), or to 30 years (i.e. only the period during which the insurance was paid), beginning in 2010. Nevertheless, there remains a possibility for entitlement to retirement pension even upon achieving a shorter insurance period, but that required shorter insurance period also is extended from 15 to 20 years. Non-contributory insurance periods, with several exceptions, will be valued at 80% for pension entitlement. The compensatory insurance period during studies is now abolished.

As a measure to increase labour market flexibility with effect from 2010, payment of half the retirement pension will be made possible after the entitlement to retirement pension for gainful activity arises, and for every 180 calendar days of this gainful activity the percentage retirement pension assessment will increase by 1.5% of the calculation basis. At the same time, there will be abolished the condition established earlier that to remain entitled to payment of retirement pension a retired person could not have additional income from gainful activity if the employment relationship was established for a period exceeding one year.

In the area of disability pensions, the division of disabilities into full disability or partial disability (and, therefore, also the division of disability pensions into fully disabled or partially disabled) will be abolished and a single type of disability (and, therefore, also a single type of disability pension) in three tiers depending on the percentage decrease in working capacity of the insuree will be introduced. The first tier relates to a decrease in working capacity by at least 35% and at most 49%. The second tier concerns a reduction of at least 50% and at most 69%, while the third tier covers a reduction of 70% or greater. For each full year of insurance, the percentage disability pension assessment will amount to 0.5% of the calculation basis for a disability pension granted for a first-tier disability, 0.75% of the calculation basis for a second-tier disability, and 1.5% of the calculation basis for a third-tier disability. It is estimated that around 74–75% of insurees who are currently categorised as partially disabled will be registered in the first tier (a result of which will be a reduction in the existing pension). About 24–25% of insurees who are currently categorised as partially disabled would be categorised in the second tier.

6.2 The Fiscal Consequences of Ageing: A Long-Term Projection

Analysis of long-term public expenditure development based upon an assumption of unchanging policies emerges from the medium-term macroeconomic and fiscal scenario through 2011 presented in previous sections and for later periods from the common assumptions discussed by the EPC's Working Group on the Ageing Population (AWG). Thus, newly approved assumptions on demographics (EUROPOP2008) and the macroeconomic framework that are over the long term consistent for EU countries were used in the analysis. The projection period was extended to 2060.

Table 6.1: Macroeconomic projection assumptions

% of GDP	Year 2007	Year 2010	Year 2020	Year 2030	Year 2040	Year 2050	Rok 2060
Labour productivity growth	4,1	3,8	2,9	1,8	1,7	1,7	1,7
Real GDP growth	6,6	4,4	2,5	1,4	0,9	0,7	1,1
Participation rate males (aged 15–64)	78,3	78,7	81,0	78,8	78,5	79,0	78,9
Participation rates females (aged 15–64)	61,6	63,3	66,7	66,0	66,0	67,8	68,1
Total participation rates (aged 15–64)	70,0	71,0	73,9	72,5	72,3	73,5	73,5
Unemployment rate	5,3	4,6	4,5	4,5	4,5	4,5	4,5
Population aged 65+ over total population	14,4	15,4	20,2	22,9	26,3	30,9	33,4

Sources: Ministry of Finance, AWG.

As compared with previous years, the results, summarised in Table 6.2, include the positive effects of the first phase of pension reform, relating in particular to the further extension of the age limit, the division of disability pensions from two into three groups, and the automatic administrative qualification of disability pensions as retirement pensions after reaching 65 years of age. The last of these measures has neutral impacts on expenditures.

Table 6.2: Long-term sustainability of public finances

% of GDP	Year 2007	Year 2010	Year 2020	Year 2030	Year 2040	Year 2050	Year 2060
Total expenditure	42,4	41,1	40,1	41,8	44,6	49,5	54,5
of which: Age-related expenditure	19,2	18,7	18,8	20,1	21,9	24,8	26,5
Pension Expenditure	8,2	7,7	7,7	8,1	9,6	11,5	12,4
Social security pensions	8,2	7,7	7,7	8,1	9,6	11,5	12,4
Old-age and early pensions	7,5	7,1	7,1	7,4	9,0	10,9	11,8
Other pensions	0,7	0,6	0,6	0,7	0,6	0,6	0,6
Occupational pensions	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Health care	6,3	6,3	6,7	7,3	7,8	8,5	8,9
Long-term care	0,2	0,3	0,3	0,4	0,5	0,5	0,7
Education expenditure	3,6	3,4	3,1	3,3	3,1	3,1	3,4
Other age-related expenditures	1,0	1,0	1,0	1,0	1,0	1,1	1,1
of which: Interest expenditure	1,1	1,1	0,8	1,2	2,1	4,2	7,5
Total revenue	41,4	39,6	39,0	39,0	39,0	39,0	39,0
of which: Property income	0,8	0,7	0,5	0,5	0,5	0,5	0,5
of which: From pension contributions (or social contributions if appropriate)	8,6	8,6	8,6	8,6	8,6	8,6	8,6
Pension reserve fund assets [(a)]	0,4	2,9	13,2	22,9	26,3	9,8	0,0
of which: Consolidated public pension fund assets (assets other than government liabilities)	0,0	0,0	0,0	0,0	0,0	0,0	0,0

(a) The cumulative positive balance on the pension account (assets of pension security funds) will be depleted between 2030 and 2040.

Source: Ministry of Finance.

Due to these measures, population changes thus have slightly more moderate impacts on public finances. Nevertheless, growth as a percentage of GDP in expenditures sensitive to the age structure of the population will be 7.2 percentage points for 2007–2060. The largest volume outlays on old-age pensions contribute most to this growth. The increase in these expenditures under an assumption of no-policy-change would cause a deepening of the primary deficit, a rise in interest payments (from the current 1.1% to 7.5% of GDP), and a rapid accumulation of government debt.

Chart 6.1: Projection of expenditures

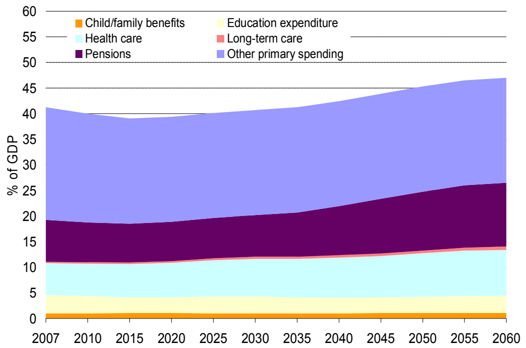
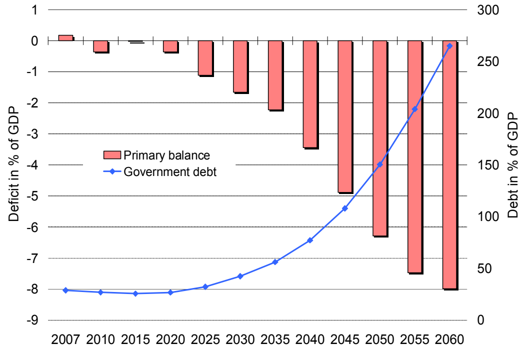


Chart 6.2: Primary deficit and debt



Source: Ministry of Finance.

The analysis identifies the scope of fiscal consolidation necessary to secure sustainability in the horizon to 2060. In this respect, it would thus be necessary to implement such measures as would reduce the share of expenditures or increase the share of revenues in GDP by 2.5 percentage points in 2011 (the so-called S1 indicator). This means that the overall general government balance should register a surplus in 2011 of 1.4% of GDP. In order to ensure the permanent solvency of the general government, a fiscal correction of 6.0% of GDP would be needed in 2011 (the so-called S2 indicator).

Table 6.3: Scope of needed fiscal consolidation

% of GDP	Year 2011	Year 2012	Year 2013
1. Revenues	39,0	39,0	39,0
2. Primary expenditures	39,1	39,1	39,1
3. Primary balance (1-2)	-0,1	-0,1	-0,1
4. Sustainability gap S1 (1)	2,5	2,6	2,7
5. Required primary balance (3+4)	2,4	2,5	2,6
6. Required total balance	1,4	1,8	1,9
Sustainability gap S2 (2)	6,0	6,1	6,2

(1) Permanent fiscal consolidation (S1) expresses as a percentage of GDP the necessity to permanently increase taxes (from the given year) or reduce expenditures in order to achieve a government debt of 60% of GDP at the end of the projection period.

(2) Permanent fiscal consolidation (S2) is similar but for an indefinite time horizon.

Source: Ministry of Finance.

The sustainability analysis showed some improvement that possibly can be attributed to the reform measures presented,[12] and particularly to the increase in the retirement age.

[12] The results given in the previous CP, however, are not fully comparable to last year's due to moderately more optimistic long-term macroeconomic and demographic assumptions. The long-term projection period also was extended by 10 years to 2060, which, from the point of view of sustainability indicators, extends the time for fiscal consolidation.