

Introduction

As a part of the European Union's multilateral fiscal surveillance and economic policy coordination process, the Czech Republic hereby submits updated Convergence Programme (the "CP").

General government finances during 2007 turned out better than expected: the government balance reached -1.0% of GDP, which represents an improvement of 1.7 percentage points year on year. In 2008 an excessive deficit procedure has been abrogated with the Czech Republic, when the ECOFIN Council stated that the ratio of its general government deficit had been reduced to below the 3% GDP reference value in a credible and sustainable way. The Czech government, nevertheless, is determined not only to maintain deficits well below 3% of GDP, but also to strive for their further reduction. At the same time, it will continue with additional reforms directed to the long-term sustainability of public finances, particularly in the health care and pension systems.

The success of this goal, however, is encumbered by substantial risks. Although the macroeconomic scenario, on the basis of which the CP is created, is— just like in previous years both realistic and conservative— the effects of the financial markets crisis on the global and Czech economies cannot, for the time being, be estimated with much certainty. Under the current state of knowledge (the CP was prepared on the basis of data available as of 1 October), real GDP growth is expected to slow to 4.4% in 2008 and to 3.7% in 2009. After overcoming the consequences of the global crisis, economic growth should accelerate to a rate of 5.2% in 2011.

From the viewpoint of public finances structure, the share of indirect taxes in GDP will continue to increase, while that of direct taxes will continue to fall. The main factor is the increase in the reduced VAT rate from 5% to 9% with effect from 1 January 2008. At the same time, the share of general government expenditures in GDP is decreasing, particularly due to saving measures in the social sphere and moderate growth in government expenditures.

The greatest risk to the long-term sustainability of public finances is expected demographic development, since according to projections the ratio between the number of persons of retirement age and the economically active population should increase in coming years. The government is prepared to confront this problem by pursuing further the already initiated reform of the pension system. Continuing reforms in health care system also should benefit the long-term sustainability of public finances.

The programme was sent to the Czech Parliament for information. The relevant committees pay greater attention to the CP every year and are regularly informed about the assessment of the programme by the European Commission and the ECOFIN Council. They have also been informed about the course and abrogation of the excessive deficit procedure.

The programme was prepared on the basis of Council Regulation (EC) No. 1055/2005, amending Council Regulation (EC) No. 1466/97 on strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies. Moreover, the CP follows principles of the Guidelines on the format and content of Stability and Convergence Programmes adopted by ECOFIN Council on 11 October 2005. The programme is available also on the Ministry of Finance's website: <http://www.mfcr.cz>.