Introduction

The update of the Convergence Programme for 2010–2014 presented here has for the first time been prepared in accordance with a new timetable, the so-called European Semester, approved by the European Council on 17 June 2010. The objective of the European Semester is to deepen and strengthen multilateral budget surveillance and fiscal and structural policy coordination within the EU. Therefore, from this year national fiscal policies will already be coordinated in the preparation phase of public budgets and their medium-term outlooks.

The Convergence Programme (CP), following from the medium-term expenditure frameworks for 2012–2014 approved by the Czech government (20 April 2011), was approved by the Government of the Czech Republic on 4 May 2011. It will therefore be possible to include the recommendations issued by the EU Council for the hereby presented fiscal policy intentions into the final state (and state funds) budget proposals and their medium-term outlooks. The presented CP is fully consistent with the National Reform Programme, approved by the Czech government on 27 April 2011, and respects its macroeconomic and fiscal impacts. This document corresponds with the rules established in the updated Code of Conduct for preparing the stabilisation and convergence programmes of the Stability and Growth Pact.

The update of the Convergence Programme ensues from the mandate of the coalition government which was established in mid-2010. In its Policy Statement from 4 August 2010, the government set out an ambitious programme focused on public finances reform aiming to halt growth in public indebtedness and with the specific objective to achieve a balanced budget in 2016. The government set as additional priorities to increase transparency in dealing with public funds, to limit corruption in the public sector, and to increase transparency of public procurement. It also declared its intention to reform fiscal institutions. In accordance with the Policy Statement, the government prepared its first consolidation budget already for 2011; it only managed, however, to incorporate short-term consolidation steps into the budget. Through rigorous implementation of the approved budgets in 2010, a year-on-year improvement in the structural deficit by nearly 1.2% of GDP in comparison with 2009 was achieved, and the government deficit was therefore decreased to 4.7% of GDP.

In accordance with the Annual Growth Survey (European Commission, 2011a) and with the Conclusions of the European Council from 24–25 March 2011, the government is now focused on preparing the necessary structural reforms aimed at improving long-term sustainability of public finances. This year, reforms of the pension and health care systems are being prepared. Their points of departure, intentions and impacts are already presented within this CP.

The macroeconomic scenario is based on current national accounts data, i.e. as of 28 March 2011. Even disregarding political factors, macroeconomic and fiscal development is currently encumbered with considerable uncertainties. The main sources of risk for the Czech Republic relate to the state of public budgets and the situation of the banking sector in several euro area countries.

Owing to the consolidation fiscal measures, a moderate slowdown in economic growth to 1.9% is expected for 2011. In the following years of the outlook, growth should gradually accelerate, and this should also improve the labour market situation from a demand perspective. It appears that consumer prices will rise by slightly over 2% in 2011, which is very close to the inflation target. Next year, inflation will be significantly influenced by the planned value added tax adjustments. The macroeconomic development is described in more detail in Chapter 2.

On 2 December 2009, an Excessive Deficit Procedure was initiated for the Czech Republic, recommending bringing the general government deficit below the limit of 3% of GDP in a credible and sustainable manner by 2013. EU Council recommendations were taken into account by the Parliament of the CR in April 2010. Information on progress toward achieving these recommended objectives is included in a separate subchapter within the Chapter Overall Policy Framework and Objectives.

The fiscal forecast discussed in Chapter 3 ensues from the results of the April fiscal notification (closing date for data sources 11 April 2011). We expect the government sector balance for 2011 to be about −4.2% of GDP. The general government debt will probably rise to 41.4% of GDP this year, with prospects for further growth. The evolution of the debt-to-GDP ratio in the near future will strictly follow the objective of the government to decrease deficits, supported by the binding expenditure frameworks which, among other things, will contribute to a slower growth of the debt-to-GDP ratio and to its subsequent absolute decline.

Due to the mentioned uncertainty of future economic development, part of Chapter 4 presents a sensitivity analysis of the Czech economy's development (and hence of public finances) incorporating different economic development in the European Union and higher oil prices.

In Chapter 5, the CP analyses long-term impacts of the current fiscal policy settings, and thus considers the long-term sustainability of the whole system.

The last two chapters are devoted to quality of public finances and adjustments to the institutional framework. On the one hand, they deal with changes which will take, or have taken, place on both the revenue and expenditure side. On the other hand, they discuss changes of institutional relations, the legal anchorage of authority and responsibility of the public sector, as well as changes in the system of public administration.