

## 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 proportion of persons of retirement age in the economically active population over the next several decades.

No new reform measures have been adopted in connection with the pension and health care systems that would lead to a change in the development of the sustainability of public finances.

### 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 common assumptions discussed by the Economic Policy Committee's Working Group on the Ageing Population (AWG). Thus, assumptions on demographics (EUROPOP2008) and the macroeconomic framework that are over the long term consistent for EU countries were used in the analysis.<sup>10</sup>

**Table 6.1: Macroeconomic projection assumptions**

% of GDP	Year 2007	Year 2015	Year 2020	Year 2030	Year 2040	Year 2050	Year 2060
Labour productivity growth	4,1	3,0	2,9	1,8	1,7	1,7	1,7
Real GDP growth	5,2	3,0	2,5	1,4	0,9	0,7	1,1
Participation rate males (aged 15–64)	78,3	80,7	81,0	78,8	78,5	79,0	78,9
Participation rates females (aged 15–64)	61,6	66,1	66,7	66,0	66,0	67,8	68,1
Total participation rate (aged 15–64)	70,0	73,5	73,9	72,5	72,3	73,5	73,5
Unemployment rate	5,4	4,5	4,5	4,5	4,5	4,5	4,5
Population aged 65+ over total population	14,6	17,9	20,2	22,9	26,3	30,9	33,4

Sources: Ministry of Finance, AWG.

The results of long-term projections are fully consistent with the analyses processed by AWG and published in spring 2009 in the latest report<sup>11</sup> on long-term projections.

Table 6.2 summarises the long-term development of expenditures related to changes in the population structure. In total, these will increase by 5.7 percentage points of GDP by 2060. The largest portion of this growth is traditionally comprised of pension expenditures, which will increase from the current level of around 7% of GDP to 11% of GDP. The increase in expenditures on health care by 2.2 percentage points since the initial year of projections is worthy of note.

<sup>10</sup> The projection assumptions and their analysis emerge from AWG's long-term assumptions and do not reflect the current medium-term macroeconomic and fiscal outlook of the Czech Republic.

<sup>11</sup> "The 2009 Ageing Report: economic and budgetary projections for the EU-27 Member States (2008–2060)".

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
<b>Total expenditure</b>	43,1	41,9	41,4	43,7	47,6	53,5	59,8
<i>of which: Age-related expenditure</i>	18,8	18,0	18,2	19,1	20,7	23,1	24,5
<b>Pension expenditure</b>	7,8	7,1	6,9	7,1	8,4	10,2	11,0
<b>Social security pensions</b>	7,8	7,1	6,9	7,1	8,4	10,2	11,0
<b>Old-age and early pensions</b>	7,1	6,5	6,3	6,6	7,9	9,7	10,5
<b>Other pensions</b>	0,7	0,5	0,5	0,6	0,5	0,5	0,6
<b>Occupational pensions</b>	0,0	0,0	0,0	0,0	0,0	0,0	0,0
<b>Health care</b>	6,2	6,4	6,9	7,4	7,8	8,1	8,4
<b>Long-term care</b>	0,2	0,2	0,3	0,4	0,5	0,5	0,7
<b>Education expenditure</b>	3,5	3,0	3,0	3,1	2,9	3,0	3,2
<b>Other age-related expenditures</b>	1,0	1,0	1,0	1,0	1,0	1,1	1,1
<i>of which: Interest expenditure</i>	1,1	1,0	1,8	3,2	5,5	9,0	13,9
<b>Total revenue</b>	42,0	41,0	40,1	40,0	40,0	39,9	39,9
<i>of which: Property income</i>	0,8	0,7	0,6	0,5	0,5	0,5	0,4
<i>of which: From pension contributions (or social contributions if appropriate)</i>	8,6	8,6	8,6	8,6	8,6	8,6	8,6
<b>Pension reserve fund assets <sup>(a)</sup></b>	0,4	3,4	17,1	32,6	45,0	42,3	24,2
<i>of which: Consolidated public pension fund assets (assets other than government liabilities)</i>	0,0	0,0	0,0	0,0	0,0	0,0	0,0

Sources: Ministry of Finance, AWG.

The sustainability analysis identifies the scope of fiscal consolidation necessary to secure the stability of public finances in the horizon to 2060. So-called sustainability indicators are calculated. These indicators show how extensive implemented measures would need to be in order to decrease expenditures or increase revenues as proportions of GDP. At present, the S1 indicator<sup>12</sup> stands at 5.3 and S2<sup>13</sup> at 7.4.

The sustainability analysis showed some improvement that may be attributed to pension system reform measures implemented in the past, particularly to the increase in the age limit. The current fiscal position that has resulted in a more rapid accumulation of debt through relatively high deficits is a negative factor of the long-term development. This has resulted in a relatively dramatic increase in interest costs.

<sup>12</sup> S1 permanent fiscal consolidation 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.

<sup>13</sup> S2 permanent fiscal consolidation expresses the level of fiscal effort necessary to achieve the equality of discounted revenues and expenditures for an indefinite period of time.