

8 Implementation of the Excessive Deficit Procedure

Based on the expected exceeding of the reference value for the government deficit in 2009, an Excessive Deficit Procedure (EDP) was initiated with the Czech Republic on 2 December 2009. The Council of the EU has recommended that the Czech Republic should bring the general government deficit below the 3% limit in a credible and sustainable manner by 2013. At the same time, the Council called upon Czech authorities to report on progress made in implementing the EDP recommendations in separate chapters of the Convergence Programme updates that they will be preparing in the period between 2010 and 2013.

The Council Recommendation of 2 December urged Czech authorities especially i) in 2010 to implement the budget reducing measures to limit the deficit as planned in the State Budget Act for 2010; ii) for the period 2010–2013 to ensure fiscal effort (in terms of improvement in the structural balance) at an average annual rate of 1% of GDP; and iii) to specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting and accelerate the reduction of the deficit if economic and budgetary conditions turn out better than currently expected. The Czech Republic should, among other things, enforce rigorously the medium-term budgetary framework and improve monitoring of the budget execution throughout the year to avoid expenditures overruns to the budget and multiannual plans.

The Czech authorities aim to correct the excessive deficit by 2013. Within the Convergence Programme's horizon, the government is planning the following consolidation strategy:

Year 2010

The worsening budgetary and financial situation prompted the government in the summer of 2009 to quickly prepare an austerity package in order to prevent further worsening of the fiscal situation in 2010. This package was already incorporated into the Draft state budget for 2010 and was approved by the Chamber of Deputies of the Parliament in October 2009, prior to the actual discussion on the Draft State Budget for 2010. The most important measures are the increases in VAT, excise taxes and property taxes as well as the abolition of certain anti-crisis measures already adopted, such as higher unemployment benefits, higher child benefits, temporary reduction in social benefits and in the public sector salaries, and freezing of pensions. According to the forecast of the Ministry of Finance from January 2010, the consolidation package will contribute to year-on-year improvement in the structural balance by approximately 2% of GDP and will enable reduction of the government deficit in 2010 to about 5.3% of GDP.

In the case of more favourable economic and budgetary conditions than are currently expected, the government is committed to faster deficit reduction.

Years 2011–2012

In the time leading up to the regular elections in May 2010, the government is concentrating on two tasks. These are rigorous implementation of the state budget in 2010 and preparation of a proposal for a set of economic policy measures (“Recovery from the Crisis – Government Policy in the Short- and Medium-term Horizon”; hereinafter referred to as “Recovery from the Crisis”). Its target is to identify growth-oriented structural measures and simultaneously will support the sustainability of fiscal consolidation. At the start of February, the Council of

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Economic and Social Agreement (Tripartite Council) approved the Proposal of Short-term Measures for Exit from the Crisis and Resolution of their Consequences.

The recovery strategy identifies consolidation of public budgets as a priority of the government in the short-term and medium-term horizon so that the deficit in public finances is gradually reduced. It continues the turnabout from the expansive fiscal policy of 2009 to a restrictive budgetary policy already being implemented during 2010. The main priority of sustainable fiscal consolidation will be the support of such structural reforms that ensure the sustainable stabilisation and subsequent reduction of the government's relative indebtedness.

Thus the current government, in cooperation with the social partners, establishes conditions for continuity of policies including continuation of the initiated consolidation. Completion of the fiscal consolidation path will be the task of the next government, including to decide to what extent it will use the proposals and recommendations from the prepared recovery strategy.

The new government will be able to build on the outputs of the expert advisory group of the Minister of Finance and the Minister of Labour and Social Affairs, which was established in January 2010 with the aim of preparing for the next government alternative proposals for pension reform. These outputs will be continuously published and will be finalised by the end of May 2010.

Table 8.1: Plan of fiscal consolidation

		2008	2009 Estimate	2010 Outlook	2011 Outlook	2012 Outlook
Autonomous outlook	(bn CZK)	-77,4	-239,6	-195,8	-215,7	-222,6
	(% of GDP)	-2,1	-6,6	-5,3	-5,6	-5,5
Cumulative consolidation	(p.p. GDP)				0,8	1,3
	(bn CZK)				30,2	53,8
Target for general government	(bn CZK)				-185,5	-168,8
	(% of GDP)				-4,8	-4,2
Structural balance	(% of GDP)		-5,5	-3,6	-3,2	-2,6
Fiscal effort	(p.p. GDP)			1,9	0,4	0,6

Source: Ministry of Finance.

With a view to the autonomous fiscal development beyond 2010 and the currently expected economic development in 2011–2012, the aimed consolidation target of an average fiscal effort of 1 percentage point over this period in line with the EDP recommendations will be ensured under following assumptions:

- (i) increase in tax revenues due to proposed changes in the tax system for 2011 and thereafter of ca CZK 12 billion,
- (ii) adherence to the intention of sustainably decreasing current and mandatory expenditures cumulatively by ca CZK 40 billion (see Chapter 5).

Achieving these fiscal objectives will require adjustment on the expenditures sides of the budget especially. Structural measures will be closely scrutinized regarding not only the consolidation effects but also their social costs. It will be the responsibility of the next government to formulate its priorities and policies and to establish a consolidation strategy for the coming periods.

There is a risk of further external shocks and in particular the slower than expected speed of the recovery in EU countries and the pace of their fiscal consolidation. The Czech authorities

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are fully aware of the risk for Czech economy, as a small and very open one, while having high fiscal stabilizers. Based on recent predictions, whether of the Ministry of Finance, the European Commission, or other international institutions, the risk of further global economic decline cannot be excluded. The Council's recommendations for the Czech Republic and the planned fiscal effort in 2010 provide a sufficient margin for manoeuvring and flexible adjustment of the fiscal consolidation path in following years according to actual economic developments.