Ministry of Finance
Czech Republic

Convergence Programme

of the Czech Republic

April 2021

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The Convergence Programme is submitted on the basis of Article 121 of the Treaty on the Functioning of the European Union and the current version of Council Regulation (EC) No. 1466/97 on the Strengthening of the Surveillance of Budgetary Positions and the Surveillance and Coordination of Economic Policies. As such, it has been drawn up in accordance with the rules in force in the Council's Economic and Financial Committee (EFC, 2017) and is consistent with the National Reform Programme of the Czech Republic (Government Office, 2021) and the National Recovery Plan of the Czech Republic (MIT, 2021).

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List of Abbreviations

CNB .... Czech National Bank
COFOG .... Classification of the Functions of Government
CP .... Convergence Programme of the Czech Republic
CZK .... Czech koruna currency code
CZSO .... Czech Statistical Office
EC .... European Commission
ESA 2010 .... European System of National and Regional Accounts from year 2010
EU .... European Union containing 27 countries
EUR .... euro currency code
GDP .... gross domestic product
MF CR .... Ministry of Finance of the Czech Republic
p. a. .... *per annum*
p. m. .... *pro memoria*
pp .... percentage point
US .... United States of America
USD .... US Dollar currency code

Symbols Used in Tables

A dash (–) in place of a number indicates that the phenomenon did not occur or is not possible for logical reasons.
“Billion” means a thousand million.

Cut-off Date for Data Sources

Macroeconomic data used pertain to the 1 April 2021 release and fiscal data and policies to the 19 April 2021 release. Notification of general government deficit and debt was specified and approved by Eurostat on 22 April 2021.

Note

In some cases, published aggregate data do not match the sums of individual items to the last decimal place due to rounding.

Introduction and Summary

The global economic downturn caused by the pandemic and by the measures taken to impede its spread has affected the conditions faced by many households, entrepreneurs and businesses. Numerous economies have proved extraordinarily resilient, and the fiscal and monetary authorities worked vigorously to mitigate any adverse effects. The Czech Republic, with its relatively low public debt, long-term adherence to its medium-term budgetary objective, leeway in conventional monetary policy, healthy banking sector, and low unemployment rate, was excellently placed to withstand a shock even of this nature.

Real gross domestic product in the Czech Republic fell by 5.6% in 2020. While the retail and service sectors in particular were directly hit by the crisis, supply chains and lower demand eventually affected most of the economy. A deeper slump was prevented by anti-crisis fiscal measures, which shifted part of the private sector's costs and losses to the public one. The government did not limit itself simply to waiving social security contributions or lowering tax rates, for example. The fall in tax revenues was also the result of a significant drop in corporate sales and profits, as well as a reduction in earnings. In addition, expenditure shot up to compensate for the loss of income from labour activity and for firms' spending on wages and certain fixed costs. In this respect, the public sector heavily cushioned the impact of the crisis on the labour market, and unemployment therefore remained very low. However, it was crucial to secure funding for the public health care system, which is responsible for dealing with the epidemic in the Czech Republic.

In many countries, the sheer scale and nature of the crisis required to adopt quite specific approach to economic policy. This not only limited the negative impact of the pandemic on short-term economic performance, but also helped to curb the effects on long-term growth. The efforts to contain the epidemic and mitigate the socio-economic impact came at the cost of a deep budgetary deficit and a corresponding increase in public debts. In the Czech Republic, general government deficit came to 6.2% of GDP in 2020, mainly due to the outcome of the state budget, which financed most of the anti-crisis measures. Debt increased by almost eight percentage points to 38.1% of GDP.

The intensification of the epidemic in the autumn of 2020, combined with new mutations of the virus, exacerbated the risks in this year and reduced the prospects for more rapid economic growth. In contrast, the approval of several types of vaccines and the gradual inoculation of the population offer hope of economic recovery, especially in the second half of the year. We expect GDP growth of 3.1% to be driven by domestic demand and partly by foreign trade. General government consumption will be fuelled by an increase in social transfers in kind and intermediate consumption in the public sector. Private investment in 2021 should benefit from renewed economic growth abroad and a special regime of tangible assets depreciation. For public investment, it is envisaged that capital outlays financed from national funds will be supplemented by Next Generation EU facility. However, none of the private-uses components should exceed the real level reported for 2019.

The labour market should continue to be affected considerably this year by government measures and delayed signs of recession. Although the unemployment rate is likely to rise during 2021, averaging 3.6% for the year, it will still be much lower than would be consistent with the cyclical position of the economy. The negative output gap and fiscal discretionary measures will lead to rather moderate wage bill growth. This, combined with renewed labour productivity growth, will direct unit labour costs downwards. Apart from the oil price, we do not expect any major upward inflationary pressure in 2021, and the average inflation rate should slow to 2.5%.

Limited tax revenues and spending related to efforts to contain the epidemic, vaccinations, the stimulation of the economy, and compensation for costs or lost earnings are expected to push the government deficit up to 8.8% of GDP this year. The deficit being run by general government institutions, and the state budget in particular, is expected to translate into a further increase in debt to 44.8% of GDP.

In 2022, the strength of the recovering economy, supported by the Next Generation EU facility, the outgoing Multiannual Financial Framework, and the start of the new programming period, should come fully to the fore. Aside from fixed capital investment, the economy – with a growth rate of 3.7% – should quickly compensate for the decline in 2020. At the same time, the negative output gap is expected to close this year. According to legislation in effect, fiscal expansion will be replaced by fiscal consolidation in 2022. To make economic recovery sustainable in the long term, the consolidation strategy is based on a minimum fiscal effort of 0.5 percentage points per year.

In addition to stabilising the economy and tackling the epidemic, a number of measures to improve the quality of public finances were prepared or implemented in the past year. Work is continuing on digitalising state administration and streamlining the public procurement system as well as management of state property. However, the long-term pressure on public finances, stemming mainly from demographic changes in the population structure, remains a challenge.

The Convergence Programme of the Czech Republic was presented at and discussed by the relevant committees of the Chamber of Deputies and the Senate of the Parliament of the Czech Republic in April 2021. It was approved by the Czech government on 26 April 2021.

1 Economic Policy Intentions and Objectives

The outbreak of the global pandemic posed entirely new challenges to economic policy. With very limited experience of such a situation, a raft of measures were needed to support the afflicted sectors and affected households and public systems, primarily the public health care system. In addition to massive fiscal expansion, monetary and credit measures were implemented. The Czech National Bank lowered its main interest rate by two percentage points, a new law expanded opportunities to strengthen the liquidity of the banking sector, and other legislation supported the cash flow of economic entities by deferring loan repayments.

The gravity of the situation is also illustrated by the application of the general escape clause at the level of the entire European Union for both 2020 and 2021. A crisis of this magnitude was sufficient reason for a temporary relaxation of fiscal rules. The Czech Republic was no exception. During 2020, two amendments to the Act on the Fiscal Responsibility Rules were passed, allowing the government to pursue fiscal expansion at a time of crisis at the cost of a deterioration in the structural balance.

1.1 Fiscal Policy

This year, public budgets remain heavily influenced by the pandemic crisis and the measures taken by the Czech Republic and other countries to combat it. Last year, the state budget was amended three times, ultimately ending up with a planned deficit of CZK 500 billion. This made room available to finance assistance for economic entities from both the private and public sectors. The cash execution of the state budget for the whole year 2020 ended with a deficit of CZK 367.4 billion, with better-than-expected developments on the revenue side.

The state budget originally approved for 2021, with a deficit of CZK 320 billion, did not include the significant fiscal stimulus in the form of the reduced effective taxation of personal income or a boost to investment activity through an adjustment to tax depreciation of tangible assets. At the same time, the unrelenting intensity of the epidemic required an extension to the main economic support measures (the “compensation bonus”, Antivirus programme, etc.) and, thus, necessitated an adjustment to the state budget, with an increase in the deficit to CZK 500 billion (see chapter 3).

As society becomes inoculated, the economy should be able to gradually open up and fiscal expansion should pave the way for economic recovery. According to the current forecast of general government balances and their cyclical components for 2020 and 2021, the scale of the fiscal stimulus is equal to around 7.5 pp, while the negative fiscal effort is 2 pp smaller. The difference between the primary fiscal effort with the opposite sign and the fiscal impulse (see Graph 1.2) is, in addition to revenues from EU funds and payments to the EU budget, mainly due to one-off measures to support the economy in 2020 and 2021.

The post-crisis fiscal policy should be restrictive. The initial settings for consolidation will be determined by expansion in 2021, i.e. the structural deficit, which the MF CR will estimate by September 2021 at the latest. The expenditure framework for 2022 will then be based on a structural deficit 0.5 pp lower than the estimate for 2021. Beyond 2022, the structural balance should improve annually by at least 0.5 pp. The consolidation trajectory set by law determines only the minimum level of fiscal effort. It does not rule out the possibility of higher year-on-year improvements in structural balances, especially if the economic situation allows.

The specific fiscal retrenchment introduced in the years of the medium-term outlook will depend on the programme pursued by the government that emerges from the elections to the Chamber of Deputies of the Czech Parliament in October 2021.

1.2 Monetary Policy

Since 1998, the CNB’s monetary policy has been inflation-targeted. Since 1 January 2010, the inflation target has been defined as year-on-year consumer price index growth of 2% with a tolerance band of ±1 pp. The CNB defines the inflation target as a medium-term target and therefore tolerates certain temporary deviations of actual inflation rate from the inflation target (e.g. as a result of adjustments to indirect taxes). Monetary policy does not normally respond to the primary effects of those deviations, instead concentrating solely on the secondary effects.

Taking into account the expected further acceleration of inflation and the heightened domestic inflationary pressures, the CNB increased its two-week repo rate to 2.25% at the beginning of February 2020. However, faced with the pandemic of a new type of coronavirus and its negative effects on the Czech economy, the CNB slashed its key interest rate sharply, first by 1.25 pp in March and then by a further 0.75 pp in May. The two-week repo rate has since remained at 0.25% p.a. In 2020, the exchange rate component of monetary conditions was also eased significantly, thus exerting a stimulating effect on the economy in the negative output gap. Against the background of the outlook for short-term interest rates and inflation, monetary conditions will continue to be expansionary in 2021 and 2022, especially in the interest rate component.

The exchange rate of the CZK to the euro depreciated by 2.9% year-on-year to CZK 26.44 per EUR on average in 2020 as a whole. The nominal exchange rate should resume a slight appreciation trend as of Q2 2021. Above all, this development should reflect the expected gradually widening positive interest rate differential vis-à-vis the euro area. Improved global sentiment, linked to the stabilisation of the epidemic situation, could also be a contributory factor.

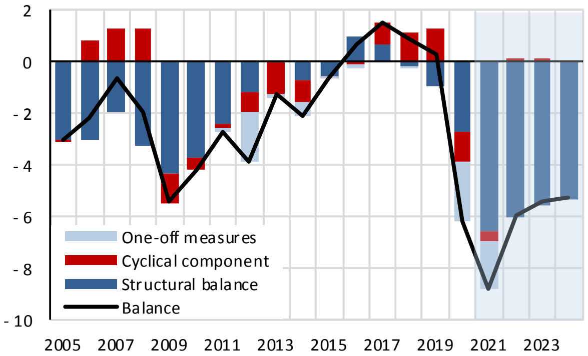
In terms of the Czech Republic's accession to the euro, on the basis of the document MF CR and CNB (2020), the Czech government decided (under Government Resolution 1283/2020) not to set a target date for joining the euro area for the time being. The Czech Republic's own formal preparedness to adopt the euro has improved, but weaknesses still remain. The structure of the Czech economy continues to differ significantly from the euro area, and the process of the Czech economy's real convergence, especially price and wage levels, is not completed. This would make the implementation of an effective single monetary policy suboptimal. Moreover, from the perspective of the Maastricht convergence criteria, in the unprecedented conditions of the COVID-19 pandemic and the related global economic downturn, the Czech Republic met only the interest rate criterion in 2020. Population ageing means that the problem of the long-term sustainability of public finances, the stabilising effect of which should partly compensate for the loss of autonomous monetary policy after the adoption of the euro, has yet to be resolved.

On the other hand, the fact that the Czech economy is very open and is closely intertwined with the euro area in terms of trade and ownership have long served as arguments in favour of adopting the euro. Moreover, the relatively stable exchange rate of the CZK to the euro, even during the 2020 recession, the renewed alignment of the financial markets in the Czech Republic and the euro area, and the resilient Czech banking sector can also be viewed as favourable factors.

In view of these facts, the Czech government has not yet set a target date to join the euro area and, for the time being, will not be seeking to enter the European Exchange Rate Mechanism II. The updated document and recommendations should be submitted to the government by the end of 2022.

Graph 1.1: General Government Balance

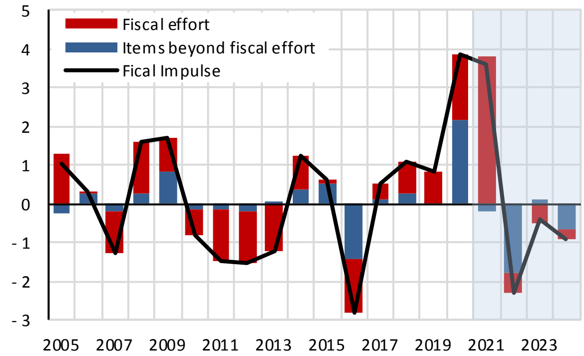
in % of GDP



Source: CZSO (2021a, 2021b). MF CR forecast and calculations.

Graph 1.2: Fiscal Effort and Fiscal Impulse

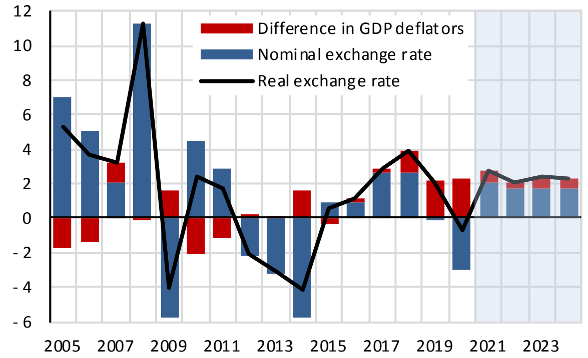
In percentage points, primary fiscal effort with opposite sign



Source: CZSO (2021a, 2021b). MF CR forecast and calculations.

Graph 1.3: Real Exchange Rate to the Euro Area

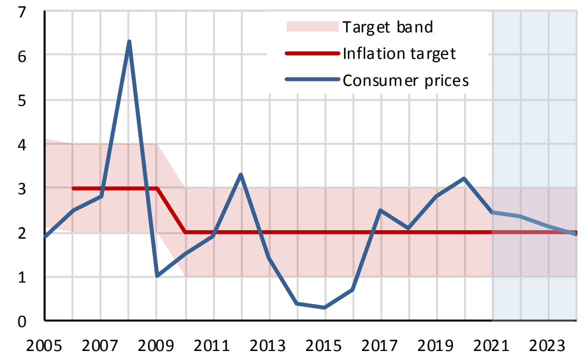
real exchange rate appreciation in %, contributions in pp



Source: CNB (2021a), CZSO (2021a), Eurostat (2021). MF CR forecast and calculations.

Graph 1.4: Consumer Prices

growth in %, national consumer price index



Note: The inflation target was defined as an interval up to 2005, since 2006 it is defined as a point with a tolerance band.
Source: CNB (2021b), CZSO (2021a). MF CR forecast and calculations.

2 Macroeconomic Scenario

The pandemic of a new type of coronavirus, the action taken to tackle the epidemic and the knock-on effects triggered a deep synchronised slump of the global economy in 2020. Its scale is unprecedented in the period since the end of the Second World War. The economic-policy response in all the countries affected was to embark on sharp easing and adopt massive fiscal and monetary stimuli. This limited the pandemic's negative impact on short-term growth. These measures also helped to lower the repercussions for long-term growth.

We estimate that domestic and foreign economic activity should slowly recover from the middle of this year. However, the forecast is burdened with huge uncertainty and the risks are clearly skewed downwards. Critical factors will be the speed and efficiency of the vaccination process and how effective the vaccines are against new coronavirus mutations.

2.1 Global Economy and Technical Assumptions

The deep downturn in the world economy in 2020 was reflected in the momentum of global trade in goods. Continued trade tensions between the US and China, as well as uncertainty over the future relationship between the UK and the EU, have contributed to the negative developments in international trade.

The US economy contracted by 3.5% in 2020, while China was the only major economy to grow (by 1.8%) in 2020. The EU's economic output fell by 6.3% last year, while the euro area's contracted by 6.8%. The key factors were falling household consumption and investment. Employment in the EU was down by 1.5%, with a larger drop prevented by economic policy responses and programmes to maintain employment levels. Even so, the labour market faces a high degree of uncertainty in connection with how the pandemic evolves.

Vaccination against COVID-19 was launched in numerous countries in late 2020. In the light of the still insufficient vaccination coverage of the population, as well as new more infectious mutations of the coronavirus, we expect the existing restrictions to be temporarily tightened or extended. Though this will hamper economic growth in the short term, by the middle of the year economic activity should be picking up as restrictions are gradually eased thanks to expected improvements in the epidemic situation. We expect the EU's GDP to grow by 3.6% this year and 3.7% in 2022. In the following years, the growth rate could hover below 2%.

In 2020, the average price per barrel of Brent crude oil was USD 42. It reached very low levels after the pandemic broke out in Q2 2020, before starting to rise to the extent that, by Q1 2021, it had already returned to pre-crisis levels. The forecast oil price reflects the downward sloping futures curve. In 2021, Brent crude should trade at an average of USD 64/bbl (versus USD 55/bbl in the European Commission's Winter Forecast, 2021a), with the price gradually falling in subsequent years to USD 56/bbl in 2024.

Based on recent developments in the USD/EUR exchange rate, we have made a technical assumption of stability at USD 1.21 per EUR starting in Q2 2021. This is entirely in line with the European Commission's assumption.

The exchange rate of the Czech koruna to the euro depreciated by 2.9% year-on-year to CZK 26.44 per EUR on average in 2020 as a whole. For this year, we expect the koruna to resume its appreciation. The exchange rate could thus strengthen by 2.1% to an average of CZK 25.9 per EUR. The koruna should slowly appreciate in the period ahead.

In view of the forecast inflation and the assumed monetary policy stance of the CNB and the European Central Bank, we believe that long-term interest rates will rise gradually from 1.5% on average in 2021 to 2.2% in 2023 and 2024.

2.2 Current Developments and a Medium-term Scenario

2.2.1 Economic Growth and the Demand Side

Real GDP fell by 5.6% in 2020. There were steep declines in all areas of domestic use except for general government consumption.

Household final consumption expenditure was pushed down by a decline in real income from labour and entrepreneurial activity, but a number of discretionary social changes and measures to support the economy had a positive impact. As a result, real disposable income growth only slowed to 2.0% (from 3.1% in 2019). However, consumption was very much dampened by an increase in the savings rate. Real household consumption thus fell by 5.2% in 2020. In 2021 and, to a lesser extent in 2022, household consumption will be stimulated by tax cuts. However, the anti-epidemic measures continue to place major constraints on households' consumption opportunities, and the savings rate is therefore likely to increase further this year. Despite an expected recovery in household consumption expenditure in the second half of the year, real household consumption is forecast to grow by just 0.1% in 2021 as a whole. In 2022, the dynamics of household consumption should be supported by significant normalisation of the savings rate, as well as the statistical effect of the strong recovery in consumer spending in the second half of this year. Household consumption could thus increase by 5.7% for the whole of 2022.

Real general government final consumption expenditure should grow by 3.4% this year, slowing to 0.9% in 2022. The slowdown can be attributed to the waning of the epidemic and the start of the government's consolidation efforts (see chapter 3). The health sector will see an increase in spending to tackle the coronavirus pandemic. Despite savings in central government, staffing increases are foreseen in education and the armed forces. Growth in expenditure on purchases of goods and services, supported by current subsidies from EU funds, may also boost momentum.

Under the weight of the global recession and a strong increase in uncertainty, fixed capital investment slumped in 2020. In contrast, monetary conditions had a positive effect on the dynamics of investment activity. In 2021, these factors should be joined by renewed economic growth abroad, which is expected to fuel a resumption in private investment. The recovery in private investment will also be supported by extraordinary depreciation of tangible fixed assets, though this will dampen investment in 2022 because accelerated depreciation will lead to a shift of some investment from 2022 to 2021. In the case of public investment, we expect to see an increase in nationally sourced capital expenditure in 2021. This year and next, investment by the general government sector should be boosted by projects co-financed by EU funds, including the Recovery and Resilience Facility (see chapter 3). Gross fixed capital formation could thus grow by 3.8% this year and by 4.5% in 2022.

Exports of goods and services declined by 5.9% in 2020 due to the downturn of export markets, which was cushioned by an increase in export performance. As export markets recover, exports are expected to grow by 5.0% this year and 5.7% in 2022, with increased competitiveness also providing a modest boost next year. The dynamics of exports and import-intensive investment demand will then be reflected in imports of goods and services, which could increase by 4.9% this year. Increased imports for household consumption should be added to these factors in 2022. Imports could thus rise by 6.6% next year.

Taking into account the development of the individual GDP expenditure components, we expect the economy to grow by 3.1% in 2021. GDP growth could accelerate to 3.7% in 2022, and economic growth could be around 2% in the following years. This should roughly correspond to the forecast potential growth.

2.2.2 Potential Output and Business Cycle

Potential output growth slowed to 1.1% in 2020. The most important component was the increase in total factor productivity, which contributed 1.0 pp. Capital stock has so far reported a relatively stable contribution of around 0.6 pp. By contrast, the labour production factor slowed potential output growth by around 0.5 pp. The population ageing, manifested by a decline in the number of people of working age, accounted for −0.3 pp, while the lower participation rate and number of hours usually worked also had a negative impact.

Potential output growth should gradually accelerate in the years ahead, but is unlikely to return to the growth rates of 2015–2018 over the horizon of the Convergence Programme. The coronavirus epidemic and the associated restrictive measures will thus have a negative impact on potential output growth also over the medium term.

The economy moved from a positive to a deeply negative output gap last year. We estimate that it averaged 3.1% of potential output for the year as a whole. However, with the economy expected to recover, the output gap should gradually close and economic output could be close to potential levels from 2022 onwards.

2.2.3 Prices

Inflation, as measured by the Harmonised Index of Consumer Prices, was above 3% for most of 2020, mainly due to exceptionally strong growth in unit labour costs, and averaged 3.3% for the year as a whole. Annual inflation slowed over the year, slipping from 3.8% in January to 2.4% in December, helped by a marked slowdown in food price growth.

In 2021 and 2022, inflation should be slowed by a decline in unit labour costs and the slight appreciation of the koruna against both major world currencies. The negative output gap should work in the same direction this year, while the oil price should have a pro-inflationary effect. In 2022, neither the output gap nor the oil price should have much effect on inflation, but renewed growth in household consumption should have a pro-inflationary effect.

Regulated prices should not skew the market inflation rate in 2021, and should make a positive contribution in 2022. In terms of changes to indirect taxes, the excise duty on diesel was reduced in 2021. In both 2021 and 2022, consumer prices will be affected by an increase in the excise duty on tobacco products. We estimate that price impact of these tax measures on the average inflation rate will be 0.2 pp in each year.

The consumer prices growth rate should thus slacken to 2.4% in 2021, while inflation could slow slightly from 2.3% in 2022 to 1.9% in 2024.

GDP deflator growth could be around 1.9% per annum over the entire horizon of the Convergence Programme. Terms of trade should put a slight brake on GDP deflator growth this year and next, while the opposite should be true in subsequent years. The contribution of the gross domestic expenditure deflator should gradually ebb.

2.2.4 Labour Market and Wages

Labour market tensions, manifested by low unemployment rate and a high number of job vacancies, eased substantially last year. The impact of the deep recession has been cushioned considerably by measures to support the economy. Despite this, permanent structural changes are likely in the labour market (OECD, 2020a). Although the unemployment rate rose gradually to around 3% in 2020, it was still the lowest in the EU. Compensation of employees increased due to wage inertia and strong earnings growth in the general government sector, although the momentum slowed considerably compared with previous years. The increase in disposable income combined with limited consumption possibilities has built up households' financial reserves. This could fuel aggregate demand once restrictive measures are eased.

We expect that the negative effects caused by the epidemic situation will continue to be mitigated by employment support measures this year. The reduction in the tax burden on labour will also make a positive contribution, as should the high number of registered job vacancies. The unemployment rate could rise to 3.6% this year and remain around that level in 2022. Employment (according to national accounts methodology) could fall by 1.1% in 2021, followed by a slight increase in subsequent years. The situation is likely to vary considerably across sectors and regions, placing increased demands on the retraining and mobility of workers. In the medium term, how adaptable applicants are to changes in labour market demand will be crucial.

The increase in the statutory retirement age and the growing share of age groups with naturally high participation rates have contributed to the rise in the economic activity rate in recent years. However, these factors will gradually falter. The worsening economic situation may lead to an increase in early retirement. Conversely, the “2021 Tax Package”, by increasing net earnings, could boost the incentive to work. The participation rate of the 20–64 age group could thus rise slightly this year and in the coming years.

In addition to support programmes, the negative effects of the economic downturn on earnings dynamics are being cushioned to some degree by increases in minimum and guaranteed wages. Structurally, so far it is the lower-paid service workers who have been the hardest hit. These factors, together with significant wage and salary increases in government-dominated sectors, have sustained the upward momentum in the total compensation of employees. On the other hand, the expected end of the Antivirus Programme this year and the layoffs of some of the employees it covered will have a negative impact. The compensation of employees could thus stagnate in 2021, before rising by 1.7% in 2022 thanks to the recovery in private-sector earnings. In subsequent years, their momentum could be around 3%.

2.3 Foreign Relations and Sectoral Balances

This part is drawn up according to national accounts methodology, which, based on the relationship between investment and savings, enables the surplus or deficit in foreign relations to be divided fully among individual sectors of the national economy. It differs from the analogous and commonly used balance of payments methodology, for example, in the way that underlying data is processed or certain items are classified.

Since 2013, the Czech economy has consistently posted a net lending/borrowing surplus vis-à-vis non-residents, with a small deficit of 0.3% of GDP recorded only in 2019. Somewhat paradoxically, however, the highest ever surplus, equivalent to 3.0% of GDP, was achieved in 2020.

Almost all items of the current and capital transactions balance contributed to this watershed. The goods and services surplus increased to 6.9% of GDP in 2020. This reflected both the ability of export-oriented industry to cope with the consequences of the deep economic downturn in partner countries and a decline in imports due to weak investment activity, especially in the private sector, and lower household consumption.

There was an even stronger positive impulse in the long-standing deficit balance of primary income, mainly driven by the distributed income of foreign-controlled companies. The primary income deficit thus declined from 6.0% of GDP to 4.0% of GDP due to a reduction in dividend payments to other countries and the lower profitability of foreign-owned enterprises.

Consequently, the current external balance with non-residents (corresponding to the current account of the balance of payments) recorded a surplus of 1.8% of GDP, compared to a deficit of 0.9% of GDP in 2019.

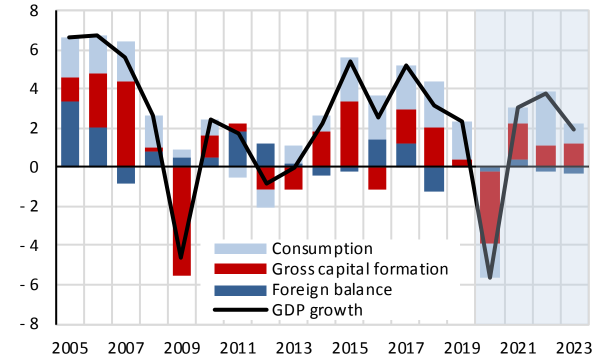
The surplus of the balance of capital transfers increased to 1.1% of GDP in 2020, mainly due to capital subsidies from the EU budget.

In the scenario of the Convergence Programme, we assume that the drastic improvement in foreign relations in 2020 was a one-off affair. In future years, the current external balance should report a deficit of around 1% of GDP due to a reduction in the surplus on the balance of goods and services and the renewed widening of the primary income deficit. However, net lending/borrowing should post a modest surplus thanks to the positive balance of capital transfers.

From the perspective of sectoral balances, the private-sector balance should report significant surpluses under the trajectory projected for the general government sector.

Graph 2.1: Decomposition of GDP Growth

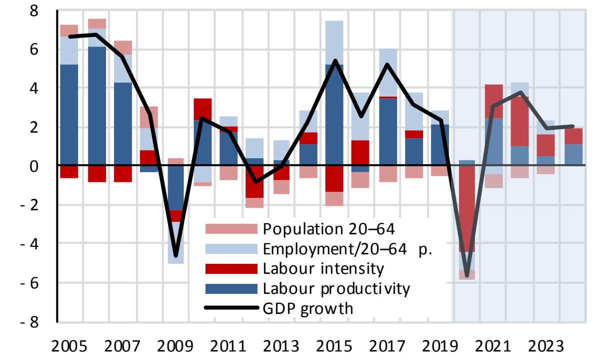
growth in %, contributions to growth in percentage points



Source: CZSO (2021a), MF CR (2021). MF CR calculations and forecast.

Graph 2.2: Contributions to GDP Growth

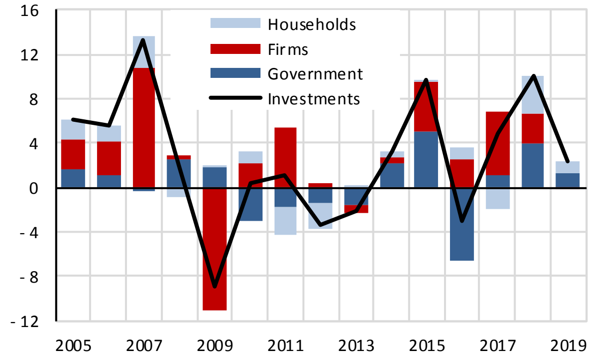
growth in %, contributions to growth in percentage points



Source: CZSO (2021a), MF CR (2021). MF CR calculations and forecast.

Graph 2.3: Investment by Sector

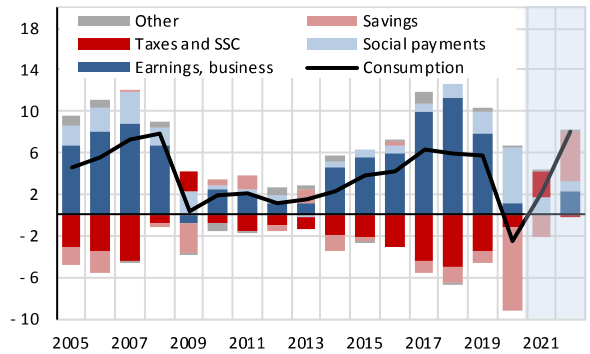
growth of real gross fixed capital formation in %, contributions in pp



Source: CZSO (2021a), MF CR (2021a). MF CR calculations.

Graph 2.4: Nominal Consumption of Households

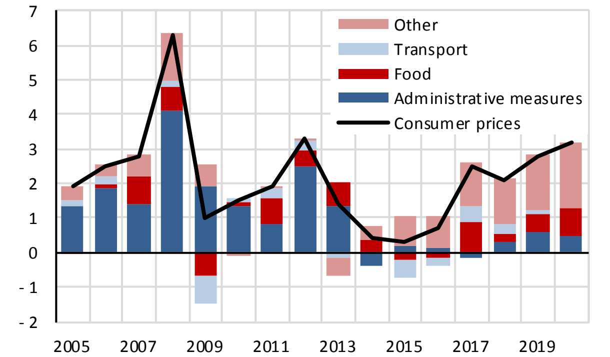
national concept, growth rate in %, contributions in pp



Source: CZSO (2021a), MF CR (2021a). MF CR calculations.

Graph 2.5: Consumer Prices

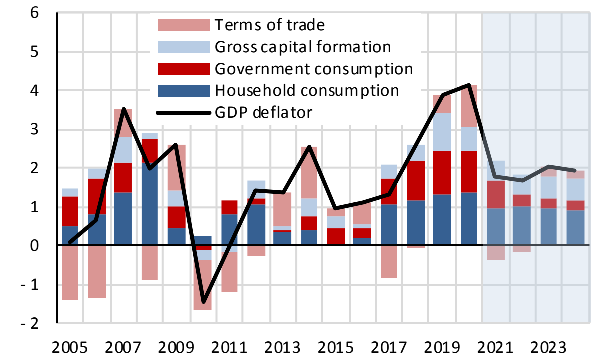
year-on-year change in %, contributions in percentage points



Source: CZSO (2021a). MF CR calculations.

Graph 2.6: GDP Deflator

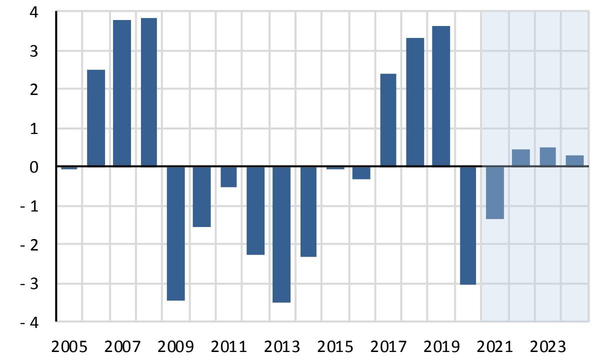
year-on-year change in %, contributions in percentage points



Source: CZSO (2021a). MF CR calculations and forecast.

Graph 2.7: Output Gap

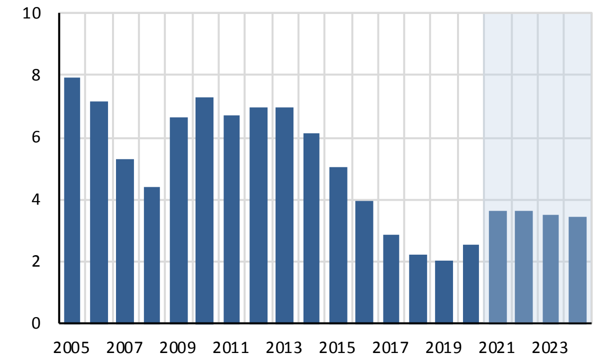
in % of potential product



Source: MF CR (2021a).

Graph 2.8: Unemployment Rate

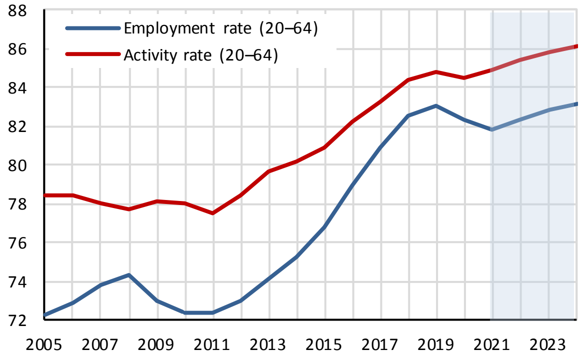
in %



Source: CZSO (2021c). MF CR calculations and forecast.

Graph 2.9: Employment and Participation Rates

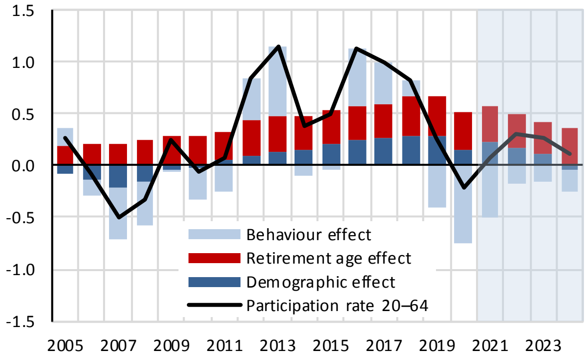
in %



Source: CZSO (2021c). MF CR calculations and forecast.

Graph 2.10: Changes in Participation Rate

change and contributions in percentage points



Source: CZSO (2021c), Eurostat (2021). MF CR calculations and forecast.

Table 2.1: Economic Output

levels in CZK billions, increases in %, contributions to growth in percentage points

	ESA Code	2020 Level	2020	2021	2022	2023	2024
			Rate of change				
Real GDP	B1*g	**5427**	**-5.6**	**3.1**	**3.7**	**1.9**	**2.1**
Nominal GDP	B1*g	**5652**	**-1.7**	**4.9**	**5.5**	**4.0**	**4.0**
Components of real GDP							
Private consumption expenditure	P.3	**2580**	**-5.2**	**0.1**	**5.7**	**1.8**	**2.2**
Government consumption expenditure	P.3	**1173**	**3.5**	**3.4**	**0.9**	**1.1**	**1.5**
Gross fixed capital formation	P.51g	**1387**	**-8.1**	**3.8**	**4.5**	**4.6**	**1.2**
Changes in inventories and net acquis. of valuables (% of GDP)	P.52+P.53	**-44**	**-0.8**	**0.1**	**0.0**	**0.1**	**0.1**
Exports of goods and services	P.6	**4023**	**-5.9**	**5.0**	**5.7**	**3.8**	**3.7**
Imports of goods and services	P.7	**3692**	**-6.1**	**4.9**	**6.6**	**4.7**	**3.4**
Contributions to real GDP growth							
Final domestic demand		-	**-3.9**	**1.8**	**3.9**	**2.3**	**1.7**
Changes in inventories and net acquis. of valuables	P.52+P.53	-	**-1.5**	**0.9**	**0.0**	**0.0**	**0.0**
External balance of goods and services	B.11	-	**-0.3**	**0.4**	**-0.2**	**-0.3**	**0.4**

Note: Real levels are in 2019 prices. Changes in inventories and net acquisition of valuables on the sixth row express change in inventories as a per cent of GDP in current prices. The contribution of the change in inventories and net acquisition of valuables is calculated from real values.
Source: CZSO (2021a), MF CR (2021). MF CR calculations and forecast.

Table 2.2: Prices of Goods and Services

indices 2015=100, rate of change in %

	2020 Level	2020	2021	2022	2023	2024
		Rate of change				
GDP deflator	**113.7**	**4.2**	**1.8**	**1.7**	**2.0**	**1.9**
Private consumption deflator	**111.4**	**2.8**	**2.1**	**2.2**	**2.1**	**2.0**
Harmonised index of consumer prices	**111.4**	**3.3**	**2.4**	**2.3**	**2.1**	**1.9**
Public consumption deflator	**122.9**	**5.1**	**3.3**	**1.4**	**1.3**	**1.3**
Investment deflator	**110.0**	**2.4**	**2.3**	**2.0**	**2.0**	**2.0**
Export price deflator (goods and services)	**98.1**	**0.5**	**-1.0**	**-0.1**	**0.2**	**0.4**
Import price deflator (goods and services)	**96.1**	**-1.1**	**-0.6**	**0.1**	**-0.1**	**0.2**

Source: CZSO (2021a), Eurostat (2021). MF CR calculations and forecast.

Table 2.3: Employment and Compensation of Employees

price levels in current prices, rate of change in %

	ESA Code	2020	2020	2021	2022	2023	2024
		Level	*Rate of change*				
Employment (thous. of persons)		**5351.0**	**-1.5**	**-1.1**	**0.1**	**0.3**	**0.1**
Employment (bn. hours worked)		**9.1**	**-6.0**	**0.5**	**2.7**	**1.7**	**0.6**
Unemployment rate (%)		**2.6**	**2.6**	**3.6**	**3.7**	**3.5**	**3.5**
Labour productivity (thous. CZK/person)		**1014.2**	**-4.2**	**4.2**	**3.6**	**1.6**	**1.9**
Labour productivity (CZK/hours)		**594.4**	**0.4**	**2.6**	**1.0**	**0.2**	**1.4**
Compensation of employees (bn. CZK)	D.1	**2596.6**	**1.3**	**0.0**	**1.7**	**2.9**	**3.1**
Compensation per employee (thous. CZK/person)		**564.2**	**2.9**	**1.0**	**1.5**	**2.6**	**3.0**

Note: Employment and compensation of employees are based on domestic concept of national accounts. Unemployment rate is based on the Labour Force Survey methodology. Labour productivity is calculated as GDP in 2019 prices per employed person or hour worked.
Source: CZSO (2021a, 2021c). MF CR calculations and forecast.

Table 2.4: Sectoral Balances

in % of GDP

	ESA Code	2020	2021	2022	2023	2024
Net lending/borrowing vis-à-vis the rest of the world	B.9	**3.0**	**0.9**	**0.4**	**0.2**	**0.6**
Balance of goods and services		6.9	6.6	5.9	5.5	5.9
Balance of primary incomes and transfers		-5.1	-7.0	-7.0	-7.0	-7.2
Capital account		1.1	1.2	1.4	1.6	1.7
Net lending/borrowing of the private sector	B.9	**9.2**	**9.7**	**6.3**	**5.6**	**5.8**
Net lending/borrowing of general government	B.9	**-6.2**	**-8.8**	**-5.9**	**-5.4**	**-5.2**
Statistical discrepancy		**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Note: National Accounts Methodology.
Source: CZSO (2021a). MF CR calculations and forecast.

Table 2.5: Basic Macroeconomic Assumptions

interest rates and growth in %

	2020	2021	2022	2023	2024
Short-term interest rate (CZ) (annual average)	**0.9**	**0.4**	**1.1**	**2.0**	**2.1**
Long-term interest rate (CZ) (annual average)	**1.1**	**1.5**	**1.8**	**2.2**	**2.2**
Nominal effective exchange rate (2015=100)	**106.9**	**110.0**	**111.9**	**113.7**	**115.6**
Exchange rate CZK/EUR (annual average)	**26.4**	**25.9**	**25.5**	**25.1**	**24.7**
World excluding EU, GDP growth	**-2.7**	**5.9**	**4.1**	**3.6**	**3.3**
EU GDP growth	**-6.3**	**3.6**	**3.7**	**1.8**	**1.6**
Growth of relevant foreign markets	**-6.3**	**5.1**	**5.4**	**3.6**	**2.8**
World import volumes, excluding EU	**-8.5**	**7.9**	**5.0**	**4.2**	**3.8**
Oil prices (Brent, USD/barrel)	**41.8**	**63.8**	**59.9**	**57.4**	**56.0**

Source: CNB (2021a), EIA (2021), Eurostat (2021a). MF CR calculations and forecast.

3 General Government Sector Finances

In 2020, the Czech general government sector ran a deficit of 6.2% of GDP. The deficit of the state budget, which decisively contributed to the fiscal stimulus of the economy, was cushioned by the positive balance of local governments. Until the pandemic crisis, the Czech Republic's public finances were fulfilling their medium-term budgetary objective. They thus created fiscal leeway, through a decline in the debt-to-GDP ratio down to 30%, to deal with negative shocks. Continued fiscal expansion in 2021 is expected to increase the general government deficit further to 8.8% of GDP and the structural balance from −2.7% of GDP to −6.5% of GDP. However, the forecast is fraught with downside risks related not only to developments in the epidemic situation and relating cost to public finances, but also risks and uncertainties in the economic environment.

3.1 Current Developments of the General Government Sector

3.1.1 Outcome in 2020

According to the Czech Statistical Office, the general government sector ended 2020 with a deficit of 6.2% of GDP. This negative result was mainly attributable to the state budget, which, in addition to its reinforced redistributive function, bore the burden of stabilising the economy and compensating for the shortfall in the income of other units of public finance. Transfers from the state budget then led to local governments again reporting a surplus, while health insurance companies ran only a slight deficit during the health crisis. In terms of structural balance, the expansionary fiscal policy resulted in a deficit of 2.7% of GDP, as a whole number of measures were one-off or temporary in nature and, to some extent, the decline in revenue was cyclical.

General government revenue fell by 2.4 % year-on-year to 41.3% of GDP. The dominant effect was a 2.7% fall in tax receipts, including social security contributions, with the largest drop in corporate income tax revenue. The tax-to-GDP ratio fell by 0.4 pp to 35.7%.

Value added tax revenues fell by 3.0%. The year-on-year momentum slowed considerably following a decline in nominal household consumption. The significant shortfall in revenue from purchases by foreign tourists could also evidently be felt. The rate for supplies of heat and cold changed from 15% to 10% with effect as of 1 January 2020 (Act No. 80/2019 Coll.). This measure, compensating for the increased costs due to a rise in emission allowance prices, translated into a decrease in revenues by CZK 2 billion. Act No. 256/2019 Coll. prompted some services and commodities to move to the second reduced rate (e.g. repairs of bicycles, footwear, leather goods and clothing, hairdressing and barber services, water and sewage rates, etc.), which pushed down revenues by CZK 1.4 billion. With effect as of July 2020, tax revenue was further inhibited by a lower tax rate on accommodation services and sports events, with an overall estimated impact of CZK 0.8 billion (Act No. 299/2020 Coll.).

Excise taxes revenue, net of subsidies for renewable energy sources, fell by 6.4%. Mineral oil tax echoed the lower consumption of diesel and petrol stemming from a sharp decline in transport, as well as the higher rebate on "red diesel". Duties on manufactured tobacco were affected considerably by the curtailment of cross-border purchases and tourism. Subdued tourism and reductions in all social activities were also reflected in beer and spirit consumption. A change in rates on manufactured tobacco and alcohol had a positive income effect, with an originally estimated impact of approximately CZK 10.3 billion (Act No. 364/2019 Coll.). Within the scope of taxes on production and imports, Act No. 364/2019 Coll. hiked up rates on gambling (only lotteries), with a projected impact of just under CZK 1 billion. The abolition of the tax on the acquisition of immovable property resulted in a revenue shortfall of CZK 13.8 billion (Act No. 386/2020 Coll.).

Revenue from income taxes fell year-on-year by 6.7%, mainly due to a loss of corporate income tax revenue. Forced constraints on production and service provision, closures and the overall economic downturn linked to the epidemic had a significant impact on the economic performance of businesses, which contributed 22.1% less in profit tax to public budgets. The "2021 Tax Package" (Act No. 609/2020 Coll.), introducing modified tax depreciation with an estimated negative impact of around CZK 11 billion and an increase in the limit for the depreciation of tangible fixed assets with an impact of CZK 2.4 billion, also played a part in this. The extension of the exemption of dividends payable to the state and regions from corporate income tax (Act No. 364/2019 Coll.) also had a negative impact, amounting to CZK 1.8 billion. Conversely, a change in the method for the creation and eligibility of insurance companies' technical provisions (Act No. 364/2019 Coll.) had a positive impact of CZK 5.3 billion on the budget. Measures adopted under the "liberalisation packages" had a minimal fiscal impact on accrual revenue.

In the case of personal income tax revenue, in part because of employment stabilisation measures, there was a 3.3% year-on-year increase. Discretionary measures included the introduction of a limit of CZK 1 million for the exemption of winnings from gambling. In the case of lotteries and raffles, this limit is applied to the gross winnings, while for other types of gambling CZK 1 million means the net prize. There was also a change in rounding when determining the tax base for income from bonds issued before 1 January 2013 (Act No. 364/2019 Coll.), with a total expected positive impact of CZK 0.6 billion. The reduction in the sickness insurance rate in connection with the abolition of the waiting period for sick pay from July 2019 had a negative impact of approximately CZK 0.3 billion (Act No. 32/2019 Coll.).

Developments in social security contributions, much like personal income tax, were determined primarily by a rise in the compensation of employees in the economy by 1.3%. The CZK 25.4 billion increase in government payments for state-insured persons to health care system also figured prominently. Extraordinary epidemic-era measures included approval of a six-month waiver of minimum advances on social and health insurance for the self-employed, with an estimated impact of CZK 14.3 billion (Act No. 136/2020 Coll. and Act No. 134/2020 Coll.), as well as a three-month waiver of employer-paid social security and state employment policy contributions (Antivirus Programme – Line C), with an impact of CZK 13.3 billion (Act No. 300/2020 Coll.). The social insurance system's income was also adversely affected by a reduction in the sickness insurance rate, introduced to make up for the abolition of the waiting period in the first three days of sickness (Act No. 32/2019 Coll.), with an impact of CZK 1.8 billion. On aggregate, all these factors contributed to a 1.6% rise in social security contributions.

In property income, there was a 41.0% (CZK 6.3 billion) year-on-year increase in dividend income, despite the assumption of a zero dividend from Prague Airport, which was heavily affected by the global pandemic and the associated air traffic restrictions. On the other hand, CEZ Group paid a much higher dividend to the state budget.

General government expenditure grew by 12.9% to reach 47.5% of GDP, representing a year-on-year increase in the expenditure-to-GDP ratio by 6.1 pp. The expenditure side was severely affected by measures taken to combat COVID-19 and schemes to mitigate its economic and social impacts.

The final consumption expenditure of the general government sector maintained its strong momentum at 8.7% due to the compensation of employees and social transfers in kind. Double-digit growth in the compensation of employees was driven by the salaries of education and health care workers, complemented by funds for compensation in the health care sector, social services and security forces. Social transfers in kind, or healthcare expenditure paid to non-government entities, grew even faster (10.6%). To boost spa tourism, the COVID-Spa programme was approved with funding of CZK 1 billion (Government Resolutions No. 703/2020 and No. 48/2021); CZK 0.1 billion of that funding has been used. In contrast, savings of CZK 2 billion were made due to lower use of discounts on bus and train fares for students and seniors at a time of limited travel opportunities. Compared with the previous components of final consumption expenditure, there was only a slight increase in intermediate consumption expenditure (1.9%). Higher consumption in the health care sector (spending on medical supplies, protective equipment, tests and vaccines), rail transport (Railway Administration) and research (public research institutions) was offset by lower intermediate consumption in the road transport sector (Directorate of Roads and Motorways), public universities or local allowance organisations.

There was a significant rise in cash social benefits in 2020. This reflected measures approved for pension benefits and state social support benefits, on the one hand, and economic developments, on the other. The average old-age pension was increased by CZK 900 with effect as of 1 January 2020 (Act No. 244/2019 Coll.). The impact of this discretionary step (i.e. a measure beyond statutory requirements) was approximately CZK 6 billion. A special CZK 5,000 contribution to pensioners as financial assistance to cover their rising living costs resulted in additional expenditure of CZK 15 billion (Act No. 469/2020 Coll.). Another measure, pushing up social expenditure by CZK 14.1 billion, was the increase of the parental allowance for all households with a child up to 4 years of age who were still actively receiving this benefit (Act No. 363/2019 Coll.). The impact of the increase in the care allowance for persons with degrees 3 and 4 of dependence is calculated at CZK 1.9 billion (Act No. 47/2019 Coll.). The CZK 25.4 billion increase in the state's contributions to health care system for state-insured individuals was mirrored in social security contributions. In addition, social security benefits rose by CZK 12 billion as a result of the temporarily increased carer's allowance for persons looking after children while schools, day care centres and similar facilities were closed during the coronavirus epidemic, and which was also payable in cases where families were ordered to quarantine (Act No. 133/2020 Coll., Act No. 230/2020 Coll. and Act No. 438/2020 Coll., Government Resolution 311, and other resolutions regulating the parameters of the carer's allowance for self-employed persons). In total, cash social benefits grew by almost 16%.

The higher borrowing needs of the state, required to cover the increased state budget deficit (Act No. 129/2020 Coll., Act No. 208/2020 Coll., and Act No. 323/2020 Coll.) and to strengthen the Treasury's liquid reserves, led to a 7.1% increase in interest payments to 0.8% of GDP.

Compared to the previous three years, the growth rate of capital expenditure slowed to 9.8%, with more than 82% of the investment nationally funded (including Czech financing). Central government increased its investments by 15.2%, while local governments recorded a rise by only 4.2%. Measures to prevent the spread of the coronavirus, which resulted in a reduction in output, also led to a decline in investment activity. The postponement of certain purchases of military equipment that, given the situation, were not essential for the state's defence capabilities, saved CZK 2.1 billion in expenditure compared to the amount originally budgeted (Act No. 129/2020 Coll.).

The increase in subsidies by more than 35% reflected the funding to support various groups of economic subjects affected by the coronavirus epidemic or, more specifically, by measures taken to prevent its spread. In particular, there was a CZK 25.5 billion contribution to wage compensation as a result of an impediment to work on the part of the employee or employer caused by quarantine or other measures related to the COVID-19 infection (Antivirus Programme – Lines A/A Plus and B under Government Resolution No. 353 and other resolutions regulating the parameters of the programme), with an additional CZK 1.4 billion paid under this programme for March 2020 recorded as a capital transfer. In terms of the volume of funds spent, the COVID-Rent programme for businesses that had to temporarily close their goods and services retail outlets or who reported a year-on-year drop in sales of at least 66% within a defined period due to the emergency measures, with an impact of CZK 5.1 billion, is in second place (Government Resolutions No. 513, 550, 1035, 1037, 1081, 1107, 1329 and 1376). CZK 2.3 billion was spent on the COVID-Accommodation and COVID-Accommodation II subsidy schemes in support of operators of accommodation facilities affected by the consequences of COVID-19 measures (Government Resolutions No. 766, 1070, 1184, 1331 in 2020, and Government Resolutions 50 and 334 in 2021). Support for bus carriers under the COVID-Bus programme resulted in expenditure of CZK 0.9 billion (Government Resolution No. 1035). Funds to compensate for the effects of the epidemic and related measures were also channelled into the arts (CZK 1 billion) and sports (CZK 0.6 billion). Many programmes were aimed at supporting businesses that make medical devices, offering new technological solutions to combat COVID-19, and introducing innovations to cope with the repercussions of the epidemic. Funds of approximately CZK 2.3 billion were earmarked for these purposes.

Other measures were implemented through transfers, which were up 28.2% year-on-year. This primarily comprised the "compensation bonus" paid to eligible self-employed individuals, small private limited companies, and employees working on the basis of an "agreement on work activity" or an "agreement on the performance of work", with a total impact of CZK 26.3 billion in 2020 (Act No. 159/2020 Coll. and amendments No. 234/2020 Coll., No. 262/2020 Coll. and No. 331/2020 Coll. thereto, and Act No. 461/2020 Coll. and amendments No. 584/2020 Coll. and No. 82/2021 Coll. thereto). In addition, there was an almost 25% increase in gross national income (GNI) based transfers to the EU budget.

3.1.2 Outcome in 2021

In 2021, the general government sector will continue to be heavily influenced by the situation caused by the coronavirus epidemic, its economic consequences, and the measures implemented in public health care system and under the stimulus fiscal policy. We therefore expect a marked deficit of 8.8% of GDP, which will again be mainly borne by the state budget. Local governments, on the other hand, are likely to post a slight surplus, helped by a tax assignment adjustment in their favour (Act No. 609/2020 Coll.). Despite a further sizeable increase in the payment for state-insured individuals to health care system, we expect social security funds to run a deficit. From the perspective of the structural balance, expansionary fiscal policy should result in a deficit of 6.5% of GDP.

General government revenue is expected to grow by 1.2% year-on-year, but to fall by 1.5 percentage points in relative terms to 39.8% of GDP. The forecast assumes approximately the same level of tax revenues, including social security contributions, as in 2020, with tax revenues themselves expected to fall by 4.7%, mainly as a result of the approved "2021 Tax Package" (Act No. 609/2020 Coll.). In this context, we also expect the composite tax-to-GDP ratio to fall to 34.0%.

According to the current forecast, revenue from income taxes will report a year-on-year decline of almost 20.0%, caused by a 33.4% drop in personal income tax revenue. Act No. 609/2020 Coll., amending certain tax laws and certain other acts, introduced the most significant changes, from a budgetary perspective, in personal taxation with effect from 1 January 2021. The effective reduction in the tax rate is expected to have an impact on public finances tantamount to CZK 99 billion. This effect emanates from an adjustment to the tax base and rates (a transition to the gross wage as the tax base and the introduction of two rates, 15% and 23%), having an impact of around CZK 85 billion, and a CZK 3,000 increase in the basic rebate for taxpayers, with an impact about CZK 13.5 billion. From 1 January 2021, a flat-rate income-tax regime for sole traders with income up to CZK 1 million will take effect (Act No. 540/2020 Coll.), as will an extension to the staff meal tax incentive and the abolition of the tax credit ceiling (Act No. 609/2020 Coll.). The overall impact of these measures is thought to be around CZK 1 billion.

In the case of corporate income tax, on the other hand, we expect growth of 6.0%. The momentum of this tax relies primarily on the gross operating surplus, but will also be steered by the effects of several "2021 Tax Package" measures. The gradual phasing-in of the tax exemption for government bond yields (with an estimated impact of CZK 1.5 billion in 2021) and the introduction of the flat-rate meal allowance, which will have an impact of CZK 1.7 billion, will have negative effects. The modified tax depreciation will reduce tax revenue by a further CZK 4.5 billion. Conversely, the negative impact of raising the entry price threshold for the depreciation of tangible assets should decrease by CZK 0.8 billion year-on-year.

Social security contributions are expected to increase by 5.9% year-on-year. This growth rate is based on the forecast for the compensation of employees in the national economy and the gradual unwinding of measures mitigating the socio-economic impact of the anti-epidemic restrictions (the waiver of minimum advances required of the self-employed, the Antivirus Programme – Line C). The increase in payments on behalf of state-insured individuals will add about further CZK 30 billion to the public health insurance system (Act No. 231/2020 Coll.). A new extraordinary allowance at CZK 370 per day for employees who have been ordered to quarantine, has been introduced with an impact of CZK 1.8 billion (Act No. 121/2021 and Chamber of Deputies Print No. 1205). The effects of the flat-rate income tax scheme and the flat-rate meal allowance should more or less cancel each other out.

We forecast growth of 3.8% in value-added tax revenue. This autonomous development is consistent with the expected growth in nominal household consumption, part of final general government consumption, and gross fixed capital formation in the general government sector. The reclassification of selected goods and services to the second reduced tax rate in the first half of 2020 (Act No. 256/2019 Coll.) will probably reduce tax receipts by CZK 1.4 billion this year. The reduction in the rate for accommodation services and for cultural and sports events from 1 July 2020 (Act No. 299/2020 Coll.), will push down tax revenue by CZK 1 billion year-on-year. Finally, the waiver of tax on diagnostic medical devices for COVID-19 testing and vaccines against this disease (Government Resolution No. 1326/2020), together with a four-month waiver of tax on respirators (Government Resolutions No. 99 and 272/2021), will reduce revenue by a total of CZK 2.3 billion.

The revenue from excises (excluding renewable energy subsidies) is projected to increase by 12.6%. Changes in manufactured tobacco rates will generate additional CZK 5.2 billion (Act No. 609/2020 Coll.). With mineral oil tax, we expect stronger growth on the back of the economic recovery, which should largely eliminate the slump in 2020. This tax revenue will, however, be dampened by the impact of the reduced tax rate on diesel by CZK 1 per litre, totalling CZK 5.6 billion (Act No. 609/2020 Coll.). In the field of other taxes on production and imports, the introduction of a register of excluded individuals will apparently reduce gambling tax revenue by CZK 1.5 billion. Taxes on production and imports, on the other hand, should benefit from the introduction of a digital services tax, with an expected impact of CZK 1.1 billion in 2021 (Chamber of Deputies Print No. 658).

For other revenue, we expect an almost 35% growth in investment subsidies in connection with the EU-budget co-funded projects in the 2014–2020 programming period and projects covered by the Recovery and Resilience Facility. We also expect growth, based on the assumption of year-on-year higher dividend payments, in property income.

General government expenditure is expected to grow by 7.5% and equal 48.6% of GDP. Final consumption expenditure, expected to grow by 6.9%, will be driven by intermediate consumption, social transfers in kind and the compensation of employees.

The approved salary increase is essentially split between education (9.0% for teaching staff and 4.3% for non-teaching staff), health care, and social services (10.0%). Other salaried employees did not receive an increase in earnings. We also include remuneration paid to medical staff in connection with the second wave of the epidemic, amounting to CZK 12.2 billion. Wage bill is expected to increase by 5.1% in total.

Growth in social transfers in kind is estimated at 11.0%. The relatively strong momentum of the previous two years should continue. We forecast that, in the first half of 2021, health spending will still be driven by the epidemic situation and the process of vaccinating the Czech population. Health insurers should also pay CZK 12 billion in remuneration to health care workers in non-government facilities. In addition, health insurers' funds will be used to cover the contribution to the self-testing of employees and the self-employed, at an estimated cost of CZK 4.8 billion (Government Resolutions 191, 242, 293, 313, Act No. 161/2021 Coll.). The COVID-Spa subsidy programme, been extended until 30 June 2021 (Government Resolution No. 48), is expected to pay out a further CZK 0.9 billion. We also expect a negative budgetary impact as a result of a renewed increase in fare rebate payments (a saving of CZK 2 billion in 2020).

Intermediate consumption is projected to grow at a rate of 8.4% this year. To some extent, this is also based on the assumption that European funds under Next Generation EU will be distributed relatively evenly. The higher rate of intermediate consumption will partly make up for its last year's lacklustre growth due to the closure of schools and other public institutions. In health care, purchases of COVID-19 vaccines (CZK 8.9 billion) and testing kits for schools (almost CZK 4 billion) should be reflected here.

The 6.1% increase in cash social benefits reflects both the statutory indexation of pension benefits and developments on the labour market, as well as the increase in transfers to public health care system. With effect from 1 January 2021, Government Regulation No. 381/2020 Coll. increased the average old-age pension by CZK 839. The higher share of unemployed people will require increased spending on unemployment benefits and social welfare benefits. The introduction and subsequent modification of the amount of the crisis carer's allowance, as well as its extension to cover a wider range of children, should result in expenditure of CZK 3.2 billion (Act No. 438/2020 Coll., Chamber of Deputies Print No. 1177, Government Resolutions No. 1053/2020 and 1260/2020). The forecast also takes into account the impact of substitute maintenance grants (Act No. 588/2020 Coll.) coming into force from the second half of 2021 with a negative impact of CZK 0.4 billion. The rate of cash social benefits is also affected by increased payments for the state-insured persons to health care system, which should rise by about CZK 30 billion year-on-year.

In view of the performance of the general government sector in 2020 and 2021 and the projected development of interest rates, interest payments should go up by 5.7%. The refinancing of past issues, some of which will continue to benefit from relatively low rates, is a positive factor. In relative terms, debt servicing costs should remain at the 2020 level (0.8% of GDP).

Fixed capital investments should accelerate to 13.5%. We expect new EU facilities to be involved here. On top of that, numerous 2020 programmes have yet to be completed and the funds to cover them have been transferred to the needs of individual headings so that those investments can be financed in 2021.

The ongoing support programmes related to the COVID-19 epidemic are the reason for the high level of forecast subsidies, as some of the measures will remain in place in the first half of 2021. This mainly concerns the Antivirus Programme (CZK 19.1 billion), COVID-Accommodation II (CZK 5.7 billion) and COVID-Rent (CZK 3.7 billion). For sport, we are anticipating a sum of approximately CZK 4 billion, while culture should be supported with around CZK 3 billion. Food manufacturing businesses supplying products to catering services can apply for support under the Agricovid Food Industry Programme, which has an allocation of CZK 3 billion (Government Resolutions No. 1052/2020, 1138/2020, and 100/2021). CZK 3.5 billion has been paid off in the Covid – Gastro – Closed Establishments Programme, which was approved at the beginning of the year (Government Resolution No. 10/2021). The COVID – 2021 Programme (Government Resolution No. 277/2021) and COVID – Uncovered Costs Programme (Government Resolution No. 278/2021), with a total estimated impact for the first round of calls of CZK 12 billion, are a new form of compensation in 2021 to mitigate the negative impact that the restrictions associated with anti-COVID-19 measures have on businesses. The programmes cannot be combined with each other or with other COVID-19 support programs (except Antivirus). At the same time, both programmes are intended to replace older specific programmes.

Besides subsidies, most crisis measures are also classified as capital transfers under the ESA 2010. Their 47.0% year-on-year growth is underpinned by the “compensation bonus”, the continued payment of which is expected to amount to CZK 33.4 billion (Act No. 461/2020 Coll., Act No. 95/2021 Coll., and the relevant Government Regulation No. 154/2021 Coll.). Not least, an accrual impact of approximately CZK 19 billion is linked to the introduction of the tax loss carryback concept, which can be used by individuals and legal entities (Act No. 299/2020 Coll.).

3.2 General Government Outlook

The primary factor determining the current fiscal policy stance which serves as the basis for this outlook, should be the consolidation trajectory set by the Fiscal Responsibility Rules Act. According to that law, the expenditure framework of the state budget and state funds for 2022 and beyond will be set in a way that corresponds to an annual improvement in the structural balance by at least 0.5 percentage points.

Local governments are forecast to report a continuing surplus. We expect prudent management of local budgets, with a more gradual increase in current expenditure and investment in the future. This should be phased in according to the economic recovery, although probably with a certain time lag. The estimate for social security funds is based mainly on the predicted wage bill growth in the economy which is a crucial determinant of future growth in contributions. Given its dynamics (see chapter 2.2.4) and the assumption of relatively lower expenditure growth, we forecast either a slight deficit or balance in health insurance companies’ economic performance. The central government components outside the state budget and state funds as a whole should average modest surpluses.

3.2.1 Revenue Outlook

General government revenue is expected to grow by 3.2% on average over the years of the outlook. However, we expect a lower growth rate of tax revenue, including social security contributions, averaging 2.9%.

In the case of personal income tax, the tax credit will increase further in 2022, with a negative impact on tax revenue of more than CZK 12 billion. Another measure extending into 2022 is the abolition of the tax bonus ceiling, with an additional effect of CZK −0.5 billion. Together with the forecasted compensation of employees, these effects will translate into average growth of 1%.

Social security contributions, on the other hand, should be almost exclusively determined by developments in the compensation of employees in the economy. In 2022, the momentum will be only slightly higher as the one-off effect of the extraordinary contribution of CZK

370 per day for people in quarantine (Act No. 121/2021 Coll.), amounting to CZK 1.8 billion, fades away. In the accrual methodology, the aggregate also includes payments from the state budget to the public health insurance system for the state-insured persons. However, in the wake of the unprecedented growth in 2020 and 2021, we do not foresee any increase here over the outlook horizon.

In the case of corporate income tax, the dynamics in 2022 will be affected by the end of the change in the method for the creation and the tax deductibility of technical provisions for insurance companies (Act No. 364/2019 Coll.), which yielded additional revenues of CZK 5.3 billion in 2020 and 2021. The abatement of the effect caused by the increased input price threshold for the depreciation of tangible assets will act in the opposite direction, with an impact of CZK 1.6 billion. The entire outlook will reflect the tax exemption for government bond yields, amounting to about additional CZK 2 billion each year. On the other hand, the termination of the modified tax depreciation regime for tangible assets will have a positive effect on revenue, estimated at CZK 16.6 billion in 2022 and another almost CZK 10 billion in 2023. The above-mentioned effects stem from Act No. 609/2020 Coll. The gradual economic recovery and the resulting growth in corporate profits should have a positive effect on tax revenue. Tax revenue is expected to grow by 8.7% on average.

Excise tax revenue (excluding the impact of payments for renewable energy) are expected to rise by an average of 2.1%. In 2022 and 2023, their momentum will be driven primarily by increases in excise duty on tobacco products (CZK 2.5 billion each year) and growth in revenues from excise duty on alcohol, which should return to its usual level after a drop due to anti-epidemic measures and restrictions on tourism. We expect the digital services tax to generate additional revenue of CZK 1.6 billion in 2022. Economic growth should have a positive effect on mineral oil excise duty revenues.

Value added tax revenue will depend primarily on developments in nominal household consumption, part of government consumption, and government investment. The 4.5% average growth in tax revenue is broadly in line with the 4.7% average growth of the macroeconomic base. Discretionary measures with negative impact relate mainly to the additional effects of previously approved changes to the tax rate of several goods and services. Act No. 256/2019 Coll. (concerning water and sewerage charges, the lending and renting of printed materials, and selected services with a higher proportion of human labour) and Act No. 299/2020 Coll. (accommodation services, cultural and sports events, and passenger transport by ski lifts) are cases in point. The overall impact next year is estimated at CZK 2.8 billion. On the other hand, the end of the tax refund claiming regime for the Czech Television and the Czech Radio to the same extent as for commercial stations (Act No. 80/2019 Coll.) will have a positive impact of CZK 0.6 billion on the dynamics of value-added tax revenue in 2022. The end of the tax exemption on sales of respirators, purchases of tests, and anti-COVID-19 vaccines will contribute to a year-on-year increase in revenue of CZK 1.6 billion in 2022 and CZK 0.7 billion in 2023.

Regarding other taxes on production and imports, we account for additional costs lowering the gambling tax revenue by CZK 1.2 billion in 2022 and by around CZK 0.2 billion in further years, because of the implementation of the register of excluded individuals.

As for other revenues, we anticipate an increase in investment subsidies in particular as the possibility to implement EU-funded projects under the 2014–2020 programming period nears its end. In 2022 and 2023, the introduction of the Recovery and Resilience Facility is expected to play a significant role in year-on-year terms. The Just Transition Fund and the REACT-EU programme should have a similar effect, albeit to a lesser extent.

3.2.2 Expected Expenditure Developments

In the years covered by the outlook, we predict that total general government expenditure will grow by an average of 0.8%. This growth is influenced by the elimination of one-off and temporary operations adopted in response to the epidemiological situation in 2020 and 2021.

Cash social benefits are expected to rise by 2.4% on average. The pace depends primarily on developments in pension benefits, which we assume to be in strict accordance to the statutory indexation formula, based on the predicted inflation rate and real wage growth. In addition, in 2022 we expect the increase in the care allowance for persons with degrees 3 and 4 of dependence (Chamber of Deputies Print No.1144) to have an impact of CZK 3.4 billion, along with an additional impact of CZK 0.4 billion in the form of substitute maintenance grants (Act No. 588/2020 Coll.) and CZK 1.8 billion in the form of an increase in child allowances (Chamber of Deputies Print No. 1116). The forthcoming act on nurseries (Chamber of Deputies Print No. 961) would have a negative budgetary impact of CZK 1.4 billion if it is fully covered by national funds. On the other hand, the termination of special schemes, i.e. the crisis carer allowance and the COVID-Carer's Allowance for the Self-Employed programme, totalling almost CZK 4 billion, will have a positive impact.

Nominal general government consumption is projected to grow between 2% and 3% in all years. Compensation of employees should be driven by salary increases in education (Chamber of Deputies Print No. 503) and, to a lesser extent, the health care sector and social services. For reasons of consolidation, we expect rather stagnation among the remainder of government employees. The pace in 2022 will be pushed lower as the special bonuses associated with the handling of the epidemic situation in 2020 and 2021 are brought to an end. On average, the compensation of employees should increase by about 2%. We expect social transfers in kind to stagnate in 2022 due to the high base in the preceding years, caused by the epidemic. Subsequently, they should grow at a relatively moderate pace as a result of efforts to ensure that health insurance companies break even. We predict that the intermediate consumption scenario will be similar to that for social transfers in kind. In 2022, they are expected to stagnate year-on-year due to lower purchases of medical devices, tests and vaccines. Conversely, the growth in intermediate consumption should be driven by higher year-on-year purchases among public institutions only partially operating during the epidemic (e.g. schools, museums, and theatres) and the gradual start-up of projects financed by EU budgets, including Next Generation EU.

In investments, we expect to see the gradual deployment of funds from the Recovery and Resilience Facility, the Just Transition Fund and REACT-EU. Regarding the programmes co-financed by the European Structural and Investment Funds, we presume their gradual acceleration and return to the usual level at the end of the outlook. This is related to the approaching end of the 2014–2020 financial perspective and the subsequent launch of the 2021–2027 programming period. In 2023, we predict higher growth in national investment due to the purchase of military equipment.

Subsidies are expected to fall as support programmes introduced during the epidemic come to an end (see section 3.1). In addition, an amendment to the Act on Subsidised Renewable Energy Sources (Chamber of Deputies Print No. 870) should save up to CZK 7 billion. Conversely, the gradual economic recovery can be expected to lead to an increase in production subsidies. Overall, we therefore forecast that subsidies will gradually return to just above 2019 levels and then, from there, grow at a rate of around 2%.

Similarly, we expect capital transfers to drop significantly in 2022 until they reach pre-crisis levels, as temporary anti-crisis measures such as the compensation bonus will no longer play a role. Loss carryback should no longer have a negative effect either. The dynamics of current transfers should depend on own-resource contributions to the EU budget.

In line with assumptions on monetary policy, interest rate developments, the volume of refinanced debt, and the size of cash budget balances, we estimate that interest expenditure will grow by an average of 7.1%. In relative terms, interest expenditure is projected to remain at 0.8% of GDP over the entire outlook horizon (see section 3.4).

3.2.3 Alternative Forecast Scenario

The alternative scenario for the CP stems from two groups of assumptions different from the baseline. The first group are the tax presumptions, as already during the debate on Act No. 609/2020 Coll. (the "2021 Tax Package") in Parliament, it was declared that lower tax burden could be a temporary measure lasting for two years. One way to fulfil this obligation was already part of the Public Finances Consolidation Strategy of the Czech Republic (MF CR, 2020b), while the tax adjustment, regarding the personal income tax rate, reflected the Policy Statement of the Government of the Czech Republic. For the purposes of the alternative Convergence Programme scenario, we are keeping to the same absolute amount of discretionary tax adjustment (at about CZK 50 billion) since 2023, but focused on taxation of consumption, global businesses or revision of tax expenditure.

The second group of assumptions concerns expenditure, specifically intermediate consumption and investment. The forecast in section 3.2.1 is based rather on the usual pattern of drawing on wherewithal from the European Structural and Investment Funds. In the alternative scenario, we assume their faster ramp-up in 2024, implying the more even involvement of EU funds in both current and capital expenditure. While both intermediate consumption and general government investment keep to the same momentum as in the baseline forecast scenario, their source of financing and impact on the balance and debt differ. In the case of intermediate consumption, the increase is co-financed by the EU, so current revenue transfers also increase proportionately. For investments, the transition between the different programming periods is expected to be much smoother, with priority given to EU-funded projects. Also, the interest expenditure is slightly lower due to lower general government deficits and debt.

The fiscal effort thus increases by 0.8 pp to 1.3 pp in 2023 in the alternative scenario and reaches the legally required 0.5 pp in 2024. This is also reflected in the development of the headline balance, which is more than one percentage point higher at the end of the outlook. Debt development also slows down. While the forecast puts general government debt at 54.6% of GDP at the end of the horizon, it also shows that active government action will be needed at least in 2024 to meet the statutory consolidation effort. The alternative scenario, on the other hand, indicates that the debt level would be about two percentage points lower in 2024. At the same time, even a continued fiscal effort of at least 0.5 pp in the following years would, under the assumptions spelt out above, stop the increase in debt at a peak below the limit set by the Fiscal Responsibility Rules Act.

3.3 Structural Balance and Fiscal Position

We estimate that the structural balance was −2.7% of GDP in 2020. This year, we expect it to deepen to −6.5% of GDP as a result of expansionary fiscal policy. In the next two years, the improvement in the structural balance should be in line with the Fiscal Responsibility Rules Act, i.e. it should be 0.5 pp higher year-on-year in each year.

In 2020, one-off and other temporary operations amounted to 2.3% of GDP. In the vast majority of cases, these were responses to the fallout from the COVID-19 pandemic. On the revenue side, the adoption of the "2021 Tax Package" meant that modified tax depreciation was introduced, impacting corporate income tax by CZK −11.1 billion, advances on social security and health insurance contributions were waived (CZK −14.3 billion), and social insurance for certain employers was also waived directly (CZK −13.3 billion). The most significant expenditure measures included a compensation bonus (capital transfer) for self-employed individuals, small private limited companies, and employees working on the basis of an "agreement on work activity" or an "agreement on the performance of work", which amounted to CZK −26.3 billion, and job support schemes, requiring CZK −25.5 billion. Other expenditure measures were the purchase of protective equipment and medical supplies, the extension and adjustment of the carer's allowance, the release of funds to tenants, and schemes to support operators of accommodation facilities and sports.

The one-off operations in 2021 are a continuation of most of the 2020 measures (with the exception of the waiver of advances and the waiver of insurance contributions for certain employers). In addition, we include the purchase of COVID-19 tests and vaccines, a contribution to self-testing, and support for food producers and other affected businesses in one-off expenditure. The amount of one-off measures is currently estimated at −1.8% of GDP, though this could change significantly over the course of the year. No one-off or temporary measures are included in the forecast for 2022–2024.

The cyclical component fell to −1.2% of GDP in 2020. It is expected to reach −0.5% of GDP in 2021 and to be more or less neutral in subsequent years.

The negative fiscal effort in 2020 was mainly due to increases in the compensation of employees, cash social benefits and investment. We expect the fiscal effort to be negative in 2021 as well, mainly because of changes in personal income tax.

The view of the fiscal effort and the structural balance in 2022–2024 is complemented by the Stability and Growth Pact expenditure rule that the growth of adjusted real government expenditure should be in line with average potential output growth (2.6% for the Czech Republic). The Czech Republic would not fulfil this rule this year due to spending on anti-crisis measures, but we expect it to be met in the following years in line with the trajectory of improvements in the structural balance.

3.4 General Government Debt, Strategy and Stability of State Debt

General government debt reached 38.1% of GDP at the end of 2020. The 7.8 pp year-on-year increase in debt is the result of a rise in sovereign debt from 28.5% to 36.3% of GDP. This reflects the impact that the epidemic and recession have had on public finances.

In the pre-crisis period, the relative debt ratio fell steadily between 2014 and 2019, going down by a total of 14.2 pp to 30.3% of GDP. This made the Czech Republic's public finances among the least indebted in the EU. They meet the Stability and Growth Pact criterion (60% of GDP) and the debt-to-GDP ratio set by the Fiscal Responsibility Rules Act (55% of GDP after adjustment for the cash reserve created by the financing of government debt). This created a fiscal cushion to soften any major negative shocks.

In addition, the Czech Republic was able to take advantage of favourable factors on the financial markets, including the positive rating of the Czech Republic's public finances by credit rating agencies. State budget revenues from sales of government bonds on the primary and secondary markets at a negative yield amounted to CZK 2.5 billion in 2015–2020. Foreign-exchange operations in the form of deposit operations, repo operations and foreign-exchange swaps on the money market generated additional state budget revenue of CZK 0.3 billion. The share of government debt with no net interest expense was 2.6% at the end of 2020.

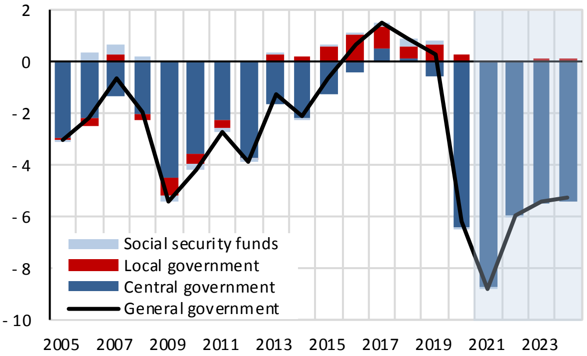
Autonomous developments in the general government sector suggest a gradual economic recovery and a decline in public deficits beyond 2021. This sector's financial management will have to be handled in line with the consolidation trajectory established by amendments to the Fiscal Responsibility Rules. Nevertheless, the debt-to-GDP ratio can be expected to continue growing over the outlook horizon. In 2021, we expect to see debt break through 40% of GDP and climb to 44.8% of GDP at the end of the year. In the outlook years, debt is expected to continue to rise because of the significant, though declining general government deficits. We forecast that government debt will come to 54.6% of GDP in 2024.

Factors contributing to the change in debt are dominated by the primary general government balance. In relative terms, interest expenditure should remain at 0.8% of GDP over the entire horizon of the CP. The forecast anticipates that government bond yields will rise. The long-term interest rate for convergence purposes is expected to move from the current 1.5% p.a. to slightly above 2% p.a. In 2020, a decline in GDP at current prices also negatively affected the debt-to-GDP ratio – until last year, this had only happened once (in 2009) in the entire time series available. From 2021 onwards, economic growth should start to slow down the increasing debt-to-GDP ratio again.

The current forecast does not envisage any significant privatisation revenues under Act No. 92/1991 Coll., on conditions for the transfer of state assets to other persons, as amended.

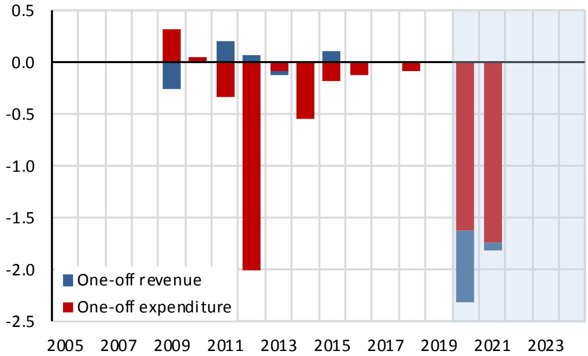
Central government accounts for the largest share of general government debt (Table 3.6). This debt is estimated to have reached almost CZK 2,200 billion in 2020, thus accounting for about 96% of total (unconsolidated) general government debt. Local governments' debt accounts for the remaining 4%. In 2020, it came to CZK 87 billion, and this year we estimate it to rise to CZK 92 billion before essentially stagnating due to the predicted surpluses. Social security funds have long reported a negligible debt ratio. In the case of health insurance companies, we forecast that their financial management will either be balanced or only slightly in the red.

Graph 3.1: Government Balance by Sub-sectors
in % of GDP



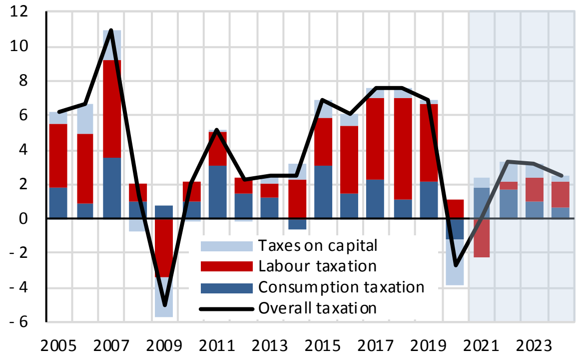
Source: CZSO (2021b). MF CR calculations and forecast.

Graph 3.2: One-off Measures
in % of GDP



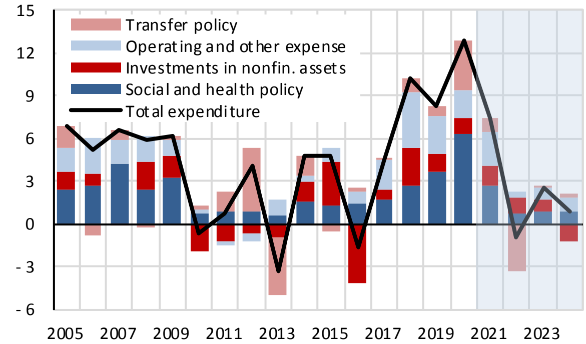
Source: CZSO (2021a), MF CR (2021a). MF CR calculations.

Graph 3.3: General Government Tax Revenue
growth in %, contributions in percentage points



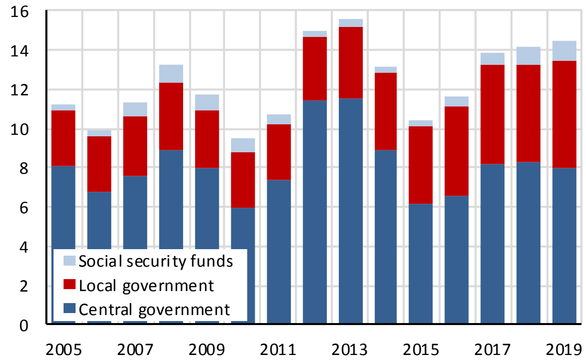
Source: CZSO (2021a, 2021b). MF CR calculations and forecast.

Graph 3.4: General Government Expenditure
growth in %, contributions in percentage points



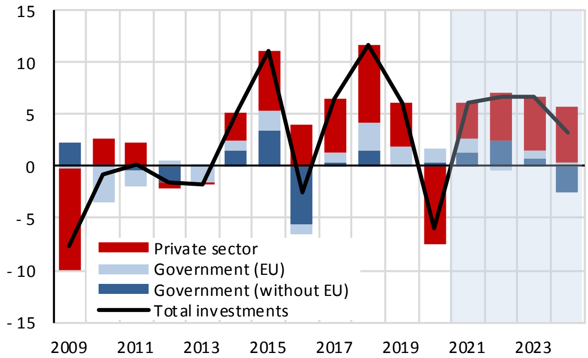
Source: CZSO (2021a, 2021b). MF CR calculations and forecast.

Graph 3.5: Liquid Financial Assets
in % of GDP, non-consolidated values



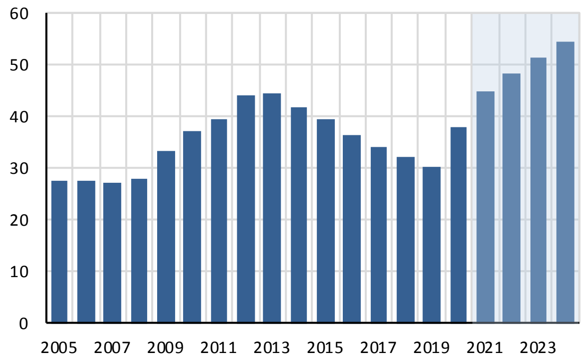
Source: CZSO (2021a, 2021b). MF CR calculations.

Graph 3.6: Investment Co-financing from EU Funds
nominal gross fixed capital formation growth in %, contributions in pp



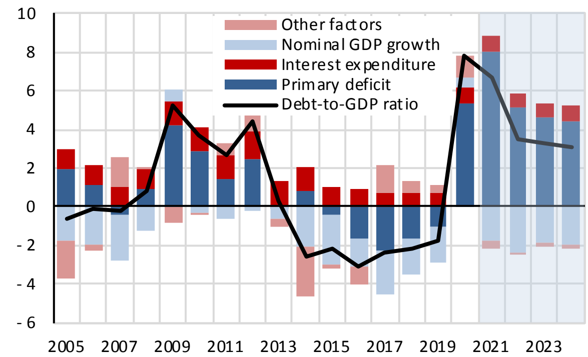
Source: CZSO (2021a), MF CR (2021a). MF CR calculations and forecast.

Graph 3.7: General Government Debt
in % of GDP



Source: CZSO (2021a, 2021b). MF CR calculations and forecast.

Graph 3.8: Changes in Debt-to-GDP Ratio
in percentage points



Source: CZSO (2021a, 2021b). MF CR calculations and forecast.

Table 3.1: General Government Budgetary Prospects
level in CZK billion, others in % of GDP

	ESA Code	2020	2020	2021	2022	2023	2024
		Level	*In % of GDP*				
Net lending (+)/borrowing (-) (B.9) by sub-sectors							
General government	S.13	**-348**	**-6.2**	**-8.8**	**-5.9**	**-5.4**	**-5.2**
Central government	S.1311	-361	-6.4	-8.7	-6.0	-5.5	-5.4
State government	S.1312	-	-	-	-	-	-
Local government	S.1313	15	0.3	0.0	0.1	0.1	0.1
Social security funds	S.1314	-2	0.0	-0.1	0.0	0.0	0.0
General government (S.13)							
Total revenue	TR	**2337**	**41.3**	**39.8**	**39.8**	**39.7**	**38.4**
Total expenditure	TE	**2685**	**47.5**	**48.6**	**45.7**	**45.1**	**43.7**
Net lending (+)/borrowing (-)	B.9	**-348**	**-6.2**	**-8.8**	**-5.9**	**-5.4**	**-5.2**
Interest expenditure	D.41	43	0.8	0.8	0.8	0.8	0.8
Primary balance		-305	-5.4	-8.0	-5.1	-4.6	-4.4
One-off and other temporary measures		**-130**	**-2.3**	**-1.8**	**0.0**	**0.0**	**0.0**
Components of revenues							
Total taxes		**1108**	**19.6**	**17.8**	**17.6**	**17.6**	**17.3**
Taxes on production and imports	D.2	651	11.5	11.6	11.6	11.5	11.2
Current taxes on income, wealth etc.	D.5	457	8.1	6.2	6.1	6.1	6.1
Capital taxes	D.91	0	0.0	0.0	0.0	0.0	0.0
Social security contributions	D.61	**909**	**16.1**	**16.2**	**15.6**	**15.4**	**15.2**
Property income	D.4	**37**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**
Other		**282**	**5.0**	**5.2**	**5.9**	**6.1**	**5.3**
Total revenue	TR	**2337**	**41.3**	**39.8**	**39.8**	**39.7**	**38.4**
p. m.: Tax burden		**2018**	**35.7**	**34.0**	**33.3**	**33.0**	**32.5**
Components of expenditures							
Compensation of employees + Intermediate consumption	D.1+P.2	**979**	**17.3**	**17.5**	**16.9**	**16.6**	**16.3**
Compensation of employees	D.1	633	11.2	11.2	10.9	10.6	10.4
Intermediate consumption	P.2	346	6.1	6.3	6.0	5.9	5.8
Social payments		**1017**	**18.0**	**18.3**	**17.8**	**17.5**	**17.2**
of which: Unemployment benefits [1)]		29	0.5	0.4	0.3	0.3	0.3
Social transfers in kind supplied via market producers	D.632	196	3.5	3.7	3.5	3.4	3.4
Social transfers other than in kind	D.62	821	14.5	14.7	14.3	14.1	13.8
Interest expenditure	D.41	**43**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**
Subsidies	D.3	**173**	**3.1**	**2.9**	**2.1**	**2.0**	**2.0**
Gross fixed capital formation	P.51g	**277**	**4.9**	**5.3**	**5.5**	**5.7**	**4.9**
Capital transfers	D.9	**63**	**1.1**	**1.6**	**0.6**	**0.5**	**0.5**
Other		**132**	**2.3**	**2.2**	**2.1**	**2.0**	**2.0**
Total expenditures	TE	**2685**	**47.5**	**48.6**	**45.7**	**45.1**	**43.7**
p. m.: Government consumption (nominal)	P.3	**1232**	**21.8**	**22.2**	**21.6**	**21.2**	**21.0**

1) Includes cash benefits (D.621 and D.624) and transfers in kind (D.631) related to unemployment benefits.
Source: CZSO (2021b). MF CR calculations and forecast.

Table 3.2: Amounts to Be Excluded from the Expenditure Benchmark
level in CZK billion, others in % of GDP

	2020	2020	2021	2022	2023	2024
	Level			*In % of GDP*		
Expenditure on EU programmes fully matched by EU funds revenue	**65**	**1.2**	**1.4**	**1.4**	**1.5**	**0.8**
Non-investment expenditure	16	0.3	0.3	0.4	0.3	0.2
Investment expenditure	49	0.9	1.1	1.1	1.2	0.6
Cyclical unemployment benefit expenditure	**17**	**0.3**	**-0.1**	**0.0**	**0.0**	**0.0**
Effect of discretionary revenue measures (year-on-year changes)	**-41**	**-0.7**	**-1.2**	**0.2**	**0.2**	**0.0**
Revenue increases mandated by law	**-**	**-**	**-**	**-**	**-**	**-**

Note: Revenue increases mandated by law can be defined as revenue increases that occur automatically to offset corresponding increases in specified expenditures (such as an automatic increase of social security contributions in reaction to a surge in social security expenditure).
Source: MF CR.

Table 3.3: A Structure of Approved Discretionary Measures in 2021–2024
year-on-year discretional change, in CZK billion

	2020	2021	2022	2023	2024
Revenue Discretioanry Measures	**-41.0**	**-73.6**	**14.1**	**10.7**	**-2.4**
Personal income tax	2.6	-98.1	-10.3	-	-
Corporate income tax	-9.9	-6.8	11.0	7.9	-2.2
Social security contributions	-20.9	30.6	11.1	-	-
Value added tax	-4.4	-4.7	-0.6	0.7	-
Excise duties	-3.5	0.7	4.1	2.4	-
Other revenue measures	-4.9	4.6	-1.2	-0.3	-0.2
Expenditure Discretionary Measures	**-218.3**	**-38.4**	**118.4**	**-**	**-**
Cash social benefits	-50.0	21.7	-4.1	-	-
Compensation of employees	-36.1	-12.5	-1.8	-	-
Health care	-53.5	-19.2	15.8	-	-
Subsidies	-44.0	-9.8	55.4	-	-
Capital transfers	-27.8	-24.6	52.3	-	-
Other expenditure measures	-6.9	6.0	0.9	-	-
Total	**-259.3**	**-112.1**	**132.6**	**10.7**	**-2.4**
% of GDP	-4.6	-1.9	2.1	0.2	-0.0

Source: MF CR calculations and forecast.

Table 3.4: Comparison of the Convergence Programme Forecast Scenario and Alternative Scenario
in % of GDP

	2021	2022	2023	2024
Total revenue - CP scenario	**39.8**	**39.8**	**39.7**	**38.4**
Total revenue - alternative scenario	39.8	39.8	40.4	39.4
Impact of alternative scenario assumptions	-	-	0.8	1.0
Total expenditure - CP scenario	**48.6**	**45.7**	**45.1**	**43.7**
Total expenditure- alternative scenario	48.6	45.7	45.0	43.6
Impact of alternative scenario assumptions	-	-	-0.0	-0.0
General government balance - CP scenario	**-8.8**	**-5.9**	**-5.4**	**-5.2**
General government balance - alternative scenario	-8.8	-5.9	-4.6	-4.2
Impact of alternative scenario assumptions	-	-	0.8	1.1
General government debt - CP scenario	**44.8**	**48.2**	**51.5**	**54.6**
General government debt - alternative scenario	44.8	48.2	50.7	52.8
Impact of alternative scenario assumptions	-	-	-0.8	-1.8

Source: MF CR calculations and forecast.

Table 3.5: Cyclical Developments

growth in %, output gap in % of potential GDP, contributions in percentage points, other in % of GDP

	ESA Code	2020	2021	2022	2023	2024
Real GDP growth (%)		**-5.6**	**3.1**	**3.7**	**1.9**	**2.1**
Net lending of general government	B.9	**-6.2**	**-8.8**	**-5.9**	**-5.4**	**-5.2**
Interest expenditure	D.41	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**
One-off and other temporary measures		**-2.3**	**-1.8**	**0.0**	**0.0**	**0.0**
One-offs on the revenue side		-0.7	-0.1	0.0	0.0	0.0
One-offs on the expenditure side		1.6	1.7	0.0	0.0	0.0
Potential GDP growth (%)		**1.1**	**1.3**	**1.9**	**2.0**	**2.1**
contribution of labour		-0.5	-0.2	0.0	0.0	0.0
contribution of capital		0.7	0.4	0.5	0.6	0.6
total factor productivity		1.0	1.1	1.3	1.4	1.4
Output gap		**-3.1**	**-1.4**	**0.4**	**0.5**	**0.3**
Cyclical budgetary component		**-1.1**	**-0.4**	**0.1**	**0.2**	**0.1**
Cyclically-adjusted balance		**-5.0**	**-8.3**	**-6.0**	**-5.5**	**-5.3**
Cyclically-adjusted primary balance		**-4.3**	**-7.6**	**-5.3**	**-4.8**	**-4.5**
Structural balance		**-2.7**	**-6.5**	**-6.0**	**-5.5**	**-5.3**

Source: CZSO (2021b). MF CR calculations and forecast.

Table 3.6: General Government Debt by Sub-sectors

in % of GDP

	ESA Code	2019	2020	2021	2022	2023	2024
General government	S.13	**30.3**	**38.1**	**44.8**	**48.2**	**51.5**	**54.6**
Central government	S.1311	31.2	39.4	45.9	49.3	52.5	55.6
Local government	S.1313	1.5	1.5	1.6	1.5	1.4	1.4
Social security funds	S.1314	0.0	0.0	0.0	0.0	0.0	0.0
Net financial debt [1]		16.2	21.7	29.5	33.9	38.0	41.8
Public sector institutions debt according to Act No. 23/2017 Coll., art. 13 [2]		**30.3**	**38.1**	**44.8**	**48.2**	**51.5**	**54.6**

1) Net financial debt is the difference between gross debt and liquid financial assets (monetary gold, Special Drawing Rights, currency and deposits, securities other than shares (consolidated at market value), shares and other equity quoted in stock exchange).

2) Public sector institutions debt according to Act No. 23/2017 Coll. is defined as the difference between the general government debt and disposable cash reserves created according to Act No. 218/2000 Coll.

Source: CZSO (2021b). MF CR calculations and forecast.

Table 3.7: General Government Debt Developments

in % of GDP, average maturity in years, contributions in % of debt

	ESA Code	2020	2021	2022	2023	2024
General government gross debt		**38.1**	**44.8**	**48.2**	**51.5**	**54.6**
Change in gross debt ratio		**7.8**	**6.7**	**3.5**	**3.3**	**3.0**
Contributions to changes in gross debt						
Primary balance		**-5.4**	**-8.0**	**-5.1**	**-4.6**	**-4.4**
Interest expenditure	D.41	**-0.8**	**-0.8**	**-0.8**	**-0.8**	**-0.8**
Stock-flow adjustment		**1.2**	**-0.3**	**-0.1**	**-0.2**	**-0.2**
Difference between cash and accruals		-0.8	0.0	0.0	0.0	0.0
Net accumulation of financial assets		1.8	-0.3	-0.1	-0.2	-0.2
Privatisation proceeds		0.0	0.0	0.0	0.0	0.0
Valuation effects and other		0.2	0.0	0.0	0.0	0.0
p. m.: Implicit interest rate on debt		**-2.5**	**-2.0**	**-1.7**	**-1.6**	**-1.6**
Liquid financial assets		**16.3**	**15.2**	**14.3**	**13.5**	**12.8**
Net financial debt [1]		**21.7**	**29.5**	**33.9**	**38.0**	**41.8**
Debt amortization (existing bonds) since the end of the previous year [2]		**3.3**	**3.3**	**3.3**	**3.1**	**3.3**
Foreign-currency exposition of the state debt [2, 3]		**3.2**	**3.1**	**2.9**	**2.8**	**2.7**
Average maturity [2]		**6.2**	**6.6**	**6.5**	**6.5**	**6.5**

1) Difference between gross debt and liquid financial assets (monetary gold, Special Drawing Rights, currency and deposits, market value of securities other than shares, shares and other equity quoted in stock exchange).

2) Figures only for the state debt. The state debt represents a debt generated by the state budget financing.

3) The debt in foreign currency, exposed to exchange rate movement after adjustment for the foreign-currency exposure of state financial assets.

Source: CZSO (2021b). State debt data, calculations and forecast of MF CR.

Table 3.8: The State Debt's Refinancing, Interest and Debt Denominated in Foreign Currency
in % of debt, average maturity in years, data in the national methodology

		2020	2021	2022	2023	2024
Refinancing						
Average maturity	*years*	**6.2**	**6.6**	**6.5**	**6.5**	**6.5**
Debt due within 1 year	*% of debt*	**10.9**	**8.4**	**7.3**	**7.4**	**7.7**
State Debt's Interest						
Debt with interest fixation within 1 year	*% of debt*	**21.2**	**22.2**	**19.6**	**21.6**	**23.5**
Fixed interest long-term debt due within 1 year	*% of debt*	8.2	8.3	3.7	7.4	7.5
Variable interest long-term debt	*% of debt*	10.7	14.1	16.1	14.2	16.0
Monetary instruments	*% of debt*	1.2	0.0	0.0	0.0	0.0
Effect of derivative operations	*% of debt*	0.9	-0.2	-0.2	0.0	0.0
Foreign Currency Exposition						
Foreign-currency exposition of the state debt[1)]	*% of debt*	**8.9**	**7.2**	**6.5**	**5.9**	**5.9**
EUR exposition	*% of debt*	8.0	6.5	5.8	5.3	5.3

1) State debt denominated in foreign currencies adjusted for collateral and assets.
Source: MF CR.

4 Comparison with the Previous Convergence Programme and Sensitivity Analysis

The comparison of this year's and last year's CPs focuses only on assessing the forecast for 2020 and the change in the forecast for 2021. Due to extreme uncertainties, last year's CP contained a horizon only until 2021.

Sensitivity analyses of the macroeconomic and fiscal forecasts, including their outlook, are based on changes in the underlying assumptions. The first scenario contemplates lower economic growth in the EU and its effects on the highly open Czech economy. The second scenario assesses sensitivity to a possible sudden hike in interest rates, while the last one reacts to the uncertainty surrounding future developments in the oil price, or an external price shock.

4.1 Comparison with the Scenario of the Previous Convergence Programme of the Czech Republic

4.1.1 Macroeconomic Scenario

The starting points of the scenarios for the CP 2020 and 2021 are very different. Last year's CP macroeconomic scenario was based on the assumption that the impact of the coronavirus pandemic, or measures taken to prevent the spread of the disease, would be limited to the first half of 2020. It is now clear that the restrictive measures will continue to hamper the economy in some respects in the first half of 2021.

Despite the turbulent and extremely volatile economic developments in the external environment, the assumptions of the two scenarios show virtually no major qualitative differences. Perhaps the only thing worth mentioning is the higher expected dollar prices of mineral fuels, though the impact on the Czech economy should be muted by the weaker exchange rate of the USD (see subchapter 2.1).

The scenario for the growth prospects of the Czech Republic remains unchanged. The Czech economy proved that it was able to adapt relatively well to the worse epidemic conditions, especially in the segment of export companies. This underpins the similar estimate of how the output gap will develop. However, differences between the scenarios can be seen in the different development of the individual components of GDP (see subchapter 2.2.1).

This year's price trajectory (see subchapter 2.2.3) markedly reflects the diverging oil price assumptions. As regards labour market developments, despite certain quantitative differences compared to the CP 2020 scenario, the main trends – a decline in employment, an increase in the unemployment rate, and a slowdown in earnings growth – remain unchanged (see subchapter 2.2.4).

4.1.2 Fiscal Scenario

Although the total economic downturn last year was same as in the April 2020 forecast, components of real growth and income structure differed. The cause was the intensity and development of the epidemic throughout the year, on which the public finances reacted not only in health care but also with a set of support and stabilisation programmes.

Last year's CP projected a 3.8% drop in tax revenues, including social security contributions. They actually decreased by 2.7%, because of higher-than-predicted revenue of income taxes overcame worse result of taxes on consumption and social security contributions. In terms of corporate income tax, the Czech economy proved more resilient and businesses reported lower losses than expected. In the case of personal income tax, the primary factor is the classification of the compensation bonus as an expenditure capital transfer. The value-added tax revenue was lowered by more marked decrease in household consumption, while excise duties suffered from longer-lasting restrictive measures and tourism restrictions. As for social security contributions, additional measures, especially the Antivirus C Programme, played a role. Regarding non-tax revenues, property income fared better than predicted.

With expenditure in 2020, the situation is reversed. The CP 2020 predicted expenditure growth of 9.6%, while the actual figure was 12.9%. Consumption in the general government sector was up by almost 3 pp, with a counteracting effect between higher growth in the compensation of employees (mainly due to the epidemic-related remuneration of workers in the health care sector, social services or armed forces) or social transfers in kind and a decline in intermediate consumption as a result of the closure of a number of institutions or home office, etc. Mainly due to higher actual investment of the central government, strong investment growth continued. One-off allowance for all pensioners in December 2020 and higher actual expenditure on the parental allowance were reflected in cash social benefits. In contrast, debt service expenditure grew at a lower rate. For subsidies and transfers, there were additional measures linked to the epidemic and some originally revenue measures reclassified.

For 2021, notwithstanding identical economic growth in both CPs, the fundamentals differ substantially. On the revenue side, tax revenue, including social security contributions, were forecasted to grow by 7.2% last year. Conversely, CP 2021 estimates year-on-year stagnation. Besides the different development of the epidemic situation, the most significant change is the adjustment to the effective tax rate for personal income, but also corporate income taxation. Excises forecasts also differ. Turning to expenditure, we assume that growth will be almost double that set out in CP 2020 due to the continuing epidemic and new discretionary measures. We are also forecasting higher investment this year than in 2020. Naturally, the year-on-year dynamics are different for all items also due to changes in the 2020 base.

4.2 Sensitivity Analysis

The sensitivity analysis is calculated using the MF CR's dynamic stochastic general equilibrium model. In the analysis, we assume different developments from the CP's baseline scenario described in chapters 2 and 3, always starting with the first quarter of 2022.

4.2.1 Lower GDP Growth in the EU in 2022

Economic developments of EU trading partners are a pivotal factor for the economic growth of the Czech Republic's small open economy. The first scenario therefore assumes slower GDP growth in the EU by 2 pp in 2022, in line with the standard deviation of EU GDP development from 2002 to 2020.

Initially, the decline of foreign demand for domestic products would negatively affect net exports. However, subsequent pressure on currency depreciation would cushion the negative effect on net exports by making imports more expensive. A worse foreign trade balance would slow the growth of the Czech economy by 0.6 pp in 2022 compared to the baseline scenario. Lower growth in corporate profits due to weaker exports would see investment growth decelerate by 0.1 pp. The lower output of firms would also have a negative impact on labour demand and, subsequently, lead to nominal wage growth. A negative income effect in the form of relatively lower wages and returns on capital would slow down household consumption by 0.1 pp.

The slowdown in aggregate demand growth would lessen tax revenue, resulting in a reduction in the general government balance by 0.1 pp, with a consequent faster increase in the general government debt relative to GDP.

4.2.2 Rise in the National Interest Rate

The dynamic model in this scenario simulates the additional tightening of monetary policy in 2022 by 1.2 pp above the baseline scenario. A value of 1.2 pp is consistent with the standard deviation of developments in the short-term interest rate in the period from 2002 to 2020.

A more restrictive monetary policy would lead to the pressure on the CZK appreciation, which would increase the price of exports, while imported goods would become relatively cheaper. On the other hand, sizeable import intensity of exports would, with exports declining, exert downward pressure on imports. Lower income and a decline in the corporate profits in a period of slowing economic growth would have a similar effect. The result would be a decline in import growth by 0.2 pp compared to the baseline scenario.

Lower household incomes due to lower wage growth would also affect consumption adversely. In addition, a higher interest rate could motivate to postponement of consumption. As a result, restrictive monetary policy would lead to a slowdown in household consumption growth by 0.1 pp.

The decline in both foreign and domestic demand would hamper businesses' profitability. They would respond to the drop in profits and the increase in the cost of borrowing by cutting investment growth by approximately 0.1 pp. A slowdown in aggregate demand would also increase the unemployment rate by 0.3 pp compared to the baseline scenario. This in turn would foster the reduction of the wage growth.

Due to the negative impact of higher interest rates on investments, consumption and exports, the resulting effect on GDP growth would also be negative by 0.2 pp. Slowdown in economic growth would lead to disinflationary pressures of 0.1 pp.

A slackening in economic expansion as a result of lower household income and corporate profits would reduce tax revenue. This would lead to decrease in the general government balance and push up the interest expenditure of debt servicing, which in turn would hasten the growth of the debt-to-GDP ratio.

4.2.3 Higher Oil Prices

The alternative scenario for oil prices is based on the assumption that the average price in 2022 will be 50% higher than in the baseline scenario (USD 89.9/bbl versus USD 59.9/bbl). Higher oil prices would be reflected in higher import prices and more expensive inputs. Companies facing higher energy costs would consequently increase the prices of their final products. Inflation would thus increase by about 1.0 pp. Higher prices would lessen real household consumption growth by up to 0.5 pp.

Declining aggregate demand would adversely affect domestic production. Companies would also become less profitable due to increased energy costs and lower export opportunities. There would also be a downturn in investment activity. The rate of investment growth would decrease by 0.3 pp. Another effect of contracted production activity would be lower labour demand and a slight increase in the unemployment rate. Overall, higher oil prices would slow down real GDP growth by 0.3 pp and lower tax revenue would impair the general government balance. The effect on expenditure would be negligible.

4.3 Verification of the Macroeconomic Scenario by the Committee on Budgetary Forecasts

The macroeconomic scenario and the general government revenue forecast were assessed, in accordance with Act No. 23/2017 Coll., by the Committee on Budgetary Forecasts on 20 April 2021. The judgement of the baseline scenario of the Convergence Programme is conducted in terms of probability of its materialisation. Both, the macroeconomic forecast and fiscal forecast of general government revenue were assessed as realistic.

Table 4.1: Change in the Indicators of the Scenario

		April 2020 CP		April 2021 CP	
		2020	2021	2020	2021
External Assumptions					
GDP growth in EU	*%*	**-5.5**	**2.8**	**-6.3**	**3.6**
Prices of oil (Brent)	*USD/barrel*	**37.9**	**39.8**	**41.8**	**63.8**
Exchange rate USD/EUR	*USD/EUR*	**1.10**	**1.09**	**1.14**	**1.21**
Exchange rate CZK/EUR	*CZK/EUR*	**26.5**	**26.2**	**26.4**	**25.9**
Real Values					
GDP	*change in %*	**-5.6**	**3.1**	**-5.6**	**3.1**
Households consumption	*change in %*	-1.5	0.8	-5.2	0.1
Government consumption	*change in %*	2.6	2.0	3.5	3.4
Gross fixed capital formation	*change in %*	-13.6	3.2	-8.1	3.8
Contribution of final domestic demand	*p.p.*	-3.6	1.6	-3.9	1.8
Contribution of foreign trade	*p.p.*	-1.2	0.7	-0.3	0.4
Output gap	*%*	**-3.3**	**-1.4**	**-3.1**	**-1.4**
Others					
Nominal GDP	*CZK bn.*	**5530**	**5781**	**5652**	**5932**
Harmonised index of consumer prices	*change in %*	**3.2**	**1.5**	**3.3**	**2.4**
GDP deflator	*change in %*	**3.7**	**1.4**	**4.2**	**1.8**
Employment	*change in %*	**-1.7**	**-0.2**	**-1.5**	**-1.1**
Unemployment rate	*%*	**3.3**	**3.5**	**2.6**	**3.6**
Wages and salaries	*change in %*	**2.6**	**0.8**	**0.0**	**0.7**
Balance of goods and services	*% of GDP*	**5.9**	**6.0**	**6.9**	**6.6**
Net lending/borrowing	*% of GDP*	**1.7**	**1.8**	**3.0**	**0.9**
General Government					
General government revenue	*% of GDP*	**41.8**	**42.5**	**41.3**	**39.8**
Taxes on production and imports	*change in %*	-2.2	5.9	-5.4	5.9
Current taxes on income, wealth etc.	*change in %*	-17.7	11.3	-6.7	-19.7
Social security contributions	*change in %*	2.6	6.4	1.6	5.9
General government expenditure	*% of GDP*	**46.9**	**46.6**	**47.5**	**48.6**
Compensation of employees	*change in %*	6.4	5.0	10.0	5.1
Intermediate consumption	*change in %*	6.2	5.6	1.9	8.4
Social transfers in kind	*change in %*	7.0	5.0	10.6	11.0
Social transfers other than in kind	*change in %*	11.9	8.4	15.9	6.1
Gross fixed capital formation	*change in %*	-1.2	7.2	9.8	13.5
General government balance	*% of GDP*	**-5.1**	**-4.1**	**-6.2**	**-8.8**
General government debt	*% of GDP*	**37.0**	**40.0**	**38.1**	**44.8**

Source: CNB (2021a), CZSO (2021a), EIA (2021), Eurostat (2021), MF CR (2020a).

Table 4.2: Basic Macroeconomic Indicators – Sensitivity Scenarios

		2021	2022	2023	2024
Baseline Scenario					
Gross domestic product	*Y-o-Y in %*	**3.1**	**3.7**	**1.9**	**2.1**
Private consumption	*Y-o-Y in %*	0.1	5.7	1.8	2.2
Gross fixed capital formation	*Y-o-Y in %*	3.8	4.5	4.6	1.2
Exports of goods and services	*Y-o-Y in %*	5.0	5.7	3.8	3.7
Imports of goods and services	*Y-o-Y in %*	4.9	6.6	4.7	3.4
Harmonised index of consumer prices	*Y-o-Y in %*	**2.4**	**2.3**	**2.1**	**1.9**
Unemployment rate	*in %*	**3.6**	**3.7**	**3.5**	**3.5**
General government balance	*% of GDP*	**-8.8**	**-5.9**	**-5.4**	**-5.2**
Gross government debt	*% of GDP*	**44.8**	**48.2**	**51.5**	**54.6**
Alternative Scenario I - Lower GDP Growth in EU in 2022					
Gross domestic product	*Y-o-Y in %*	**3.1**	**3.1**	**1.8**	**2.0**
Private consumption	*Y-o-Y in %*	0.1	5.6	1.7	2.1
Gross fixed capital formation	*Y-o-Y in %*	3.8	4.4	4.5	1.2
Exports of goods and services	*Y-o-Y in %*	5.0	4.0	3.4	3.6
Imports of goods and services	*Y-o-Y in %*	4.9	5.6	4.3	3.3
Harmonised index of consumer prices	*Y-o-Y in %*	**2.4**	**2.2**	**1.9**	**1.8**
Unemployment rate	*in %*	**3.6**	**4.1**	**3.7**	**3.5**
General government balance	*% of GDP*	**-8.8**	**-6.0**	**-5.5**	**-5.3**
Gross government debt	*% of GDP*	**44.8**	**48.3**	**51.7**	**54.8**
Alternative Scenario II - Higher Interest Rates					
Gross domestic product	*Y-o-Y in %*	**3.1**	**3.5**	**1.8**	**2.0**
Private consumption	*Y-o-Y in %*	0.1	5.6	1.6	2.0
Gross fixed capital formation	*Y-o-Y in %*	3.8	4.4	4.4	1.1
Exports of goods and services	*Y-o-Y in %*	5.0	5.5	3.6	3.6
Imports of goods and services	*Y-o-Y in %*	4.9	6.5	4.5	3.2
Harmonised index of consumer prices	*Y-o-Y in %*	**2.4**	**2.2**	**1.9**	**1.8**
Unemployment rate	*in %*	**3.6**	**4.0**	**3.8**	**3.4**
General government balance	*% of GDP*	**-8.8**	**-6.1**	**-5.6**	**-5.3**
Gross government debt	*% of GDP*	**44.8**	**48.4**	**52.0**	**55.1**
Alternative Scenario III - Higher Oil Prices					
Gross domestic product	*Y-o-Y in %*	**3.1**	**3.4**	**1.6**	**1.8**
Private consumption	*Y-o-Y in %*	0.1	5.2	1.6	2.0
Gross fixed capital formation	*Y-o-Y in %*	3.8	4.2	4.0	0.7
Exports of goods and services	*Y-o-Y in %*	5.0	5.4	3.4	3.4
Imports of goods and services	*Y-o-Y in %*	4.9	6.3	4.3	3.0
Harmonised index of consumer prices	*Y-o-Y in %*	**2.4**	**3.3**	**2.6**	**2.2**
Unemployment rate	*in %*	**3.6**	**3.7**	**3.6**	**3.5**
General government balance	*% of GDP*	**-8.8**	**-6.0**	**-5.6**	**-5.4**
Gross government debt	*% of GDP*	**44.8**	**48.3**	**51.8**	**55.0**

Note: Different values in the text and in the table are caused by the rounding of values to one decimal place.
Source: CZSO (2021a), EIA (2021), Eurostat (2021), MF CR calculations and forecast.

5 Sustainability of Public Finance

Long-term sustainability is a frequently discussed issue in relation to Czech public finances. The greatest risk is posed by demographics projection, as the number of people of retirement age relative to the working-age population will evidently increase significantly in the next few decades. In fact, population ageing is not a matter for the distant future; it is already happening. This puts pressure on public finances and hence the need to reform social systems. The Organisation for Economic Cooperation and Development carried out an independent pension review which assessed the current situation and offered a number of recommendations to achieve greater simplicity, cover the population in the future, change the structure, and ensure financial sustainability. However, population ageing is a phenomenon not only related to old-age pensions, but also to other parts of public finances, such as health care, long-term care and education.

5.1 Government Strategy and Implemented Reforms

5.1.1 Current State of the Public Pension System

The pay-as-you-go pension system regulated by Act No. 155/1995 Coll. has undergone many changes since its inception. These have mainly concerned the retirement age, the calculation of pensions, and the method or amount of indexation. The pension calculation system draws on insured individuals' previous earnings, adjusted using reduction thresholds. The amount of income relevant to the calculation of pensions is included in full up to 44% of the average wage. From 45% to 400% of the average wage, only 26% of that income is counted. Income above 400% of the average wage does not affect the basis of assessment for the pension calculation; this is fully in line with the social insurance contribution cap of the same amount.

The latest adjustment to the pension system, concerning the retirement age, has applied with effect since 1 January 2018 (Act No. 203/2017 Coll.). The retirement age of both men and women will be increased until it is unified at 65 years after 2030. The Ministry of Labour and Social Affairs is also required by law to report to the government on the pension system at five-year intervals (the first report was discussed by the government in September 2019). The aim of the reports is to assess the current retirement age and, if appropriate, to propose an adjustment to it so that persons insured under the system can spend, on average, a quarter of their life in retirement. Changes to the retirement age do not apply to persons who are over 55 at the time of the revision. However, the revision mechanism does not impose any obligations on the government. Instead, it only serves as a recommendation for the government to submit a proposal for a change in retirement age to the Czech Parliament for approval. The government has taken advantage of this rule by deciding to leave the retirement age as it is for the time being. The statutory retirement age also affects the conditions pertaining to permanent widow and widower pensions, as the age limit here is tied to old-age pensions. For early retirement, the threshold is gradually shifting from three to five years before the statutory retirement age. This maximum period of five years may, at the cost of significant penalties, be used by those whose statutory retirement age is at least 65 years.

Early retirement entails several penalty rates, which progressively reduce the resulting benefit throughout the period over which the pension is collected. Up to 360 days before the statutory retirement age is reached, a reduction of 0.9% applies to the basis of calculation; for the period from 361 to 720 days before reaching the retirement age, the reduction is 1.2%; finally, for periods exceeding 720 days (up to the limit permitted by law), the reduction is 1.5%. The variable amount of the old-age pension is then reduced by these amounts for every 90 days inclusive.

In addition, there is a pre-retirement scheme that allows those participating in supplementary pension savings (Pillar III) to draw their funds without penalty up to five years before reaching the statutory retirement age. However, a condition of pre-retirement is that funds accumulated under the private Pillar III must ensure a monthly pension of at least 30% of the average wage. The old-age pension is not reduced for those years in which pre-retirement is used. By the end of 2020, the possibility of drawing pre-retirement had only been used by 4,825 persons with an average benefit of CZK 10,911.

As for disability pensions, there are three groups in the Czech Republic, classified according to the degree of disability. A disability pension can be awarded to someone whose work capacity has decreased by at least 35% due to long-term adverse health conditions. The first degree of disability applies to a decline in capacity from 35% to 49%, the second degree from 50% to 69%, and the third degree from 70%.

The indexation of pensions paid out of the pay-as-you-go scheme is determined by the sum of the growth of the consumer price index, or the cost of living index of pensioners (whichever is higher), and one half of real wage growth. In addition, there is the possibility for the government to adjust the rate of indexation in periods of low inflation and/or low real wage growth. In this respect, if the increase in the average pension according to the standard indexation formula is less than 2.7%, the government is entitled to issue a regulation for the indexation of pensions up to this value. In other cases, the statutory indexation formula is adhered to strictly. Naturally, this does not exclude the possibility of different indexation by way of a special law. In addition, for persons over particular age, there is an increase in the earnings-related part of pension benefit by a stated amount (by CZK 1,000 per month for persons over 85 years and by a further CZK 1,000 per month for persons over 100).

5.1.2 Development in the Healthcare System

Health insurance companies' balances in bank accounts stood at 0.3% of GDP in 2012–2015. From 2016, this ratio gradually increased to 1% of GDP in 2020. During this period, the resilience of the public health care system to short-term negative shocks therefore increased. Starting in 2021, according to the health insurance plans, the upward trend should reverse and the share of health insurance balances relative to GDP should decrease. This decline is due to the higher growth in health care expenditure in connection with the expected reimbursements associated with COVID-19 epidemic and the high growth of wages and salaries in the health care system. Health insurance plans' dynamics of health care expenditure compared to revenues (mostly in 2021 and 2022) could lead to a decrease in health insurance companies' balances to 0.3% of GDP in 2023.

If so, this development could be a contributory factor jeopardising the medium-term stability of the public health care system. It is thus desirable, after the pandemic is over, hamper the dynamics of the expenditure compared to the revenue growth, not only in the medium term, but especially in the longer term due to population ageing effects on social welfare systems. This makes the risks of the current public health care system significant in terms of the sustainability of financing in the long run. The point at issue is not so only the amount of revenues available but also their structure.

No systemic changes have been made in the area of health care financing resources in recent years, except for ad hoc requirements for additional funds from the state budget. In this context, the assessment base for payments for state-insured persons was increased to CZK 11,607 as of June 2020 and to CZK 13,088 as of 1 January 2021 (Act No. 231/2020 Coll.). Due to these increases the public health care system's resources will be strengthened by a total of 1% of GDP. As a result of the increase in the minimum wage (Government Regulation No. 487/2020 Coll.), the monthly amount of contributions for persons without taxable income also increased to CZK 2,052 as of 1 January 2021. However, the impact of this increase is negligible from the perspective of the system's overall resources.

In the coming years, the health care system in the Czech Republic should develop on the basis of the Strategic Framework for the Development of Health Care in the Czech Republic up to 2030 (Health 2030), which was approved by the government in 2019 (Government Resolution No. 817/2019). Certain priorities were adjusted in response to the health and economic impacts of the COVID-19 pandemic (Government Resolution No. 743/2020). The future development of the health care sector is based on three strategic objectives: protect and improve the health of the population, optimise the health care system, and support of science and research. The objectives encompass seven specific areas (e.g. the reform of primary care, the implementation of integrated care models, the digitalisation of health care, optimisation of the reimbursement system, etc.), and their gradual implementation should lead to greater efficiency, economy and sustainability of the health care system in the context of demographic, economic and social developments.

In primary care, further steps are being taken to strengthen the role of general practitioners as gatekeepers and their involvement in prevention programmes. The reimbursement mechanism for primary care should also be changed, with an emphasis on strengthening the performance service component while keeping to a fixed capitation payment.

The DRG Restart project is being implemented in the acute inpatient care segment as part of the optimisation of the reimbursement system and is newly scheduled to be completed in February 2023. The goal is to create a long-term sustainable data, information and personnel base with a view of optimising the reimbursement system for this segment. The change in the method of reimbursement should make the financing of acute inpatient care more efficient as the system will reflect the real cost of procedures.

In the area of digitalisation of health care system, a draft of Act on eHealth was approved by the government in 2021 (Chamber of Deputies Print No. 1163). The adoption of this Act will create a system based on three core health registers –for health care providers, for health care workers and for patients. These will be interlinked into a one non-public unit that can be used by a legally defined group of persons within a defined scope and purpose. This will ensure accurate, real-time data on health care providers, health care workers and patients. The aim of the gradual introduction of electronic devices of the health care sector is to make the provision of health care services, their reimbursement, and checks in the provision of health care more efficient.

5.2 Fiscal Impacts of Population Ageing

The results of the impacts of population ageing are based on long-term projections drawn up in cooperation with the Ageing Working Group of the Council of the European Union's Economic Policy Committee. The analyses are based on assumptions about demographic developments and a methodologically consistent macroeconomic framework for EU countries, the UK and Norway (European Commission, 2020). Therefore, these projections do not reflect the current medium-term macroeconomic and fiscal outlook of the Czech Republic. The projections are conducted on the constant-policy assumption. As such, they shed light on the system legally enshrined at the time of the projection, taking into account current practices, if discretion is allowed in the given legal order. Long-term analyses aim not to predict specific values, but to point out trends and dynamics in the long run. The long-term projections were last updated in autumn 2020 in connection with the preparations for the 2021 Ageing Report and cover the period up to 2070.

Eurostat population projections (European Commission, 2020) underpin the latest results of long-term projections. The previous Eurostat projection (European Commission, 2017a) and the mid scenario of the Czech Statistical Office's current projection (CZSO, 2018) can be used for comparison. The latter was used to assess the relationship between the current retirement age and life expectancy. It was also the basis for the OECD (2020b). The Czech Statistical Office updates its demographic projections once every five years, i.e. the next one will be published at the end of 2023.

A basic comparison of these demographic projections shows that, in the long term, a decrease in the Czech population can be expected. Relatively speaking, the most optimistic projection is that of the Czech Statistical Office, and the most recent Eurostat projection has now come closer to that (see Graph 5.2). The difference between the two scenarios stems almost entirely from a different net migration. While the Czech Statistical Office projects a constant net influx of 26,000 persons per year over time, Eurostat's update foresees a gradual decline from the current approximately 24,000 to around 8,000 persons per year.

However, the population structure is particularly important for projections of expenditure within the social and health care systems. The dependency ratio, measured as the ratio of the number of persons over 65 years of age to the number of persons of working age (15–64 years), is developing along very similar lines when viewed from the perspective of individual projections. It should almost double by 2060 to reach around 55% (see Graph 5.3).

Naturally, this can be attributed not only to a decline in the number of working-age individuals, but also to an increase in average life expectancy. The share of persons aged 85 and over in the number of persons aged 65 and over is expected to more than double at the projection horizon. In subsequent decades of projections, there should only be a temporary reduction in the dependency ratio. The main reason for strong growth after 2035 and a peak in the period between 2045 and 2060 is the demographic bulge of those born in the 1970s. After 2060, their influence should weaken, but in the subsequent period the dependency ratio will be influenced by the fact that there is currently a strong birth rate.

The economic activity rates for age cohorts over 54 years are projected to increase until 2030 as the statutory retirement age goes up. However, they remain more or less constant after 2030, reflecting the current institutional set-up of the pension system. Although the revision mechanism is part of the pension system, it does not impose any obligations on the government. Instead, it only serves as a recommendation for the government to submit a proposal for a change in retirement age to the Czech Parliament for approval. Consequently, the European Commission refused the application of the revision mechanism in long-term projections. The projection therefore works with a retirement age that has a fixed ceiling of 65 years from 2030 onwards.

Developments in pension expenditure relative to GDP were quite favourable in the pre-crisis period, mainly due to the macroeconomic environment. The initial value of expenditure in past projections was 9.0% of GDP in 2013, while in 2019 pension expenditure was 1.0 pp lower. On the other hand, the revenue side of the system has risen dynamically on the back of the higher growth in wages and salaries, employment and the participation rate. This positively influenced the system's balance, which in 2019 (the base year of the projections) came to 0.3% of GDP (Ministry of Finance, 2021b).

The trend in pension expenditure projection is primarily determined by demographics and the retirement age. However, the current situation, in view of the sizeable economic downturn, also plays a significant role in the medium term. These assumptions imply that pension spending as a share of GDP will rise to 9.5% in 2020 and then gradually fall below 9% by 2030. After 2030, however, the rise in the retirement age will stop and those born in the demographic bulge in the 1970s will start retiring. This will quite dramatically increase expenditure to 11.9% of GDP just before 2060, followed by a decline in expenditure to 10.9% of GDP at the end of the 2070 projection horizon (Graph 5.4). The decline in the expenditure-to-GDP ratio is again due to demographic factors, when those born in the demographic trough in the 1990s or later will retire and replace those born during the demographic bulge.

The revenue of the pension system relative to GDP is considered to be constant over the projection horizon. This stems from the assumption that the volume of wages and salaries in the economy should evolve in line with labour productivity over the longer term. Consequently, the share of labour production factor in GDP, from which a constant pension insurance rate of 28% of the gross wage or salary is derived, is kept fixed. This brings the system's revenue to the 2019 baseline level of 8.5% of GDP over the entire horizon.

With revenue in relative terms kept constant, the resulting projection of the pension system balance mirrors the trajectory of pension expenditure (see Graph 5.4). We expect the balance to be relatively stable by 2030, while in the period beyond that the balance will deteriorate and bottom out at −3.2% of GDP around 2060. It will improve again in the final decade, reaching −2.5% of GDP. Compared to the European Commission (2018), the long-term sustainability of the system has deteriorated. The effects of the deterioration in the balance of the pension system can generally be divided into two groups: assumptions (e.g. different demographics) and changes in the pension system (e.g. a different indexation formula and, in particular, the capping of the retirement age). Unlike the situation in previous years, the deterioration in long-term sustainability can be attributed solely to the diverging assumptions. Changes to the system such as the higher-than-statutory indexation in previous years affected the base expenditure levels and were carried over to the next period through indexation of higher values.

The situation in health care and long-term care is similar to previous projections from the perspective of the growth momentum of expenditure. The baseline scenario anticipates an increase of almost one fifth for health care (from a baseline 5.6% of GDP in 2019 to 6.6% of GDP in 2070) and a rise by more than double for long-term care (from 1.5% of GDP in 2019 to 3.2% of GDP in 2070).

The reference scenario differs from the purely demographic scenario in several respects. As far as health care is concerned, there is higher income elasticity, with demand for health services initially rising by 10% faster than the standard of living measured as GDP per capita. Furthermore, in terms of increased life expectancy, half of the gain is expected to be spent in good health (as opposed to any increase in poor health in the baseline scenario). Moreover, the reference scenario for long-term care includes the assumption of higher growth in the compensation of employees in social services as labour productivity in the economy increases (instead of GDP per capita growth, which is lower).

Healthcare expenditure is increased 1.2 pp by demographic effects and another 0.3 pp by higher income elasticity, while the impact of good health in the additional years of life expectancy reduces the increase in expenditure in the reference scenario by 0.6 pp. In the case of long-term care, the impact of demographic trends is quantified at 1.4 pp and the higher compensation of employees an additional 0.3 pp. The effect of the impact of good health in additionally lived years in the projection outweighs the higher income elasticity.

Finally, the last major item of long-term expenditure, education, should grow from 3.4% of GDP in 2019 to 4.1% of GDP in 2070. This is basically the same as in the previous projections and, at the same time, it is the highest increase in the EU as a whole. The increase is due to higher growth in the compensation of employees in education relative to the projected economic growth.

The total increase in expenditure between 2019 and 2070 is more than 6 pp, as shown in Graph 5.7. The increase for health care, long-term care and education, taken together, is 3.3 pp. However, these are just the baseline scenarios. With health care and long-term care in particular, most alternative (sensitivity) scenarios show an increase that, for the most part, is higher. The only exception is scenarios that include the impact of a healthier lifestyle.

5.3 Sustainability Analysis

A sustainability analysis, identifying the extent of any fiscal consolidation to ensure the stability of public finances, builds on the long-term projections. Sustainability indicators are calculated for this purpose. These show how far-reaching measures would be needed to reduce the expenditure ratio or increase the revenue-to-GDP ratio accordingly.

The European Commission regularly publishes three sustainability indicators (European Commission, 2019). In general, the S1 indicator expresses the percentage of GDP by which the primary structural balance of the general government needs to be adjusted so that general government debt in 2030 is 60% of GDP. This indicator for the Czech Republic currently stands at –0.9% of GDP (European Commission, 2021b). That negative value documents that the increase in age-related expenditure up to 2030 is "cancelled out", in particular, by the relatively low general government debt, boosted by the fact that this debt has fallen in recent years.

The S2 indicator determines the degree of fiscal effort required to achieve equality between discounted revenue and expenditure over an infinite horizon. According to the most recent calculations, it is 4.8% of GDP. The value of this indicator is mostly influenced by the cost of ageing, which amounts to 4.6% of GDP; the impact of the initial budgetary position is the remaining 0.2% of GDP.

The S0 indicator indicates potential fiscal or financial risks in the short term. S0 is therefore different in nature from S1 and S2, as it quantifies the level of risk. The Czech

Republic's current S0 value is 0.37, which is in the low-risk zone below the critical threshold of 0.46.

In terms of the long-term sustainability of public finances, the Czech Republic is currently rated as a medium-risk country. In order to return to the low-risk zone, it is necessary to resolve, in particular, future pressure exerted on public finances by demographic changes. This applies to all components of long-term projections, i.e. pensions, health care and long-term care, and education.

5.4 General Government Guarantees

The view of the long-term sustainability of public finances is complemented by the guarantees provided by the general government sector to other entities. These guarantees comprise an increase in general government expenditure when debtors are unable to meet the obligations for which the guarantee was provided. The volume of guarantees provided had been steadily declining in the pre-crisis years. At the end of 2019, they totalled 0.1% of GDP.

The majority share of general government guarantees was taken up by guarantees provided by local governments, amounting to 0.1% of GDP. The most important of these is the guarantee made for Prague Transport Company and relates to deferred payments for the purchase of trams amounting to CZK 4.5 billion. Other guarantees are provided by local governments for loans related to housing needs (CZK 0.3 billion).

State guarantees have been steadily falling mainly because the financing of infrastructure development has not been covered by guarantees since 2001. In 2016, Czechoslovak Trade Bank's rights to activate the guarantee deriving from the takeover of Investment and Post Bank expired. Although only a fraction of the guarantee was paid out (CZK 6.1 billion out of a total of CZK 160 billion), the final court case, with a potential claim exceeding CZK 23 billion, has yet to be concluded. In 2019, a credit facility for a programme to improve the condition of international roads in the Czech Republic, from which more than CZK 0.5 billion was drawn, was repaid.

No new state guarantees were provided in 2019. The last state guarantee was provided in 2018 to secure a CNB loan to the International Monetary Fund from its foreign reserve assets (Act No. 179/2018 Coll.) under a new contract. The promised credit line is up to EUR 1.5 billion, but the amount of the guarantee reported depends on the credit actually drawn. The guarantee has not been drawn yet.

In order to address the crisis inflicted by the pandemic, the government approved the COVID II Guarantee Programme (Government Resolution 260) in March 2020, with indirect support for the affected businesses in the form of state guarantees with a guarantee capacity of CZK 20 billion. The volume of guarantees provided under this guarantee programme came to CZK 11.6 billion. On 20 April 2020, the COVID PRAGUE Programme was announced. It complemented the COVID II Programme and similar terms and conditions applied. The guarantee provided last year under this programme amounted to CZK 1.3 billion.

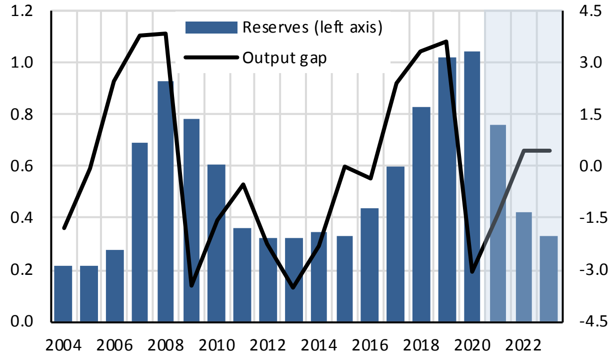
The adoption of Act No. 228/2020 Coll. created leeway for the implementation of the COVID III Guarantee Programme (Government Resolution 553). Support is provided in the form of a guarantee by Czech-Moravian Guarantee and Development Bank to a cooperating bank for its portfolio of final beneficiaries' transactions. The programme guarantees 90% of the principal of a loan up to CZK 50 million for operational or investment financing or 50% for investment credits up to CZK 90 million for businesses with up to 250 employees. For a business with 250 to 500 employees, the programme guarantees 80% of the amount of the operational or investment loan, up to a maximum of CZK 50 million; or 50% for investment loans up to CZK 80 million. The maximum guarantee period is three years (operational loans) or six years (investment loans). In 2020, guarantees amounting to CZK 19.7 billion were provided.

In addition to these programmes, Czech-Moravian Guarantee and Development Bank provides guarantees under the COVID Sport Guarantee scheme (Government Resolution 46) with a maximum three-year guarantee period and the COVID Travel Agency Guarantee scheme for small and medium-sized travel agencies (Government Resolution 51) with a guarantee period of 1.5 years. The total insurance capacity under both programmes is CZK 1.3 billion.

The adoption of Act No. 214/2020 Coll. enabled Export Guarantee and Insurance Corporation – EGAP to expand its portfolio of activities to include the provision of guarantees under the COVID Plus Programme. These guarantees are intended for large businesses that have at least 250 employees and where exports account for at least one fifth of their sales revenue. The amount of the loan ranges from CZK 5 million to CZK 2 billion. The maximum loan amount is 25% of the company's annual turnover. The guarantees cover 90% of the principal amount of the loan, or 80% if EGAP's internal rating is "B-" (the scale used by EGAP is consistent with the ratings of S&P and Fitch). The programme is not intended for companies that were already struggling before the state of emergency was declared. A company applies for a guarantee via a commercial bank, and the maximum guarantee duration is six years. Guarantees provided by the end of 2020 amounted to CZK 9.7 billion.

Graph 5.1: Health Insurance Companies' Reserves

left axis: in % of GDP, right axis: in % of potential product

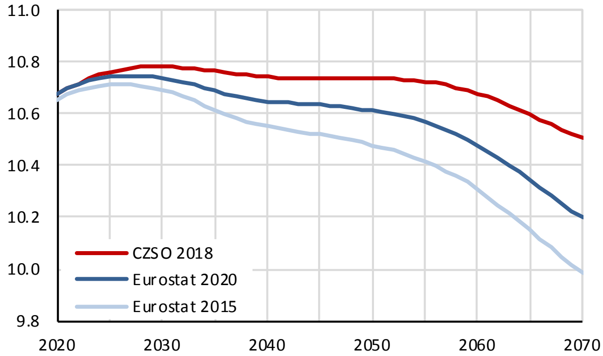


Note: "Reserves" on health insurance companies' accounts.

Source: Statements of Health insurance Companies, MF CR.

Graph 5.2: Czech Population in Different Projections

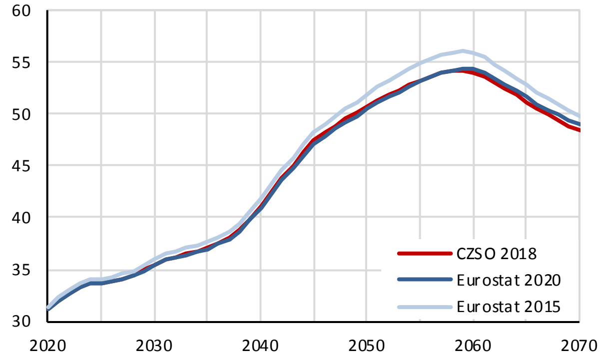
millions of persons



Source: EC (2017a), CZSO (2018), Eurostat (2020).

Graph 5.3: Old-age Dependency Ratio

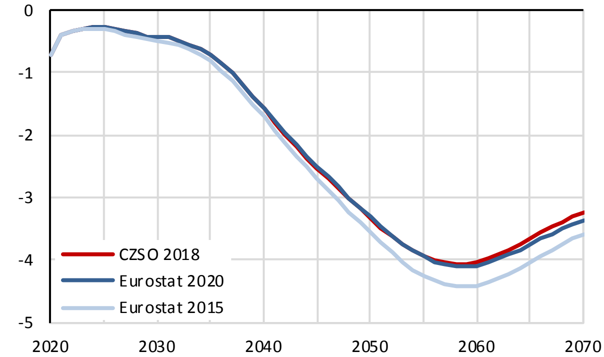
in %, ratio of persons aged 65+ to persons aged 15–64 years



Source: EC (2017a), CZSO (2018), Eurostat (2020).

Graph 5.4: Projection of Pension Account Balances

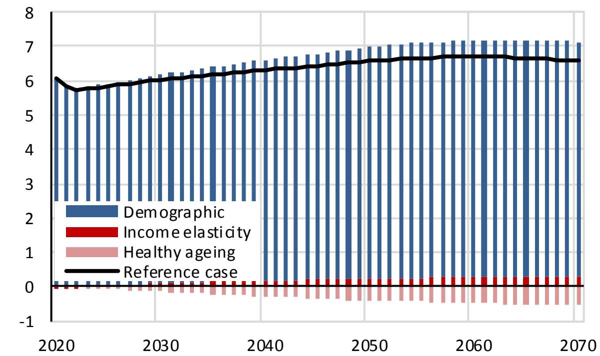
in % of GDP



Source: MF CR calculations and forecast

Graph 5.5: Health Care Scenarios

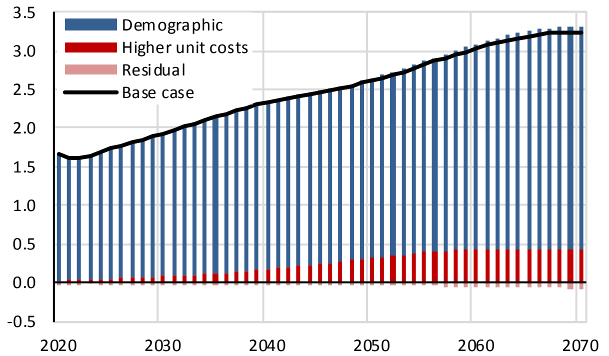
difference in pp from the reference case in % of GDP



Source: EC (2018). MF CR calculations.

Graph 5.6: Long-term Care Scenarios

difference in pp from the base case in % of GDP

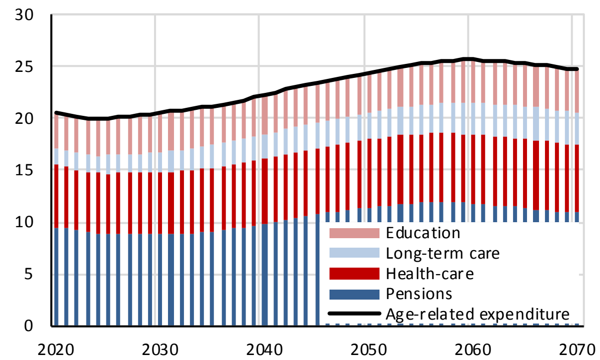


Note: Residual is difference of income elasticity and healthy aging impacts.

Source: EK (2018). MF CR calculations.

Graph 5.7: Expenditure Projections – Reference Cases

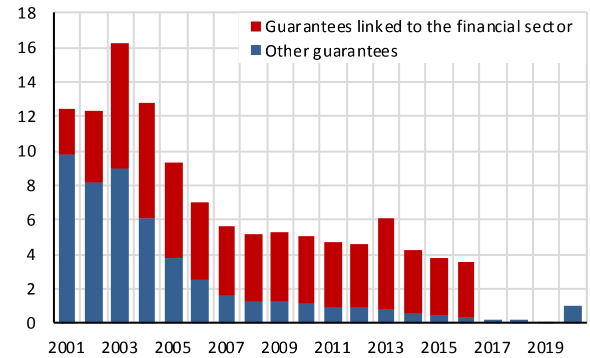
in % of GDP, age-related expenditure



Source: EC (2018). MF CR calculations.

Graph 5.8: General Government Guarantees

in % of GDP



Source: MF CR.

Table 5.1: Long-term Sustainability of Public Finances
expenditure and revenue in % of GDP, growth and rates in %

	2019	2020	2030	2040	2050	2060	2070
Total expenditure	**41.4**	**47.5**	**45.3**	**47.4**	**50.4**	**52.4**	**52.2**
of which: Age-related expenditures	18.5	20.6	20.6	22.3	24.5	25.7	24.7
Pension expenditure	8.0	9.4	8.8	9.8	11.4	11.8	10.9
Social security pensions	8.0	9.4	8.8	9.8	11.4	11.8	10.9
Old-age and early pensions	6.7	7.9	7.4	8.5	10.1	10.4	9.5
Other pensions	1.3	1.5	1.4	1.4	1.3	1.4	1.4
Occupational pensions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Health care	5.6	6.1	6.0	6.3	6.6	6.7	6.6
Long-term care	1.5	1.7	1.9	2.3	2.6	3.0	3.2
Education expenditure	3.4	3.4	3.8	3.8	3.9	4.2	4.1
Other age-related expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest expenditure	0.7	0.8	1.1	1.6	2.3	3.2	3.9
Total revenue	**41.7**	**41.3**	**40.4**	**40.4**	**40.4**	**40.4**	**40.4**
of which: Property income	0.6	0.7	0.6	0.6	0.6	0.6	0.6
of which: Pension contributions	8.5	8.5	8.5	8.5	8.5	8.5	8.5
Pension reserve fund assets	**0.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
of which: Consolidated public pension fund assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Systemic Pension Reforms							
Social contributions diverted to mandatory private scheme	-	-	-	-	-	-	-
Pension expenditure paid by mandatory private scheme	-	-	-	-	-	-	-
Assumptions							
Labour productivity growth	**2.0**	**1.9**	**2.2**	**2.1**	**1.9**	**1.7**	**1.5**
Real GDP growth	**2.6**	**-6.2**	**1.9**	**1.3**	**1.3**	**1.7**	**1.5**
Participation rate of males (aged 20–64)	**89.3**	**89.4**	**87.8**	**86.4**	**87.3**	**88.0**	**87.4**
Participation rate of females (aged 20–64)	**74.5**	**74.6**	**75.3**	**73.7**	**74.3**	**75.6**	**74.9**
Total participation rate (aged 20–64)	**82.0**	**82.2**	**81.7**	**80.3**	**81.0**	**82.0**	**81.3**
Unemployment rate	**2.1**	**5.0**	**3.7**	**3.7**	**3.7**	**3.7**	**3.7**
Population aged 65+ over total population	**19.8**	**20.1**	**22.1**	**25.0**	**28.3**	**29.6**	**27.9**

Note: Macroeconomic assumptions are based on long-term projections of the EC and can differ from the medium-term macroeconomic scenario presented in Chapter 0. Total revenue and the age-unrelated expenditure in relative terms are kept constant to their 2024 level to mitigate distortion in impacts of ageing on public finance. On the other hand, total revenue and expenditure in the long run are thus distorted by the medium term budgetary position and the development after 2024, when the autonomous development of the projection is not corrected by the statutory trajectory of public finance consolidation and subsequent adherence to the medium-term budgetary objective.
Source: EC (2020). MF CR calculations.

Table 5.2: Sustainability Indicators S1 and S2
in % of GDP

	S1	S2
Cost of Ageing	1.1	4.6
Initial budgetary position	-0.8	0.2
Debt requirement	-1.2	-
Total	**-0.9**	**4.8**

Source: EC (2019), EC (2021b).

Table 5.3: Contingent Liabilities
in % of GDP

	2020
General government sector guarantees	**1.0**
of which: Linked to the financial sector	0.0

Source: MF CR.

6 Quality of Public Finance Revenue and Expenditure

The exceptional situation last year resulted in numerous measures to support the affected areas of the economy. This support is mainly aimed at boosting private consumption, investment and the availability of operational financing aimed at the overall economic recovery. The revenue side of public budgets was a source of significant support in maintaining employment and increasing the cash flow of companies.

The long-term priority of the Czech Republic's tax policy remains the minimisation of distortions, digitalization, protection of health and the environment, and tackling tax evasion. The focus is also on reducing the administrative burden, enhancing legal certainty and simplifying the tax administration.

Although the government's economic policy had to address quite extraordinary matters and needed to take urgent measures in response to the epidemic, several measures were also taken during the last year to support the rationalisation of the expenditure side. This applies, for example, to remuneration policy and the role of the state as the owner of property. In public procurement area, environmental criteria will also be taken into account and the administrative burden of announcements should be reduced.

6.1 Tax Policy Outlook

6.1.1 Tax Policy Strategy

Tax policy in the Czech Republic is headed towards adaptation and stabilisation of a transparent and predictable tax environment. There is respect for the principle of neutrality, as reflected in efforts to merge and revise tax exemptions in tax legislation which in turn creates space for reducing the tax burden. The removal of these exemptions will simplify the tax system, relieving it of numerous contentious and non-systemic elements that often lead taxpayers to behave in ways that are economically irrational under normal circumstances. This will prevent the distortion of the business environment and the creation of unjustifiable differences in the tax burden of individual taxpayers. Social aspects are also taken into account in the pursuit of these objectives.

6.1.2 Upcoming Tax Changes

The MF CR is working intensively on a new amendment to the Act on Accounting that will reduce the administrative burden on business entities. The new legislation will also attempt to rationalise subordinate legislation. The new organisation of accounting legislation will better reflect the real needs of accounting entities.

Following the amendments to the Act on Accounting, there should also be changes in the area of direct taxes, consisting primarily of a reduction in special tax regimes – especially in terms of the depreciation of assets or the introduction of the possibility of applying international financial reporting standards to determine the income tax base.

The Czech Republic uses indirect taxes as an economic instrument that is appropriate to reduce negative externalities and to manage energy products in a more environmentally friendly and efficient way. This makes it possible to target, with precision, specific activities that generate substances harmful to society or the environment. An example of this is a taxation based on the energy content or emission component of fuels, including potential benefits of alternative fuels and fuels from renewable sources. Excise duty settings and rates are also being adjusted within the EU, especially in the context of the forthcoming revision of the Energy Efficiency Directive.

In order to settle the market, a proposal for a digital services tax was submitted to legislative process (Chamber of Deputies Print No. 658). This proposal is based on the concept of a directive on the common system of a digital services tax. It has been proposed that this unilateral measure should be limited in time. The Czech Republic significantly supports work on a global solution within the Organisation for Economic Cooperation and Development.

6.1.3 Efficiency of Tax Collection

The digitalisation of tax administration and the deepening of the pro-client approach remain a priority. On 28 February 2021, the Financial Administration launched an online tax office – "MOJE daně", offering a modern, simple and above all online solution to tax obligations. An integral part of the digitalization of tax administration is to make tax collection more efficient by using software (analytical) tools and by managing audit activities with the support of computer technology in order to reduce the burden on taxable entities.

6.1.4 Fighting Tax Evasion

An important tool in tackling tax evasion at the international stage is the ever-evolving and expanding scope of the international exchange of information on tax administration. In August 2020, Act No. 343/2020 Coll. came into force, introducing a new type of automatic exchange between EU Member States – the so-called exchange of information reported by intermediaries of cross-border arrangements. It contains information on cross-border tax arrangements that have risk elements in terms of tax evasion. Due to coronavirus restrictions, the deadlines for the first reporting of information on these schemes were postponed until the first quarter of 2021. There are ongoing efforts to prepare and supplement the necessary rules of interpretation for this legislation.

Preparations are under way for a transposition amendment that will extend the information subject to international automatic exchange to a new range of information; specifically information obtained from cross-border digital platform operators. From 1 January 2023, the collection and sharing of this information by EU Member States' tax authorities will strengthen the administration of taxes, fees and other similar monetary transactions of sellers using these platforms to facilitate the provision of goods and services.

6.2 Tax Assignment

Act No. 609/2020 Coll., amending some tax acts and other related acts, also includes an amendment to Act No. 243/2000 Coll., on the Tax Assignment. With effect from 1 January 2021, changes were made to Sections 3 and 4, which determine the share of regions and municipalities in total tax revenues. With all shared taxes, this share increases to 9.78% (from 8.92%) for regions and to 25.84% (from 23.58%) for municipalities.

The change in the tax assignment was mainly a response to personal income tax adjustments, where the effective tax rate was reduced due to the different tax base and an increase in the basic taxpayer credit. If the conditions had not been revised, the revenues of regions and municipalities would have decreased by around CZK 33 billion.

However, the change in the tax assignment will have a positive impact on the budgets of local governments of almost CZK 23 billion. The net effect will thus be a negative impact of CZK 8 billion on municipalities and CZK 2.5 billion on regions.

In addition to the above-mentioned change, the Act on the Tax Assignment was also amended in connection with the introduction of a flat-rate tax, with a slightly positive effect for local governments at the expense of the state budget.

6.3 Rationalisation of General Government Expenditure

6.3.1 Joint Procurement of the State

In the Czech Republic, two systems of centralised public procurement had been operating in parallel since 2016 – the departmental system of centralised public procurement and the system of central state purchases. Both have been replaced by "joint state procurement" (Government Resolution No. 487/2019), which aims to spend public funds economically and use the administrative capacities efficiently. Joint procurement is managed and coordinated by an inter-departmental coordination group for which the MF CR and the Ministry of the Interior are responsible. The group approves technical standards binding for all public procurement by ministries and their subordinate organisations, regardless of who the contracting authority is. In 2020, technical standards were announced in the form of minimum quality parameters for passenger cars, office supplies, cleaning services and ICT commodities.

6.3.2 Changes in Public Procurement

Awarding Public Procurement

In 2020, Act No. 543/2020 Coll. was approved. This law amended Act No. 134/2016 Coll., on Public Procurement. As of 1 January 2021, the contracting authority (even for small-scale contracts) is obliged to comply with the principle of "socially responsible procurement, environmentally responsible procurement and innovation" when preparing the terms of reference for newly launched procurement procedures, as well as when assessing the eligibility and exceptionally low prices of contracts already implemented, and to justify its approach in the procurement documentation. This new principle is then applied together with the original 3E principles and the proportionality principle.

The government also approved a large-scale amendment to the Act on Public Procurement (Chamber of Deputies Print No. 1099), which aims in particular to transpose European procurement directives and reduce the administrative burden on contracting authorities and suppliers alike.

Information Technology Procurement

Since 2016, public administration projects related to information and communication technologies have been assessed by the Service of the Chief eGovernment Architect at the Ministry of the Interior (Government Resolution No. 889/2015) before a public tender is announced or a contract is signed. Consequently, project authors are not allowed to enter into a contract or to complete the preparation of the tender dossier before receiving an affirmative opinion from that service. According to Government Resolution No. 86/2020, since February 2020 the information obligation has applied to all expenditure related to digitalisation and to information and communication technologies where this expenditure is intended for the acquisition or technical enhancement of a designated public administration information system or is expected to entail supplies exceeding CZK 6 million. The Service of the Chief eGovernment Architect thus has an overview of the different systems, which can then be interconnected to exploit various synergies.

6.3.3 Budgetary Rules

In 2020, Act No. 484/2020 Coll., amending Act No. 218/2000 Coll., on Budgetary Rules, was approved. With effect from 1 January 2021, on the basis of that amendment, the rationalisation of state budget spending on state employees' salaries will be increased. Organisational units of the state are now obliged to tie a part of their compensation of employees on posts vacant for all the calendar days in a calendar month (funds are not tied for the first month in which the post is vacant). Vacancies are specified as those that can be filled by an employee, a member of the security corps or a professional soldier and are budgeted for. However, a position that is not occupied due to an employee's illness or quarantine is not treated as a vacancy.

6.3.4 Property of the Czech Republic

In the management of state fixed assets, property worth CZK 1.1 billion was sold or leased through the Office for Government Representation in Property Affairs in 2020. The electronic auction system, in operation since 2018, has generated cumulative revenue of CZK 667 million. Also, thanks to the State Asset Map project, the number of unclaimed properties registered to defunct and untraceable state entities continues to decrease. To increase efficiency in the use of public funds, the Central Register of Administration Buildings was set up. The system keeps records of all state-owned administration buildings and is helpful in optimising the occupancy of buildings by relocating state institutions to them that had been paying rent to non-public entities. In 2020, there were 88 relocations from private rentals to state buildings, which resulted in savings in rent payments and operating and maintenance expenses totalling CZK 23.6 million. Since 2015, 397 relocation plans have been implemented, saving the state nearly CZK 174 million per year in rent and more than CZK 42 million in operating and maintenance costs.

In 2020, the government approved the State Ownership Policy Strategy (Government Resolution No. 115/2020), which is based on the Organisation for Economic Cooperation and Development's Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015). It defines the principles underlying the behaviour of the state as an owner or co-owner of commercial companies or state-owned enterprises and ensures the transparent and effective exercise of ownership rights. According to the Strategy, the state will own companies only if they are strategically important in order to pursue economic policy objectives, or if it needs them to effectively ensure its functioning or to provide the necessary services to the public. All other companies in which the state has a participating interest or state-owned enterprises should subsequently be privatised or liquidated. The strategic importance of and need for existing companies in which the state has a participating interest and state-owned enterprises will then be continuously evaluated, along with their business strategies. Following the adoption of this Strategy, the first Report on the Activities and Results of Strategic Companies with State Ownership, State-Owned Enterprises and National Enterprises was published in 2020 (MF CR, 2020c). This means that, for the first time, there is a comprehensive overview of these companies (34 in total at the end of 2019), including key financial indicators such as earnings before interest, taxes, depreciation and amortisation, and information on the staffing of management bodies.

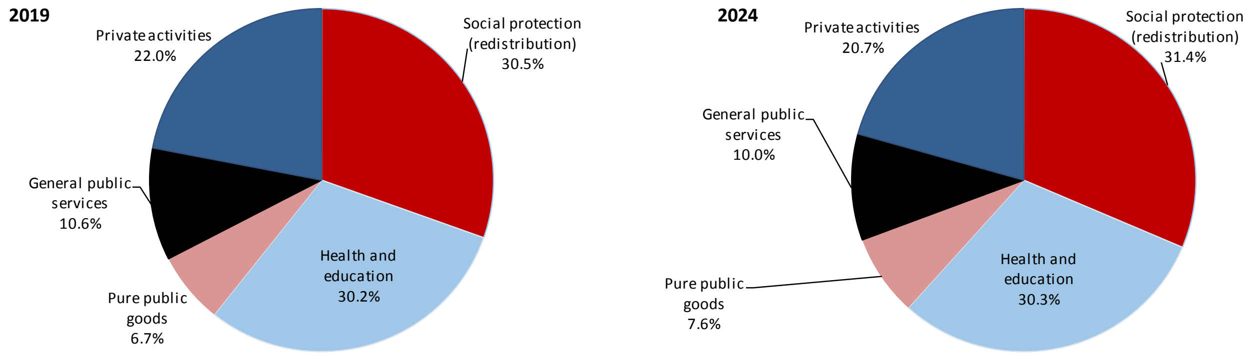
6.4 Composition of General Government Expenditure

In 2009–2017, with the exception of 2012, the total amount of general government expenditure relative to GDP decreased by an average of 0.7 pp per year. This downtrend was reversed in 2018, and the growth in total expenditure relative to GDP continued in 2019, when it increased by 0.8 pp year-on-year. In absolute terms, total spending in 2019 increased by CZK 181 billion year-on-year. This rise was mainly driven by expenditure in Social Affairs section (due to growth in cash social benefits in the Old Age group), in Education section (mainly because of growth in the compensation of employees in regional education and gross fixed capital formation in the Secondary Education group) and in Economic Affairs section, which saw a significant increase in gross fixed capital formation in the Transport group. By contrast, a year-on-year decrease in expenditure was reported in Housing and Community amenities section, primarily due to a reduction in capital transfers linked to the administration of water supply.

After rapid spending growth in 2020 and 2021, mainly caused by the government's fiscal measures to support households and companies as they tackled the impacts of the COVID-19 epidemic, we expect total expenditure relative to GDP to follow a downward trajectory in 2022–2024, and even a decline in absolute terms in 2022. In 2024, however, total general government expenditure as a share of GDP is expected to be 2.3 pp higher than in 2019. We estimate that the largest increase will be in Social Affairs section (by 1.1 pp), mainly due to an increase in cash social benefits. We also predict a significant increase in expenditure on Defence section (by 0.6 pp) and Health section (by 0.4 pp). Over the years of the outlook, we forecast an average year-on-year growth rate of 0.8% for general government expenditure, with the highest average contribution to growth being reported in Social Affairs, Education and Defence.

Graph 6.1 and Table 6.1 show the structure of general government expenditure by function in 2019 and projected one in 2024. In 2024, we expect almost half of total general government expenditure to be spent on social security and health care for the population (i.e. 21.7% of GDP, an increase of 1.5 pp compared to 2019).

Graph 6.1: Structure of General Government Expenditure, Divided by Function
in % of total expenditure



Note: The category "Pure public goods" includes "Defence" and "Public Order and Security". The category "Private activities" is a sum of "Economic Affairs", "Environmental Protection", "Housing and Community Amenities", and "Recreation, Culture and Religion". For details see ECB (2009).
Source: CZSO (2021d). MF CR calculations and forecast.

Table 6.1: General Government Expenditure by Function
in % of GDP

	Code	2019	2024
General public services	1	4.4	4.4
Defence	2	0.9	1.4
Public order and safety	3	1.9	1.9
Economic affairs	4	6.2	6.2
Environmental protection	5	0.8	0.8
Housing and community amenities	6	0.7	0.7
Health	7	7.6	8.0
Recreation, culture and religion	8	1.4	1.4
Education	9	4.9	5.2
Social protection	10	12.6	13.7
Total expenditure	TE	41.4	43.7

Note: Year 2024 outlook.
Source: CZSO (2021d), MF CR (2021a). MF CR calculations and forecast.

7 Changes in the Institutional Framework of Fiscal Policy

In addition to the adoption of a number of measures to strengthen transparency and combat corruption, the epidemic situation has necessitated several changes in the institutional setting. In fiscal policy, this has mainly involved adjusting the fiscal rule based on the structural balance. An amendment has allowed the government to compensate for restrictive anti-epidemic measures and the decrease in tax revenues in accordance with the general escape clause from the rules of the European Stability and Growth Pact. For measures to mitigate the effects of the recession, it was also necessary to expand the portfolio of activities and strengthening certain institutions, such as the Czech-Moravian Guarantee and Development Bank and the Export Guarantee and Insurance Corporation. The preparation of the National Recovery and Resilience Plan for the implementation and disbursement of funds from the Recovery and Resilience Facility is also an important new element. Together with the European Structural and Investment Funds, these should help the Czech economy to recover. Additional resources for financing public projects should be provided by the National Development Fund.

7.1 Changes Related to Investment and the Capital Market

7.1.1 National Development Fund

In 2019, a memorandum was signed between the government and four commercial banks on the establishment of the National Development Fund. This financial institution, formed on 1 February 2021, operates under Czech and European law as a société d'investissement à capital variable (SICAV). The National Development Fund will expand the possibilities for long-term public investment projects. The Fund will provide junior financing (i.e. if funds for the repayment of a debt are limited, the claims of senior debt holders take priority) and assume part of the project risk, thus increasing private entities' interest in financing the project. Investments should focus mainly on transport infrastructure, digitalisation, health care facilities and education. Moreover, National Investment Council, as the Fund's advisory body, is to make observations on strategic investment projects.

7.1.2 Investments from the Modernisation Fund

Under Directive (EU) 2018/410 of the European Parliament and of the Council amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments, and Decision (EU) 2015/1814, the European Commission has established so-called Modernisation Fund for the period from 2021 to 2030, which will enable investments to be carried out in the modernisation of energy systems and improvements in energy efficiency. The implementation of this financial instrument in the Czech Republic was initiated by the adoption of Act No. 1/2020 Coll. amending Act No. 383/2012 Coll., on Conditions for greenhouse gas emission allowance trading, as amended. The resources of the Modernisation Fund will come from all revenues generated by derogation allowances and half of the revenues derived from solidarity allowances. Revenues in 2021–2030 are estimated at approximately CZK 150 billion for the Czech Republic. In 2021, the government approved (Government Resolution No. 64) the General Programme Document for the Implementation of the Modernisation Fund in the Czech Republic, which provides a specific mechanism for the implementation of the fund and the distribution of the total allocation to fields that are to contribute to the fulfilment of climate objectives. The first calls for projects financed by this fund were to be made in March 2021.

7.1.3 Next Generation EU

In response to the expected impacts of the COVID-19 epidemic, at the end of May 2020 the European Commission presented a proposal for a Regulation establishing the Recovery and Resilience Facility. As the largest part of the Next Generation EU scheme, the facility allocates approximately CZK 171 billion in grants and CZK 400 billion in loans to the Czech Republic between 2020 and 2026. These funds can be used to finance structural reforms and public investment projects. The requirement for the use of the funds is the preparation of a National Recovery and Resilience Plan in the form of a comprehensive package of measures to implement the intended reforms and investments. The plan has to be submitted to the European Commission for assessment under the European Semester and it is required to reflect three groups of criteria. The first is consideration for specific national priorities (e.g. decarbonisation of the economy, the automation of labour, etc.), with the plan serving as a vehicle for their gradual implementation. The second is the response to the country-specific recommendations of the Council of the European Union from 2019 and 2020, which were released within the framework of the European Semester. The proposed measures must also build resilience and lead to digital and green transformation. It is essential to ensure that at least 37% of the allocated funds are earmarked for climate change, with at least 20% allocated to support digitalisation. The plan must also be consistent with the Partnership Agreement, the Territorial Just Transition Plans under the Just Transition Fund, the Climate and Energy Plan, and the National Reform Programme. In addition, the plan should make a balanced contribution to the six pillars of the Recovery and Resilience Facility. The third requirement is that the reforms and investments have to meet the principle of no significant harm to the environment. Besides these three key groups of parameters, the Czech Republic should take into account the seven flagship initiatives. These are common EU-wide challenges set by the European Commission (e.g. the promotion of clean technologies and the use of renewable resources, an increase in the energy efficiency of buildings, etc.).

In October 2020, the Government discussed the starting points of the National Recovery and Resilience Plan that launched consultations with the European Commission on the National Recovery and Resilience Plan for the Czech Republic. The government will submit the final version to the European Commission by 30 April 2021, with a possible update in 2022. The European Commission will examine the plan within two months and then pass it to the Council of the EU for approval. The Czech Republic will be able to request pre-financing of 13% of the allocated funds. Applications for payments may be made until the end of August 2026, and eligible expenditure may be incurred from February 2020 onwards.

In addition to the Recovery and Resilience Facility, Next Generation EU includes REACT-EU and the Just Transition Fund. REACT-EU instrument is intended to strengthen the capacity of Member States to respond immediately to the COVID-19 epidemic crisis. The Czech Republic's allocation for 2021 will be approximately EUR 800 million in current prices, i.e. approximately CZK 21 billion. The allocation for 2022 will not be known until autumn 2021. According to current estimates, the Czech Republic could receive a total of around EUR 1.1 billion, i.e. around CZK 27 billion, in 2021 and 2022. At present, it is expected that the funds will be used for the purchase of medical equipment, for the integrated rescue system, and for retirement homes.

The Just Transition Fund's objective is to mitigate the adverse impacts of climate transition by supporting the most affected areas and affected workers. It will also support investments in the clean energy transition, such as investments in energy efficiency. The Czech Republic will receive EUR 1.6 billion from this fund in current prices (approx. CZK 43 billion). Three regions in the Czech Republic are expected to be eligible to use this fund: Moravian-Silesian region, Ústí region, and Karlovy Vary region.

7.1.4 Long-term Investment Account

In 2020, the Government approved a draft bill (Chamber of Deputies Print No. 993) aimed at implementing legislative measures resulting from the Concept for the Development of the Capital Market in the Czech Republic in 2019–2023. Among other things, the draft introduces long-term investment accounts and regulates alternative participation funds for supplementary pension savings. The long-term investment account, a new product on the financial market, is an alternative to existing tax-supported old-age savings products (pension funds and life insurance). It introduces a form of "individual savings account", which is widely used in developed markets and helps to motivate investors to manage their old-age savings. In this context, an extension to the Financial Arbitrator's competence is proposed in order to cover long-term investment account managers. Furthermore, investment opportunities should also be expanded.

7.1.5 Alternative Participation Fund

With supplementary pension savings, pension companies will be able to offer a new type of participation fund (an "alternative participation fund"), intended as an alternative to dynamic funds. The fee policy will be designed to allow pension companies to invest, for example, in private equity funds. In this way, they will be able to offer participants potentially higher returns in the long run, though higher risk will be attached to their investment.

7.1.6 Pan-European Personal Pension Product

The draft bill on the pan-European personal pension product (Chamber of Deputies Print No. 1145) adapts the legal order to the new Regulation (EU) 2019/1238 of the European Parliament and of the Council, which is intended to lay the foundations for a safer, more cost-effective and transparent market in voluntary pension savings managed on a European scale. It also aims to address the consequences of demographic developments, complement existing pension products, and boost the cost-effectiveness of pension products by providing appropriate opportunities for long-term investment in the realm of private pensions. The pan-European personal pension product will be a supplementary personal pension product that is offered and taken up voluntarily, i.e. without a link to the pay-as-you-go pension system (Pillar I). The product may be offered, for example, by insurance companies, banks or investment companies. Depending on the nature of the product (up to six investment options) and the contract with the participant, it can be paid as a lump sum, gradual drawdown, or an annuity. In terms of tax incentives, the pan-European personal pension product will use the existing tax incentive framework for supplementary private pension scheme. This means that the requirement of a participation period of at least 5 years and withdrawal of funds at the age of 60 at the earliest will also have to be met.

7.1.7 Recovery and Resolution of the Financial Crisis

An amendment to the Act amending Act No. 374/2015 Coll., on Recovery and resolution in the financial market (Chamber of Deputies Print No. 904) transposes Directive (EU) 2019/879 of the European Parliament and of the Council amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC ("BRRD II") into Czech law. The essence of the amendment is that it adapts the rule governing the setting of the minimum capital requirement and eligible liabilities to internationally accepted standards regarding the requirement for total loss-absorbing capacity. The adoption of this law will increase financial stability and reduce the likelihood and extent of public funds being used in the event of a crisis.

7.2 Increasing Efficiency and Transparency of Public Finances

7.2.1 Open Public Administration Data

Open data of public administration has been defined in Czech law since 1 January 2017, when an amendment to the Act No. 298/2016 Coll., amending Act No. 106/1999 Coll., on Free access to information, as amended, came into force. The list of information to be disclosed is specified in more detail in Government Regulation No. 425/2016 Coll., as amended by Government Regulation No. 184/2018 Coll. Open data is published in the National Open Data Catalogue managed by the Ministry of the Interior. Directive (EU) 2019/1024 of the European Parliament and of the Council on Open data and re-use of public sector information is currently being transposed by means of the so-called implementation amendment that amends Acts No. 106/1999 Coll., No. 123/1998 Coll. and No. 130/2002 Coll. The main change will be an extension of the range of obligated entities to include public enterprises operating in the transport and public services sector, and the possibility of publishing dynamic data through programmable application interfaces. At present, 43 entities (the Office of the Government of the Czech Republic, 11 ministries, the Czech National Bank, Czech Radio, the Supreme Audit Office and 8 other authorities, 9 regions, and 11 municipalities) provide 135,000 datasets to the National Open Data Catalogue on either a mandatory or voluntary basis.

Open data related to public finances is primarily disclosed by the MF CR, with 565 datasets currently published (e.g. data from the Central Register of Subsidies, the Central Administration Buildings Register, and an overview of checks in the field of electronic registration of sales). Several information systems are also part of the MF CR's open data. First, there is Monitor, an information portal that provides data on budgetary and accounting information from all levels of state administration and local governments, including illustrative graphical outputs. Then there is CEDR III, an information system providing data on subsidies, repayable financial assistance and other similar transfers provided from the state budget, state funds, state financial assets and the National Fund (including European subsidies), and their beneficiaries. Finally, the DotInfo information system makes it possible to run searches for providers of subsidies and repayable financial assistance from the state budget.

7.2.2 Register of Beneficial Owners

In 2021, Act No. 37/2021 Coll., on the Registration of beneficial owners was approved. With effect from 1 June 2021, it redefines a beneficial owner that is now considered to be a natural person who is the ultimate beneficiary or has so-called "ultimate influence" (i.e. someone who ultimately derives significant benefit, directly or indirectly, from the activities or liquidation of a legal entity, from the administration or from the dissolution of the entity, and does not pass on this benefit further, or a person who exercises decisive influence over the administration of a company and its organisation). An ultimate beneficiary is a person who shares in the profits of a legal entity to an extent of more than 25% or who holds more than 25% of the voting rights or more than a 25% share in the registered capital. If the beneficial owner cannot be ascertained, or if it becomes apparent that ultimate influence is exercised by a legal entity that does not have a beneficial owner, the legal fiction that the beneficial owner is any person in its senior management applies. The law also stipulates that certain entities do not have a beneficial owner (e.g. the state, local governments, state-owned companies, political parties, churches, trade unions, etc.). Beneficial owners will be subject to registration in an information system administered by the Ministry of Justice. In addition to Czech legal entities, this register will include beneficial owners of trust funds and similar legal forms if their trust is domiciled in the Czech Republic and the trust is administered from the Czech Republic and manages assets in the Czech Republic.

With effect from 1 January 2021 entered into force Act No. 527/2020 Coll., which transposes "5. Anti-Money Laundering Directive" (Directive (EU) 2018/843 of the European Parliament and of the Council) into Czech law. For the purposes of this law, a beneficial owner is deemed to be either an entity under Act No. 37/2021 Coll. or an individual on behalf of whom trade is conducted. The amendment also has an impact on supplier selection under the Act on Public Procurement. With effect from 1 June 2021, a contracting authority will be obliged to exclude a selected supplier or to terminate a public contract if the supplier is a Czech or foreign legal entity whose beneficial owner could not be ascertained from the register of beneficial owners (or from a foreign register similar to the register of beneficial owners) or if the information provided is not true. As of 1 June 2021, the conditions in place for legal entities when applying for a subsidy or repayable financial assistance from the state budget will also change. It will be necessary to indicate the beneficial owner as per the register of beneficial owners, as well as information identifying entities in which the legal entity has a share, and the amount of that share.

7.2.3 Protection of Whistle-blowers

In keeping with the government's policy statement, in January 2021 the government approved a draft bill on the protection of whistle-blowers (Chamber of Deputies Print No. 1150), the adoption of which will transpose Directive (EU) 2019/1937 of the European Parliament and of the Council on the Protection of persons who report breaches of European Union law. The aim of this law is to enable workers in the private and public sectors to safely submit reports within compulsorily established internal mechanisms (for all employers with more than

25 employees and all contracting authorities under the Act on Public Procurement, except for municipalities with a population of up to 5,000 inhabitants that are not municipalities with extended powers, as well as for employers operating in civil aviation, maritime transport, oil and gas, consumer credit, capital market business, the activities of investment companies or investment funds, and insurance or reinsurance), or through external mechanisms (by filing a criminal complaint or by notifying the competent authorities or the Ministry of Justice of misdemeanours), and subsequently to protect them from retaliation of employers or other entities. Early detection of criminal or other illegal activities on the basis of whistle-blowing can result in savings of public funds, which the European Commission has estimated at EUR 270 million per year for the Czech Republic in public procurement alone (EC, 2017b).

7.2.4 Definition of Lobbying

The government's draft bill on lobbying (Chamber of Deputies Print No. 565), which defines lobbying, sets out the scope of lobbying in both positive and negative terms, and defines categories of lobbyists and the lobbied, is in its first reading in the legislative process. A new register of lobbyists and lobbied persons will be established, which will be maintained by the Office for Economic Supervision of Political Parties and Political Movements. This register will also record quarterly information on the contacts of lobbyists and the lobbied. These parties are also obliged to publish a quarterly lobbying report. The adoption of this law will strengthen the fight against corruption. In safeguarding and enforcing lobbying rules, it will increase the credibility of the Czech Republic.

7.2.5 Powers of the Supreme Audit Office

A government draft bill amending Act No. 166/1993 Coll., on the Supreme Audit Office, as amended (Chamber of Deputies Print No. 360), is in its third reading in the Chamber of Deputies. This law will be an implementing regulation for an amendment to the Constitution of the Czech Republic, currently under discussion, that extends the constitutional framework of supervisory competence of the Supreme Audit Office. The aim of the amendment to the Act is to enable the more comprehensive auditing of other entities defined by law, such as local governments, health insurance companies, public universities, legal entities majority owned or controlled by the state or a local government unit, etc. In parallel with the government draft bill, a parliamentary draft bill amending the Act on Supreme Audit Office (Chamber of Deputies Print No. 230) is also in its third reading. However, unlike the government draft bill, it covers narrower range of entities. Moreover, Chamber of Deputies Print No. 626 proposes extending the Supreme Audit Office's powers to include auditing of the management of the properties of Czech Television and Czech Radio.

7.2.6 Withdrawal of a Subsidy or Loan

In 2020, Act No. 484/2020 Coll. was adopted, amending the Budgetary Rules Act's provisions on the withdrawal of subsidies and repayable financial assistance. With effect from 1 January 2022, if there is a final decision taken to withdraw a subsidy, any claim to the release of funds not yet paid will be lost. In addition, it will be possible to order a refund of already paid out money if it is discovered that the decision to grant a subsidy or repayable financial assistance was issued in contravention of national or EU law. Under the new legislation, a subsidy or repayable financial assistance may only be provided to a tax resident of the Czech Republic, an EU Member State or a state with which the Czech Republic has concluded an international treaty governing the avoidance of double taxation of all types of income or governing the exchange of information in income tax matters.

7.2.7 Public Spending Review

In its efforts to engage in public spending as efficiently, economically and effectively as possible, the MF CR has joined an EU project focused on public spending review. The project was approved in March 2020 and is being drawn up by the Organisation for Economic Cooperation and Development. The project has two stages. The first is to understand the meaning of the spending review and how it will work in a Czech institutional setting. The second stage should follow with practical application to selected areas. The health care workers training subsidy scheme, for which the Ministry of Health is responsible, was selected as a pilot. The experience from this pilot should then be used to expand into other areas of spending. In November 2020, the first round of talks with representatives of the MF CR, the Ministry of Health and the Supreme Audit Office took place. On the basis of the findings, in particular as regards process of budgeting and setting up budgetary relations between ministries, an initial summary report was to be drawn up by the end of March 2021. This report should provide information on best spending review practices, including areas where there is room for improvement in the Czech Republic. The report should be consulted with the various stakeholders, and a workshop on its conclusions should follow. The first stage will be completed by a technical study containing targeted recommendations. The total duration of the project is planned to be 18 months.

7.3 Budgetary Policy

7.3.1 Use of the State Budget Surplus

In 2020, Act No. 484/2020 Coll. was approved, on the basis of which, with effect from 1 January 2022, the obligation to use the achieved state budget surplus solely to reduce the state debt is stipulated. In case of the state budget deficit the Chamber of Deputies, on a proposal from the government, will decide how to cover it. The government will also decide on the use of state financial assets and on the provision of subsidies or repayable financial assistance from state financial assets.

7.3.2 Fiscal Framework Flexibility

The budgetary process in the Czech Republic starts with the approval of expenditure ceilings for the state budget and state funds according to a fiscal rule based on the structural balance. The original anchor was the structural balance equal to the medium-term budgetary objective. As a consequence of last year's recession, government revenues slumped. Adherence to the original rule would have meant the need for expenditure cuts corresponding to the decrease in (structural) revenues. However, this approach would have spelt severe fiscal restriction in the midst of an economic recession.

The aim of Act No. 207/2020 Coll. was to make fiscal expansion possible, i.e. to introduce the possibility of reducing the structural balance below the medium-term budgetary objective. Because of considerable uncertainty surrounding the duration of the epidemic and anti-crisis measures, but also due to additional fiscal stimuli needed, especially on the revenue side, the fiscal rule was changed by a further amendment (Act No. 609/2020 Coll.), which postponed the final derivation of the expenditure ceilings for the years 2022 to 2024 until the end of summer 2021. At that time, the uncertainty about the further development of the epidemic should be significantly lower. Therefore, the MF CR does not prepare an April Budgetary Strategy for the General Government Sector this year.

The specific level of the structural balance for 2022 will be determined by the estimate of the structural balance for 2021 increased by 0.5 pp. In line with the general escape clause at EU level, this will allow the government to carry out a fiscal expansion this year according to the needs of the economic development and the epidemic situation. In subsequent years, consolidation will then continue by at least 0.5 pp per year until the medium-term budgetary objective is reached. Pursuing minimum consolidation faster than legally required will create a reserve against further negative fiscal shocks in future years. All other provisions of the Act on Fiscal Responsibility Rules remain in force unchanged.

7.4 Institutional Changes in Public Finances

In 2018, government decided (Government Resolution No. 171/2018) to transfer the competence for the management of the state's equity interests in Czech Export Bank and Export Guarantee and Insurance Corporation from the Ministry of Industry and Trade, the Ministry of Foreign Affairs and the Ministry of Agriculture to the MF CR. This made the MF CR the sole representative of the state as a shareholder. In 2019, the ownership consolidation of the Czech Export Bank as a wholly owned subsidiary of the Export Guarantee and Insurance Corporation was carried out (under Government Resolution No. 839/2019), thus creating a new institutional arrangement for export support of the state. Under Act No. 171/2018 Coll., the Export Guarantee and Insurance Corporation became a "sui generis" insurance company insuring export credit risks, with the Czech Export Bank financing those risks. Act No. 214/2020 Coll. was adopted as part of the support planned for export companies affected by the government's restrictive measures to combat the COVID-19 epidemic. This new legislation extends the range of support instruments to include the possibility of providing guarantees for the liabilities of exporters, manufacturers and trading companies (see chapter 5.4). Under that law, the provision of guarantees is not treated as the insurance of export credit risks and is therefore not regulated by the Czech National Bank. The law also establishes the Fund for the Coverage of Liabilities from Guarantees, which is made up of state budget funds allocated on the basis of a government decision and is not subject to Act No. 320/2001 Coll., on Financial control in public administration. The implementing Government Regulation No. 215/2020 Coll., as amended, specifies the purpose and scope of the guarantees, the conditions for their provision, the amount of coverage of the outstanding loan principal, and the procedure for the disbursement of any funds from the state budget to the Export Guarantee and Insurance Corporation on account of the provision of guarantees. Act No. 214/2020 Coll. also introduced the obligation for both institutions to keep funds (provided from the state budget) in bank accounts subordinated to the State Treasury and maintained by the Czech National Bank.

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Resolution No. 743 of the Government of the Czech Republic of 13 July 2020 on the Strategic Framework for the Development of Health Care in the Czech Republic up to 2030.

Resolution No. 766 of the Government of the Czech Republic of 20 July 2020 on the Support of Accommodation Facilities (COVID-Accommodation Programme).

Resolution No. 1035 of the Government of the Czech Republic of 14 October 2020 on the Support of Entrepreneurs in Non-scheduled Bus Transport affected by the Worldwide Spread of COVID-19 caused by the SARS-CoV-19 COVID-BUS and on amending the Resolution No. 550 of the Government of the Czech Republic of 18 May 2020 on the COVID-RENT Programme.

Resolution No. 1037 of the Government of the Czech Republic of 14 October 2020 on the Continuation of the Programme of the Ministry of Industry and Trade COVID-Rent, Call 2.

Resolution No. 1052 of the Government of the Czech Republic of 16 October 2020 on reducing the Impact of the Crisis Situation caused by the Coronavirus Pandemic through a New Subsidy Programme for the Food Industry using Instruments Implemented under the Auspices of the Ministry of Agriculture.

Resolution No. 1053 of the Government of the Czech Republic of 16 October 2020 on the Programme for the Support of Small Enterprises Affected by the Global Spread of the COVID-19 Caused by the SARS-CoV-2 - "CARE ALLOWANCE II" for the Self-Employed.

Resolution No. 1070 of the Government of the Czech Republic of 19 October 2020 on the Support of Tourism (Subsidy title COVID – Support of Tourism) and on amendment of Government Resolution No. 766 of 20 July 2020 on the Support of Accommodation Facilities (COVID-Accommodation Programme).

Resolution No. 1081 of the Government of the Czech Republic of 21 October 2020 on the Continuation of the Ministry of Industry and Trade Programme COVID – Rent, Call 2 and on amending Resolution No. 550 of the Government of the Czech Republic of 18 May 2020 and Resolution No. 1037 of the Government of the Czech Republic of 14 October 2020.

Resolution No. 1107 of the Government of the Czech Republic of 27 October 2020 on the Continuation of the Ministry of Industry and Trade Programme COVID – Rent, Call 2 and on amending Resolution No. 550 of the Government of the Czech Republic of 18 May 2020, Resolution No. 1037 of the Government of the Czech Republic of 14 October 2020 and Resolution No. 1081 of the Government of the Czech Republic of 21 October 2020.

Resolution No. 1138 of the Government of the Czech Republic of 2 November 2020 on the Implementation of the New Subsidy Programme AGRICOVID FOOD INDUSTRY under the Auspices of the Ministry of Agriculture.

Resolution No. 1184 of the Government of the Czech Republic of 16 November 2020 on the Support of Accommodation Facilities for Outdoor Schools (COVID-Outdoor Schools) and on amendment of Government Resolution No. 1070 of 19 October 2020 on the Support of Tourism (Subsidy title COVID - Support of Tourism) and on amendment of Government Resolution No. 766 of 20 July 2020 on the Support of Accommodation Facilities (COVID-Accommodation Programme) and on amendment of Government Resolution No. 631 of 8 June 2020 on the Crisis Action Plan for Tourism in the Czech Republic 2020–2021.

Resolution No. 1260 of the Government of the Czech Republic of 30 November 2020 on securing financing for the Care Allowance for the Self-Employed Programme, the Smart Parks for the Future Programme, and the CZECH RISE UP 2.0 Programme.

Resolution No. 1283 of the Government of the Czech Republic of 7 December 2020 on Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area.

Resolution No. 1326 of the Government of the Czech Republic of 14 December 2020 on the Decision on Value-added Tax Remission in Connection with an Emergency caused by the Spread of Coronavirus (SARS CoV-2).

Resolution No. 1329 of the Government of the Czech Republic of 14 December 2020 on the Continuation of the COVID-Rent Programme.

Resolution No. 1331 of the Government of the Czech Republic of 14 December 2020 on the Support of Accommodation Facilities COVID - Accommodation II and amending Government Resolution No. 1184 of 16 November 2020.

Resolution No. 1376 of the Government of the Czech Republic of 23 December 2020 on the Adoption of Crisis Measure.

Resolution No. 10 of the Government of the Czech Republic of 4 January 2021 on the Programme of Support for Entrepreneurs affected by the Worldwide Spread of COVID-19 caused by the SARS-CoV-19 "COVID - Gastro - Closed Establishments".

Resolution No. 46 of the Government of the Czech Republic of 18 January 2021 on the COVID Sport Guarantee Programme.

Resolution No. 48 of the Government of the Czech Republic of 18 January 2021 on the Extension of COVID-Spa Support until 30 June 2021.

Resolution No. 50 of the Government of the Czech Republic of 18 January 2021 amending Government Resolution No. 1331 of 14 December 2020 on the Support of Accommodation Facilities COVID - Accommodation II.

Resolution No. 51 of the Government of the Czech Republic of 18 January 2021 on the COVID Travel Agency Guarantee Programme.

Resolution No. 64 of the Government of the Czech Republic of 25 January 2021 on General Policy Document for the Implementation of the Modernization Fund in the Czech Republic.

Resolution No. 99 of the Government of the Czech Republic of 1 February 2021 on issuing of a Decision on the Exemption of Value-added Tax in Connection with an Emergency caused by the spread of Coronavirus (SARS CoV-2).

Resolution No. 100 of the Government of the Czech Republic of 1 February 2021 on reducing the Impact of the Crisis Situation caused by the Coronavirus Pandemic through the Second Call of the AGRICOVID FOOD INDUSTRY Grant Programme.

Resolution No. 191 of the Government of the Czech Republic of 24 February 2021 on the Support of the Testing for COVID-19 by a Lay Person at Companies doing Business in the Czech Republic and Self-employed Persons from the Funds of Prevention of Health Insurance Companies.

Resolution No. 242 of the Government of the Czech Republic of 1 March 2021 on Extraordinary Measures of the Ministry of Health.

Resolution No. 272 of the Government of the Czech Republic of 8 March 2021 on the Decision on Tax and Tax Accessories Remission in Connection with an Emergency caused by the Spread of Coronavirus (SARS CoV-2).

Resolution No. 278 of the Government of the Czech Republic of 8 March 2021 on the COVID – Uncovered Costs Programme.

Resolution No. 293 of the Government of the Czech Republic of 15 March 2021 on the Change in the Extraordinary Measure of the Ministry of Health.

Resolution No. 313 of the Government of the Czech Republic of 22 March 2021 on Extraordinary Measures of the Ministry of Health.

Resolution No. 334 of the Government of the Czech Republic of 29 March 2021 on the Change of Framework Conditions approved by Government Resolution No. 50 of 18 January 2021.

Annex: Convergence

According to preliminary figures for 2020, the economic level of the Czech Republic, expressed in terms of GDP per capita at current purchasing power parity, reached approximately 93% of the EU level and 76% of the German level. Strong economic growth during the boom in 2000–2008 was reflected in a fast pace of convergence with the EU's economic performance. However, the convergence process then came to a halt in the face of recessions and sluggish recovery in economic activity, and only resumed after 2013 (see Graph P.1).

The synchronised downturn in economic activity in 2020, followed by rather slow recovery in EU countries, should temporarily interrupt the convergence process, which we do not expect to resume either this year or next. The relative development indicator of the Czech economy shall probably stagnate around 92% of the EU level.

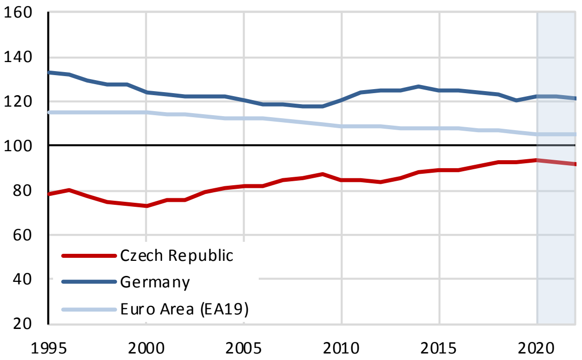
The comparative price level of GDP showed an increasing trend until 2008 and remained close to the 2008 level, i.e. slightly above 70% of the EU level, in the following years (with the exception of 2009). During 2013 and 2014, the comparative price level fell by 8 pp to the 2006 level after the CNB introduced a monetary policy aimed at depreciating the CZK against the euro. Since 2015, however, it has been approaching the EU average again and has again remained slightly above 70% of the EU level in the last three years (see Graph P.2). In 2021 and 2022, the comparative price level could increase further, rising to around 75% of the EU level.

As regards the hourly labour productivity (Graph P.3), the relatively slower economic recovery in the CR compared to the EU will have a negative effect. On the other hand, the predicted appreciation of the CZK/EUR exchange rate, which will more than compensate the weaker economic development, will be a significant support factor. The labour productivity in the CR should thus gradually increase to more than 58% of the EU level in 2022.

Wage convergence (Graph P.4) came to a temporary stop after 2008. Between 2009 and 2016, the average private sector wage was around 45% of the EU average. This ratio then gradually increased to 54% in 2019 on the strength of an economic upturn and increases in the minimum and guaranteed wage.

Graph P.1: Relative Economic Level

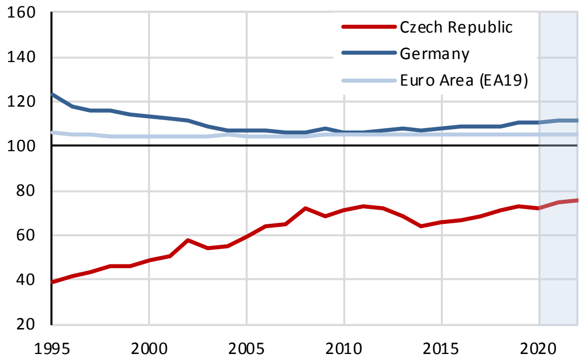
EU27=100, GDP per capita in current purchasing power parities



Source: CZSO (2021a), Eurostat (2021). MF CR calculations and forecast.

Graph P.2: Comparative Price Level

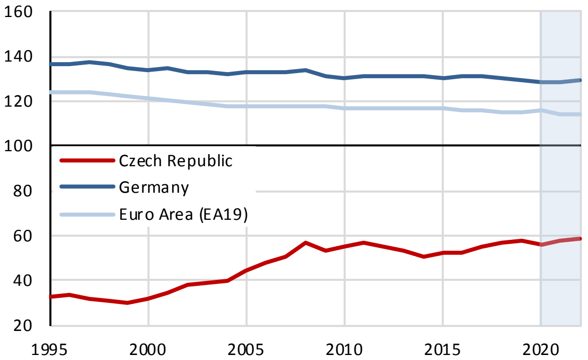
EU27=100



Source: CZSO (2021a), Eurostat (2021). MF CR calculations and forecast.

Graph P.3: Real Labour Productivity

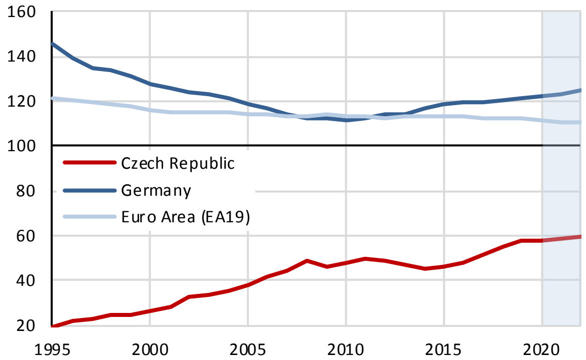
EU27=100, constant prices of 2010, per hour worked



Source: Eurostat (2021). MF CR and AMECO (2021) calculations and forecast.

Graph P.4: Average Compensation of Employee

EU27=100



Source: AMECO (2021), Eurostat (2021). MF CR calculations and forecast.

Glossary of Terms

Accrual methodology means that economic transactions are recorded at the time an economic value is created, transformed or cancelled or when receivables and liabilities increase or decrease, regardless of when the transaction will be paid (unlike the cash principle, which is the basis of, for example, the state budget).

Balance of payments captures economic transactions between residents and non-residents for a given territory in a certain period of time. The basic structure of the balance of payments is based on the methodology of the International Monetary Fund and includes the current, capital and financial accounts (including changes in foreign-exchange reserves).

Capital transfers include acquisition or loss of an asset without equivalent consideration. They may be made in cash or in kind. **Capital transfer in cash** is defined as cash transfer without expected consideration from the unit which received the transfer. **Capital transfer in kind** is based on the transfer of ownership of an asset (other than inventory and cash) or decommitment by a creditor for which no consideration, assumption of debt, etc. was received.

Comparative price level is the ratio of the GDP at market exchange rate to the GDP in purchasing power parity.

Consumer price index is one of the indexes measuring the price level. It is constructed on the basis of regular monitoring of the prices of selected goods and services (so-called representatives) in the consumption basket of households. Each representative has a certain weight. The consumption basket is divided into 12 categories (e.g. food and non-alcoholic beverages; alcoholic beverages, tobacco; clothing and footwear; housing, water, electricity and fuel; etc.). **Harmonised index of consumer prices** is calculated in EU countries according to uniform and legally binding procedures, which (unlike national indexes) allows for comparability of this indicator among countries.

Cyclically adjusted balance of the general government sector is used to identify the fiscal policy stance because it does not include the impact of those parts of revenues and expenditures which are generated by the position of the economy in the business cycle.

The **debt rule of the national fiscal framework** activates legally defined measures if the relative government debt ratio (minus the cash reserve of government debt financing) exceeds 55% of GDP. These measures set out the conditions for the preparation of budget drafts for individual segments of the general government sector (state budget, budgets of the state funds, health insurance plans of health insurance companies and budgets of local governments) and other public institutions limit new liabilities leading to an increase in the general government debt with a maturity of more than 1 year.

Dependency rate (demographic) is the ratio of the senior-age population (over 64 years old) to the working-age population – it thus does not reflect retirement age extending. **Dependency rate according to the applicable legislation** is the ratio of the retirement-age population according to the applicable legislation to the number of other inhabitants over 14 years of age. **Effective dependency rate** refers to the ratio of the number of old-age pensions paid to the number of employees.

Discretionary measures represent direct interventions of executive or legislative authorities in general government revenue and expenditure.

The **expenditure rule of the national fiscal framework** serves as the basis for the preparation of the draft of the state budget and the budgets of state funds. The rule derives the maximum amount of government sector expenditure from the structural part of the government sector revenue increased by 1% of GDP. This increase represents the established medium-term budgetary objective of the Czech Republic. The rule is supplemented by an automatic correction mechanism reflecting in retrospective the gap between the actual level of expenditure and the expenditure prescribed by the rule, and is accompanied by precisely defined escape clauses under Act No. 23/2017 Coll., on fiscal responsibility rules.

The **expenditure rule of the Stability and Growth Pact** limits the growth of adjusted real expenditure of general government sector adjusted by discretionary revenue measures (so-called adjusted expenditure), thus the given member state shall reach the medium-term budgetary objective and would follow it henceforward. The adjusted expenditure of countries which meet their medium-term budgetary objective shall grow at most by the average rate of growth of the potential output calculated in 10-year horizon containing 5 past years, the current year and 4 following years. The average rate of the potential output growth is updated annually, based on the Spring European Economic Forecast with the validity period for the following year. For countries which have not yet reached their medium-term budgetary objective, the highest acceptable rate of adjusted expenditure growth is lower than the average growth of the potential output. The difference between the two rates is referred to as the convergence margin, which reflects the fiscal effort required for the gradual achievement of the medium-term budgetary objective.

Fiscal impulse is used to assess the impact of government fiscal policy on economic growth. Unlike the primary fiscal effort, it does not include revenues from EU funds and expenditures to the EU budget, and on the contrary, it includes certain one-off operations (usually government measures with a direct fiscal impact).

Fiscal effort is a year-on-year change in the structural balance indicating expansive of restrictive fiscal policy in a given year.

Fiscal sustainability indicators, based on long-term projections, characterise the sustainability of public finances and the extent of the changes necessary to attain it. The EC uses three main indicators. **Indicator S0** consists of 28 macro-financial and fiscal indicators and indicates fiscal risks for the coming year. **Indicator S1** indicates by how many percent of GDP the primary structural balance must be improved in the medium term for next 5 years to make the general government sector debt reach 60% of GDP in 2030. **Indicator S2** enumerates by how many percent of GDP the primary structural balance must be permanently improved to make the general government debt remain stable in an infinite time horizon (i.e. the current value of future primary balances to be equal to the current general government debt).

The **general government sector** is defined by internationally harmonised rules of the EU. In the Czech Republic, it includes, in the ESA 2010 methodology, three main subsectors: central government, local government and social security funds.

Government Deficit and Debt Notification is the quantification of fiscal indicators submitted by each EU member state twice a year to the EC under Council Regulation (EC) No. 479/2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, as amended. It is compiled for the general government sector using the accrual methodology. The Czech Statistical Office processes the data for the past four years and MF CR prepares the prediction for the current year. The notification contains both a basic set of notification tables, including key indicators such as balance and debt, with an explanation of the transition from the balance in the national methodology to the accrual balance and contributions to the change in debt, as well as a number of supplementary questionnaires, such as the guarantee table.

Government final consumption expenditure includes government payments which are subsequently used for consumption of individuals in the household sector (mainly reimbursement of health care by health insurance companies for services provided by medical facilities) or are consumed by the entire society (such as expenditure on army, police, judiciary, state administration, etc.). General government services, provided for consumption to the entire society, are usually valued at the level of own costs for a given service because they do not pass through a market which would value them. For the above reasons, consumption consists mainly of intermediate consumption (i.e. goods and services, excluding fixed assets consumed in the production of other goods or services), compensation to employees (wages and salaries including the part of social security contributions paid by employers), social transfers in kind to households (in particular payments by health facilities outside the general government sector) or consumption of the fixed capital. The value calculated is not the entire value of these transactions but only the value associated with the production valued at own costs. The costs associated with the production of activities which pass a market fully or partly and for which the general government sector receives payment are excluded from its consumption.

Gross fixed capital formation represents the investment activities of units. Fixed capital is represented just by assets used in production for more than one year. It also includes for example military equipment, expenditure on research and development, etc.

Gross domestic product (GDP) is the monetary expression of the total value of goods and services newly created in a given period in a given territory. **Real GDP** is the gross domestic product, expressed in the prices of the reference year. This transformation enables, in analysing GDP (or other variables), to eliminate the impact of price changes over time and to focus only on the changes in physical volume. **Gross value added** represents the difference between the value of production and intermediate consumption (production consumed in the production of other goods or services).

Inflation is a sustained growth in the general price level, i.e., internal currency depreciation. The price level is measured using price indices, such as the consumer price index or the harmonised index of consumer prices. The most commonly mentioned **year-on-year inflation rate** is the relative change in the consumer price index compared to the same month of the previous year. The **average inflation rate** is the relative change in the average of the consumer price index in the last 12 months compared to the average of the consumer price index in the previous 12 months. Inflation rates are expressed as a percentage. By **administrative measures on consumer prices** are meant state measures that directly affect the price level. They include the effect of changes in indirect taxes (value added tax, excise and energy taxes) and regulated prices (e.g. electricity, gas, heat, water and sewerage, public urban transport).

Long-term interest rates are measured on the basis of yields of long-term government bonds or comparable securities until maturity in percent per year. Bonds with residual maturity ranging from 8 to 12 years (the use of these limits is fully based on the conditions of the Czech government bond market, which were set based on the periodicity of Czech government bond issues) are classified as representative. From this set, a combination of bonds whose average residual maturity is closest to the 10-year limit is then generated.

Medium-Term Budgetary Objective is expressed in the structural balance of general government sector and should ensure the sustainability of public finance of the given country. It reflects both the growth potential of the country and its level of indebtedness. Compliance with the medium-term objectives should allow Member States to maintain sufficient reserves of −3% of the GDP against the reference value of the balance of general government sector during common cyclical fluctuations, to secure the progressive steps towards sustainability and ensure space for any necessary budgetary operations. The procedure for its calculation is determined by the Code of Conduct (EFC, 2017). For the Czech Republic it currently corresponds to the level of structural balance of −0.75% of GDP and is revised every three years.

One-off and other temporary measures are revenue or expenditure measures that only have a temporary impact on the general government balance and often stem from events outside the direct control of executive or legislative authorities (e.g. flood relief expenditure).

Output gap is the difference between real and potential output measured in percent of potential output. It serves to identify the position of the economy in the cycle.

Potential output is the level of economic output in the "full" utilisation of available resources. Full utilisation of resources is meant here rather as optimal and balanced, which does not lead to pressures such as changes in the inflation dynamics, etc.

Short-term interest rate is in the Czech Republic represented by PRIBOR 3M, as the reference value for the interest rate indicating the average rate, for which banks can borrow on the market for interbank deposits with a maturity of three months.

Using the **purchasing power parity** method, comparison of the economic performance of individual countries within the EU is carried out in Purchasing Power Standards, which is an artificial currency unit that expresses a quantity of goods that can be purchased on average for 1 euro in the EU after currency conversion for countries using a different currency unit than the euro.

Social benefits in cash are social benefits (e.g., pension insurance benefits, state social security benefits) paid to households from the general government sector.

Structural balance is the difference between cyclically adjusted balance, and one-off and temporary measures (for both components see above). **Primary structural balance** is further adjusted for interest payments.

Unemployment (Labour Force Sample Survey) corresponds to the number of persons who simultaneously met three conditions in the reference period (reference week): they were not employed, actively sought work and were ready to take up work within 14 days at the latest. **Unemployment rate** expresses the ratio of the number of the unemployed and the labour force. A person unemployed for more than 12 months is considered **long-term unemployed**.

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