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(Information)

COUNCIL

COUNCIL OPINION

of 5 July 2004

on the Convergence Programme of the Czech Republic, 2004-2007

(2004/C 320/01)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 9(2) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 5 July 2004, the Council examined the convergence programme of the Czech Republic, which covers the period 2004 to 2007. The programme complies only partly with the data requirements of the revised 'code of conduct on the content and format of stability and convergence programmes'. In particular, the quality of ESA95 data on revenues and expenditures of both the functional sub-components and the sub-sectors of the general government needs to be further improved.

The budgetary strategy underlying the programme aims at gradual reduction of the general government deficit to 3,3 % of GDP in 2007 from 12,9 % in 2003 (5,9 % of GDP excluding a major one-off operation related to imputed state guarantees). The programme further mentions that the proposed path of deficit reduction indicates that the elimination of the excessive deficit would be completed by 2008. This goal is set to be achieved by fiscal consolidation measures adopted to a large extent in 2003 and 2004. The programme envisages that the fall in the general government revenue-to-GDP ratio is more than offset by the cut in the general government expenditure ratio. On the revenue side, the programme constitutes a shift from direct to indirect taxation. On the expenditure side, the programme foresees a decrease in transfers and subsidies and in government consumption. The programme envisages a slight increase in public investment expenditures as a share of GDP.

The macro-economic scenario underlying the programme reflects cautious growth assumptions, i.e. growth of 2,8 % in 2004 and an acceleration thereafter, reaching 3,5 % in 2007. This scenario is taken as the reference scenario for assessing budgetary projections. The projection for inflation appears realistic.

([1]) OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

The programme foresees the deficit to be reduced to 3,3 % of GDP in 2007 and to fall further thereafter, with the following intermediate targets: 5,3 % of GDP in 2004, 4,7 % of GDP in 2005, and 3,8 % of GDP in 2006. The adjustment path is not very ambitious in the absence of fundamental reforms in social expenditures and taking account of the projected recovery. The risks to the budgetary projections appear broadly balanced. On the one hand, the cautious macroeconomic scenario suggests that revenues could be better than expected and that expenditures could be less than budgeted. On the other hand, the impact of the numerous coinciding tax changes in 2004 on the behaviour of economic agents remains uncertain. In addition, important savings measures, particularly regarding government consumption, still need to be agreed upon. The budgetary stance in the programme seems sufficient to reduce the deficit to the 3 % of GDP deficit threshold by 2008.

The debt ratio increases by 4,1 percentage points over the programme period, reaching 41,7 % of GDP in 2007. The evolution of the debt ratio may be less favourable than projected, given possible developments affecting the stock-flow adjustment.

Regarding long term sustainability, the Czech Republic faces serious risks of budgetary imbalances in meeting the cost of an ageing population. Making progress towards securing an adequate primary surplus is essential to ensure that the public finances are on a sustainable footing. Furthermore, the budgetary strategy based on a gradual consolidation over the programme period needs to be complemented by measures that address directly the expected surge in age-related expenditures, including a comprehensive reform of pension and healthcare systems.

On 5 July 2004, on the basis of recommendations from the Commission, the Council decided that an excessive deficit existed in the Czech Republic in accordance with Article 104(6) of the Treaty and made recommendations under Article 104(7) to the Czech Republic with a view to bringing that situation to an end, in which the Council expresses its policy advice.

Key projections from the convergence programme of the Czech Republic

	2003	2004	2005	2006	2007
Real GDP growth (%)	2,9	2,8	3,1	3,3	3,5
Employment growth (%)	− 0,7	− 0,8	− 0,3	0,0	0,1
HICP inflation (%)	− 0,1	2,8	2,6	2,2	2,2
General government balance (% of GDP)	− 12,9	− 5,3	− 4,7	− 3,8	− 3,3
Government gross debt (% of GDP)	37,6	38,4	39,7	41,0	41,7