COUNCIL OPINION

of 18 January 2005

on the updated convergence programme of the Czech Republic, 2004-2007

(2005/C 79/02)

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(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 18 January 2005 the Council examined the updated convergence programme of the Czech Republic, which covers the period 2004 to 2007. The programme complies broadly with the data requirements of the 'code of conduct on the content and format of stability and convergence programmes'. In particular, in spite of a revision in the data provided after the submission of the update, the expenditure and revenue ratios are not fully consolidated in line with ESA95 statistical standards. Accordingly, the Czech Republic is invited to achieve compliance with the data requirements.

The programme contains different scenarios for the macroeconomic and budgetary projections: a 'baseline' scenario, an 'optimistic' scenario and a 'pessimistic' scenario. The 'baseline' scenario is considered as the reference scenario for assessing budgetary projections, because it reflects plausible growth assumptions. This scenario expects real GDP growth to be 3,8 % in 2004. In 2005, real GDP is forecast to reach 3,6 % and to accelerate slightly later on, reaching 3,8 % in 2007. The programme's projections for inflation appear realistic.

On 5 July 2004, the Council decided that an excessive deficit existed in the Czech Republic and recommended that this be corrected by 2008.

The programme aims at reducing the deficit from 5,2 % of GDP in 2004 (including one-off expenditures of about 1,2 % of GDP) to below the 3 % of GDP reference value in 2008, in line with the Council recommendation under Article 104(7). Compared with the May 2004 convergence programme, there is no change in the deficit targets for 2005-2007 although GDP growth has been revised upward and the budgetary outcome for 2004 (excluding one-offs) is better than expected. The programme targets a cut in the general government deficit by 1,9 percentage points between 2004 and 2007 and a cut in the primary deficit by 2,3 percentage points over the same period. The adjustment is foreseen to be gradual, by about 0,5 % of GDP annually, except in 2006, when the deficit improvement is planned to be almost 1 % of GDP. Both revenues and expenditure are planned to fall over the programme period (as a percent of GDP), with public investment is the only expenditure item expected to increase, from 4,2 % of GDP in 2003 to 4,6 % of GDP in 2007, well above the EU-average (2,4 % of GDP in 2004).

The risks to the budgetary projections in the programme appear broadly balanced. On the one hand, the macroeconomic scenario suggests that revenues could be better than expected and that expenditures could be lower than budgeted. Moreover, further risks to the budgetary targets linked to the state guarantees and debt assumption appear to be limited. On the other hand, important expenditure cuts, particularly regarding government consumption, still have to be adopted in order to meet expenditure ceilings in 2006 and 2007. Also, the implementation of expenditure ceilings is subject to a risk ahead of the next regular parliamentary elections scheduled for June 2006. In view of this risk assessment, the budgetary stance in the programme seems sufficient to reduce the deficit to below 3 % of GDP by 2008 as envisaged in the programme.

([1]) OJ L 209, 2.8.1997, p. 1.

The debt ratio is estimated to have reached 38,6 % of GDP in 2004, well below the 60 % of GDP Treaty reference value. The programme projects the debt ratio to increase by 1,4 percentage points over the programme period.

The Czech Republic appears to be at serious risk with regard to the long-term sustainability of the public finances, on grounds of the very important projected budgetary costs of an ageing population. In particular, the strategy of fiscal consolidation outlined in the programme needs to be complemented with additional reforms to reduce the sustainability risks associated with the projected increase in pension and health-care expenditures.

The economic policies outlined in the update are partly consistent with the country-specific broad economic policy guidelines in the area of public finances. On the one hand, the programme is in line with the reduction of the general government deficit recommended by the Council and the reduction is based on legally binding medium-term expenditure ceilings. On the other hand, the implementation of the recommended cuts of the wage bill of central government envisaged in the May convergence programme is proving difficult and measures to control the deficits and debt of regional governments and municipalities might not be sufficient. In addition, the programme does not present concrete steps to safeguard the long-term sustainability of the public finances, specifically through the implementation of pension and healthcare reforms.

In view of the above assessment, and in the light of the recommendations made by the Council under Article 104(7), the Czech Republic is recommended to allocate higher-than-budgeted revenues to deficit reduction and adhere strictly to the medium-term expenditure ceilings for central government, which become legally binding from 2006. Furthermore, the Czech Republic is invited to step up the pension reform and to undertake the reform of the healthcare system to improve the long-term sustainability of the public finances.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007
Real GDP (% change)	**CP December 2004**	**3,8**	**3,6**	**3,7**	**3,8**
	COM autumn 2004	3,8	3,8	4,0	n.a.
	CP May 2004	*2,8*	*3,1*	*3,3*	*3,5*
HICP inflation (%)	**CP December 2004**	**2,7**	**3,2**	**2,6**	**2,2**
	COM autumn 2004	2,8	3,1	2,9	n.a.
	CP May 2004	*2,8*	*2,6*	*2,2*	*2,2*
General government balance (% of GDP)	**CP December 2004**	**– 5,2**	**– 4,7**	**– 3,8**	**– 3,3**
	COM autumn 2004	– 4,8 ([1])	– 4,7	– 4,3	n.a.
	CP May 2004	*– 5,3*	*– 4,7*	*– 3,8*	*– 3,3*
Primary balance (% of GDP)	**CP December 2004**	**– 4,0**	**– 3,3**	**– 2,3**	**– 1,7**
	COM autumn 2004	– 3,6 ([1])	– 3,3	– 2,9	n.a.
	CP May 2004	*– 4,1*	*– 3,4*	*– 2,4*	*– 1,7*
Government gross debt (% of GDP)	**CP December 2004**	**38,6**	**38,3**	**39,2**	**40,0**
	COM autumn 2004	37,8 ([1])	39,4	40,6	n.a.
	CP May 2004	*38,4*	*39,7*	*41,0*	*41,7*

([1]) The Commission services forecast for 2004 did not include the imputed state guarantee of 0.8% of GDP.

Sources:

Convergence programme (CP); Commission services economic forecasts (COM)