

**Statement of the Czech Fiscal Council concerning the amendment doing away with
super-gross wage taxation and loosening the fiscal rules set out in the Act on
Budgetary Responsibility Rules**

On 26 October 2020, House Document No. 910 was published on the website of the House of Deputies, containing an amendment put forward by Member of Parliament Andrej Babiš, concerning the government draft act amending certain acts in the sphere of taxation and certain other acts. The substance of the amendment lies in doing away with the taxation of the super-gross wage and further loosening budgetary responsibility rules.

With respect to the amendment, the CFC states the following:

- The amendment of the Act on Budgetary Responsibility Rules confirms that the proposed doing away of the taxation of super-gross wage as well as the set-up of the government budget for 2021 do not comply with the structural balance limits set by the current text of the Act. Following the spring loosening that shifted the structural balance limit for 2021 to -4% of GDP, however, the Act already gives the government sufficient room for an active fiscal policy. In the CFC's opinion, further deepening of the fiscal imbalance is therefore not required at this point.
- Given that the government budget proposal for 2021 as approved by the government assumes a structural balance of -4.5% of GDP, doing away with the taxation of the super-gross salary with the parameters proposed would result in a further deepening of the structural deficit to approximately 6% of GDP. If subsequent consolidation of 0.5% of GDP per year were done (as the amendment assumes), the original limit of structural balance, of -1% of GDP, would only be achieved in 2031.
- Such a loosening of fiscal policy would result in a long-term increase of the debt quota that would peak around 2027, when the debt brake limit would be reached (55% of GDP). If, however, public sector finances in 2020 came out with a result worse than that foreseen by the current macroeconomic prediction, which may be seen as highly likely, with a view to the restrictive measures taken in connection with the second wave of the epidemic, the debt brake limit would be reached even earlier. Analysis in June of this year had estimated that Czech public finance would reach the debt brake point in approximately 2043.





- The form of the amendment as well as the method of its submission constitute serious violations of elementary rules of the budgetary process: the government has already approved the draft 2021 budget, which does not plan on such a significant intervention in public processes. This constitutes a breach of the principle of that the budget be complete and correspond to reality.
- The fact that the Act on Budgetary Responsibility Rules is so seriously altered by a parliamentary amendment, points to the dismal and irresponsible approach of the government to the institute of fiscal rules. Such a fundamental change should have passed through the standard legislative process, been discussed with relevant stakeholders (including the CFC) and featured a well-worked-out macroeconomic impact analysis. In addition the material is of poor quality in formal terms, as well – containing both factual and formal errors.
- The proposed reduction of individual income tax will also have a significant impact on municipal and regional budget income. An outage of around CZK 20 bn can be expected for the former, CZK 7 bn for the latter. Municipalities and regions cannot be expected to reduce their operating expenses to such a degree, or secure sources by increasing their indebtedness. The consequence of the step will thus be a drop in their investment activity, with an adverse impact on aggregate demand and on the rate of recovery of the country's economy.
- The rationale of the amendment states that the income tax reduction is intended to apply for two years and that the final tax regime and rates would be decided upon based on current economic and fiscal developments. The amendment of the Act does not, however, set out any mandatory review after two years.
- The method chosen for alleviating the tax burden on individuals cannot be considered appropriate, from the macroeconomic point of view, if it is to lead to stimulating consumer demand. From the point of view of net income, more will be gained by higher-income households, which can be expected to save a significant portion of their extra income, which means that the funds will not be moved back to the real economy.

Based on the above, the CFC does not recommend adopting the proposed regulation of individual income tax and of the Act on Budgetary Responsibility Rules, as it would fundamentally deepen the imbalance of public finance and not yield any significant positive impact on the economic situation in the Czech Republic.

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