Convergence process in the new EU members

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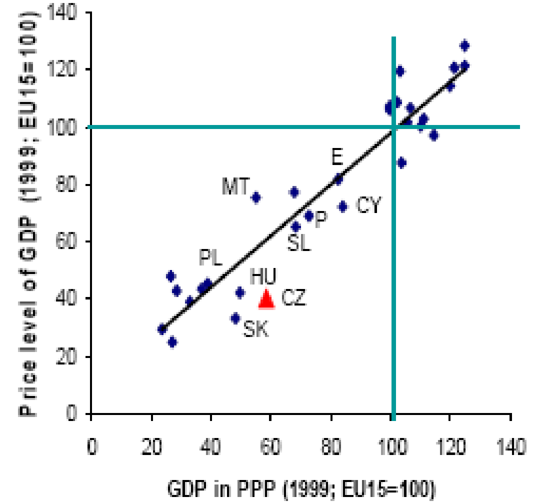
Content:

Real vs. nominal convergence

- ***Real convergence*** = Catching-up of per capita income levels and institutional structures
  - Copenhagen criteria – *political* – stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, *economic* – functioning market economy as well as capacity to cope with competitive pressure and market forces within EU, *adoption of the acquis* – ability to take on obligations related to membership, including adherence to the aims of political, economic and monetary union
- ***Nominal convergence*** = Fulfilling the Maastricht criteria



Source: Zdeněk Tůma - Czech Republic´s accession to the EMU, CEPS, Brussels, 24 June 2002

Real vs. nominal convergence

- „the real versus the nominal convergence“ = “Copenhagen versus Maastricht”.
- two sets of criteria - competition or complementarity?
  - the nominal convergence – restrictions to economic growth
  - x ECB - the two processes in parallel
- the Czech economy - promising growth rates in 1995-96, release of the restrictions on the free movement of capital, CZK externally convertible x widening imbalances, a speculative attack on CZK, austerity packages, political crisis, economic downturn ⇒ one-sided preference of the real convergence = risk of a boom-bust pattern which may prolong the process of catching up with the EU and may translate itself into extra social costs
- process of catching up with the EU price level
  - the disinflation strategy only postpones the necessary hike in prices to bring them to the same level as that prevailing in the EU
  - the strategy is counterproductive by exposing the economy to the danger of a massive price jump upon the entry to the EU
  - doubts about the consistency of the Maastricht criteria which require in parallel the price and exchange rate stability while candidate country supposedly needs to close the price gap either by way of higher inflation or by way of nominal appreciation
- Balassa-Samuelson effect (BS) - a higher productivity or a faster growth will inevitably lead to a higher inflation
  - a too ambitious disinflation = a restriction to productivity growth and real convergence
  - the BS effect - abstraction from the capital flows ⇒ a higher inflation rate, higher interest rate differential = adjustment mechanisms carried by the capital flows may cause overshooting, with subsequent economic turbulence
- the existing price gap
  - the danger of a price jump due to the functioning of price arbitrage
  - the agriculture where price distortions can be attributed to the Common Agriculture Policy
  - lower indirect taxes
  - unfinished changes to administrative prices
- the policy trade-offs involved in the issue of the real versus the nominal convergence should be addressed by an efficient system of co-ordination between government and central bank policies

Source: Oldřich Dědek, Vice Governor Czech National Bank - Challenges of Real and Nominal Convergence

Content:

Economic situation - Summary

	GDP real (yoy, %)		Gross fixed capital formation (real, yoy, in %)		CPI (yearly average)		Unemployment (yearly average)		Budget balance (in % of GDP)		CA (% of GDP)		FDI (inflow, net in EUR mil.)		Gross foreign debt (in % of GDP)		Average exchange rate -/EUR
	2003	2005	2003	2005	2003	2005	2003	2005	2003	2005	2003	2005	2003	2005	2003	2005	2005
Bosnia and Herzegovina	3.5	5.5	n/a	n/a	0.6	2.9	n/a	n/a	-1.3	0.0	-24.5	-22.5	337	240	57.1	50.2	1.96
Bulgaria	4.5	5.5	13.9	19.0	2.3	5.0	14.3	11.5	0.0	3.2	-9.2	-11.8	1,827	1,856	60.2	67.7	1.96
Croatia	5.3	4.3	16.8	4.8	1.8	3.3	19.5	18.0	-6.1	-4.2	-7.1	-6.3	1,788	1,328	83.6	82.4	7.40
Czech Republic	3.2	6.0	4.7	3.7	0.1	1.9	9.9	8.9	-12.5	-2.6	-6.3	-2.1	1,875	8,806	34.3	41.7	29.80
Estonia	6.7	9.8	8.5	12.4	1.3	4.1	10.0	7.9	2.6	1.8	-13.0	-10.5	797	2,480	68.7	92.1	15.65
Hungary	3.4	4.1	2.5	6.6	4.7	3.6	5.9	7.2	-6.4	-6.1	-8.7	-7.3	424	4,271	64.7	77.4	248.00
Latvia	7.2	10.2	12.3	20.0	2.9	6.7	10.6	8.9	-1.6	-1.0	-8.1	-12.5	228	390	79.1	101.1	0.70
Lithuania	10.5	7.5	18.7	7.1	-1.2	2.7	12.4	8.5	-1.2	-0.5	-6.8	-7.1	160	488	40.6	46.0	3.50
Poland	3.8	3.2	-0.1	6.2	0.8	2.1	20.0	18.2	-4.8	-3.8	-2.1	-1.6	3,660	6,920	43.7	43.5	4.00
Republic of Macedonia	2.8	3.8	7.5	7.0	1.2	0.5	36.7	36.5	-0.7	-1.0	-3.3	-1.5	85	78	39.2	40.3	61.20
Romania	5.2	4.1	8.6	13.0	15.3	9.0	7.6	5.8	-2.2	-0.8	-5.8	-8.7	1,910	5,208	33.9	38.5	3.60
Serbia and Monte-Negro	2.4	6.1	n/a	n/a	9.7	15.2	31.7	32.5	-3.4	0.9	-9.8	-8.7	1,241	1,530	69.9	61.6	83.20
Slovakia	4.5	6.0	-1.5	12.4	8.5	2.7	15.2	11.6	-3.5	-3.1	-0.8	-8.8	506	1,534	53.3	60.6	38.60
Slovenia	2.7	3.9	7.1	3.7	5.6	2.5	6.7	6.6	-2.9	-1.8	-0.4	-1.1	-118	-45	52.2	71.3	239.60
Austria	1.4	1.9	6.1	0.9	1.3	2.3	4.3	5.1	-1.5	-1.5	-0.2	1.2	6,330	7,170	167.9	174.5	-
Eurozone	0.7	1.4	0.8	2.1	2.1	2.2	8.7	8.6	-3.0	-2.7	0.6	-0.2	138	53	30.1	30.9	-

Source: CEE Economic Data - Outlook for 2007, Issue 1; Bank Austria Creditanstalt; http://economicresearch-e.ba-ca.com

Current conditions
- Growth of close to 4.6% in 2005
- Increasing domestic and foreign investment
- Rising intra-regional trade
- Expanding world market shares
- Deepening structural reforms

Necessary to
- Continued improvements in labor productivity
- Accelerated infrastructural development
- Greater macroeconomic discipline

External risks
- Growth in the CEE-8's key EU-15 markets
- Dollar decline
- Heightened competition for foreign direct investment

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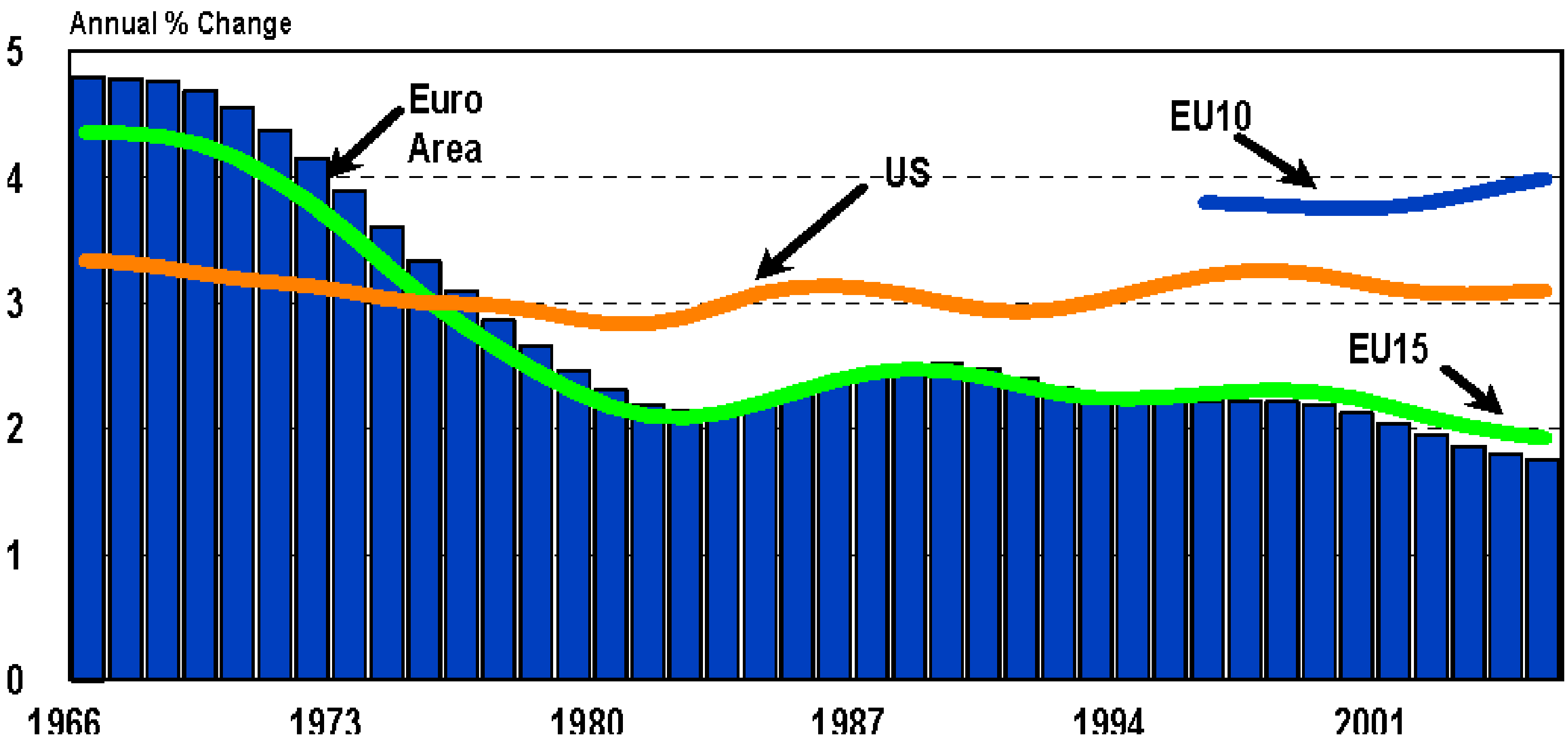
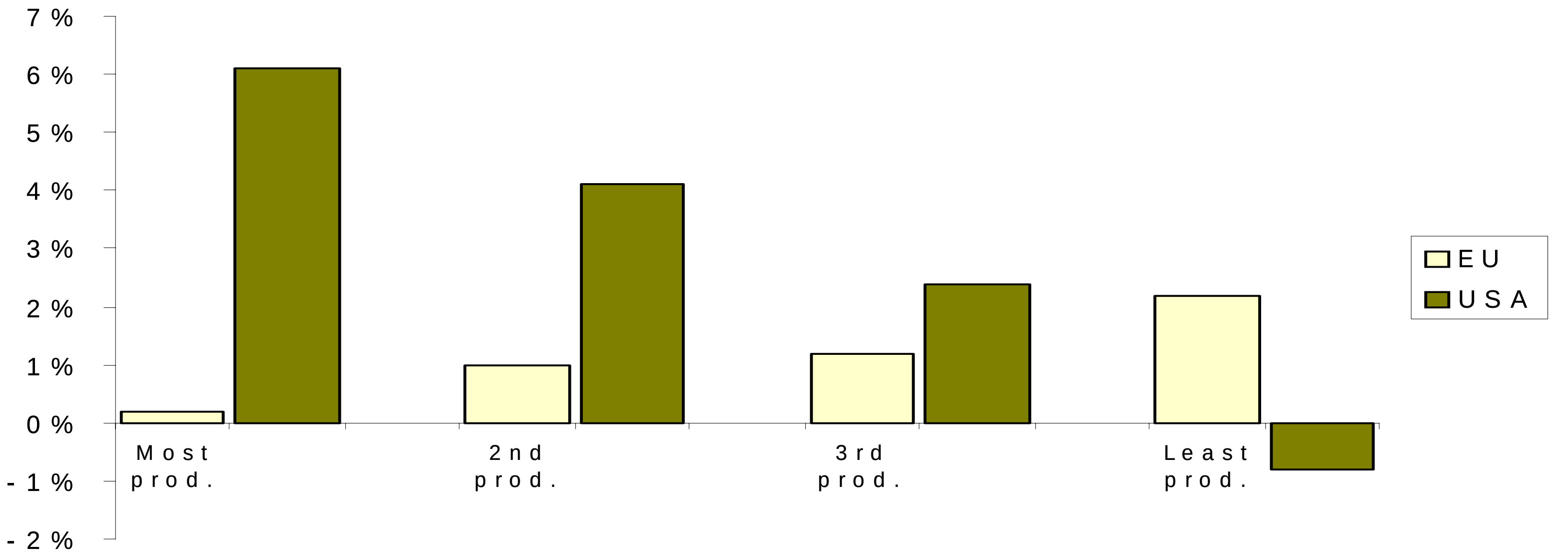
Current attractivity of Euro zone and EU 15 for new EU members



Source: EU Growth Trends at the Economy-Wide and Industry Levels, European Commission, April 2006

Growth of Employment by Productivity Quartiles – knowledge, competition and flexible labour markets needed

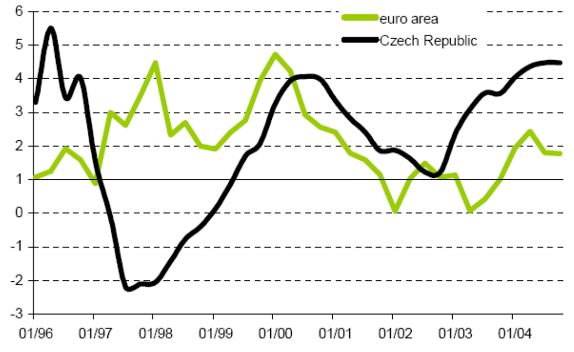
Current EU 15 rigidity versus US flexibility



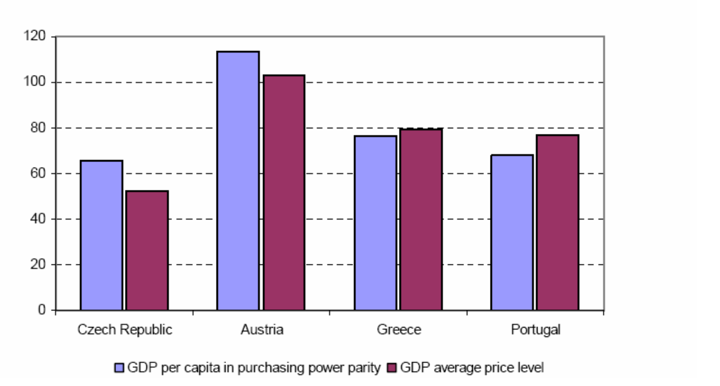
Source: Gretschmann K., Innovation, Competition and Economic Growth, presented at Knowledge Economy Forum V, Prague March 2006

Real convergence - the Czech Republic

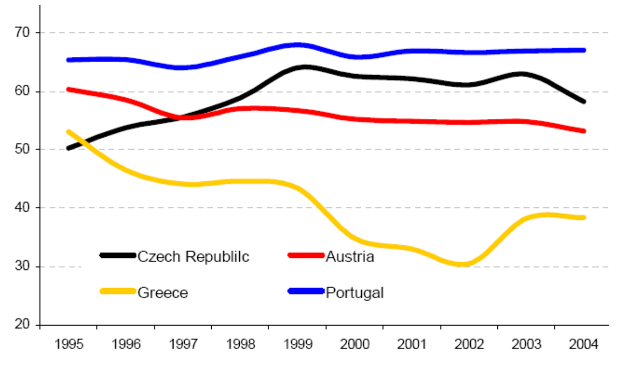
GDP growth in the Czech Republic and the euro area (in%, year on year)



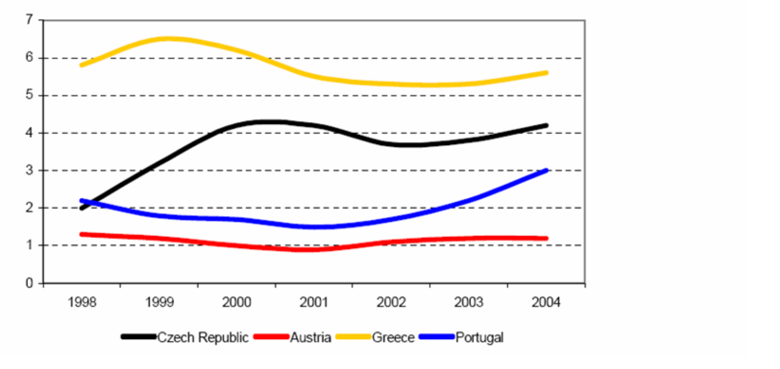
Real economic convergence of selected states towards euro area in 2004 (euro area average = 100)



Exports to the euro area as a percentage of total exports



Long-term unemployment: ratio of persons unemployed for more than one year to the labour force (%)



Source: Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area - A joint document of the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on November 23, 2005

Content:

1. Real vs. nominal convergence
2. Real convergence – Economic indicators
3. **Nominal convergence – Growth and Stability Pact, convergence criteria, convergence programme**
4. Structural convergence

Maastricht convergence criteria

Convergence criteria						Obligation to adopt [4]	Target date		Euro coins design
Country [1]	Inflation rate [2]	Government finances		ERM II membership	Interest rate [3]		set by the country	recommended by the Commission	
		annual government deficit to GDP	gross government debt to GDP						
Reference value [5]	**max 2.6%**	**min. -3%**	**max. 60%**	**min. 2 years**	**max 7.9%**	**NA**	**NA**	**NA**	**NA**
United Kingdom	2.20%			0 years		opt-out	conditional	NA	NA
Denmark	2.10%			joined ERM II on 1 January 1999		opt-out	not yet set	NA	NA
Sweden	0.50%			0 years		yes	not yet set	NA	none yet
Slovenia	2.30%	-1.90%	29.40%	joined ERM II on 28 June 2004		yes	2007	yes	ready
Estonia	1.30%	1.80%	4.90%	joined ERM II on 28 June 2004		yes	2008	TBA	ready
Cyprus	2.40%	-4.10%	71.90%	joined ERM II on 2 May 2005		yes	2008	TBA	in progress
Malta	0.40%	-5.20%	75%	joined ERM II on 2 May 2005		yes	2008	TBA	ready
Latvia	2.90%	-0.70%	14.30%	joined ERM II on 2 May 2005		yes	2008	TBA	ready
Lithuania	-1.20%	-2.50%	19.70%	joined ERM II on 28 June 2004		yes	2009	TBA	ready
Slovakia	2.70%	-3.30%	43.60%	joined ERM II on 28 November 2005		yes	2009	TBA	ready
Bulgaria	4.60%	3.10%	29.90%	0 years	3.80%	yes	2009	NA	in progress
Czech Republic	2.90%	-3%	37.40%	0 years		yes	2010	NA	in progress
Hungary	4.70%	-5.40%	60.40%	0 years		yes	*2010-2014*	NA	in progress
Poland	0.70%	-6.80%	47.70%	0 years		yes	2011	NA	in progress
Romania	15.30%			0 years		yes	2012	NA	none yet
Croatia	1.80%			0 years		yes	NA	NA	NA
Macedonia	1.20%			0 years		yes	NA	NA	NA
Turkey	7.70%			0 years		yes	NA	NA	NA
Albania	2.40%			0 years		yes	NA	NA	NA
Bosnia and Herzegovina	0.90%			0 years		yes	NA	NA	NA
Serbia				0 years		yes	NA	NA	NA
Montenegro				unilaterally adopted		yes	NA	NA	NA

1) Current EU member states that have not yet adopted the Euro, candidates and official potential candidates.

2) No more than 1.5% higher than the 3 best-performing EU member states.

3) No more than 2% higher than the 3 best-performing EU member states.

4) Formal obligation for Euro adoption in the country EU Treaty of Accession or the Framework for membership negotiation.

5) Values from 2005 statistics.

Source: www.wikipedia.org

Maastricht convergence criteria – the Czech Republic

- The Czech Republic is currently compliant with the criterion on price stability
  - CNB’s inflation target for the national consumer price index for the period starting 2006 set at 3%
  - + CNB´s endeavour to ensure that actual inflation does not differ from this target by more than one percentage point in either direction
  - target = conditions for the fulfilment of the criterion near its reference value, provided that inflation in the EU Member States does not deviate too far downwards from the ECB’s definition of price stability (inflation “below, but close to 2%”).
- The Czech Republic is not compliant with the criterion on the sustainability of the government financial position.
  - draft of the 2005 Convergence Programme - a sustainable decrease in the public budgets deficit to below 3% of GDP can be expected from 2008 onwards = a major limitation with respect to the timing of euro adoption
  - the government debt - still relatively low in comparison with the reference value of 60% of GDP
- Exchange rate criterion - possible after the Czech Republic joins ERM II and announces the central parity for the CZK exchange rate within this mechanism
  - The fluctuations in the CZK/EUR exchange rate over the last few years have been distinctly smaller than the hypothetical band of ±15% - however, the deviations from the average rate quite significant (an appreciation trend for some time)
    - ⇒ impossible to say for sure whether the past developments would have been assessed as compliant with the condition of movement close to the central parity “without severe tensions”
- The Czech Republic is currently compliant with the long-term interest rate criterion without any problems
  - complying with this criterion is conditional on maintaining financial market confidence in the successful completion of the public finance reform
    - if the reform not realised ⇒ downgrading of the Czech Republic’s international rating, a higher risk premium on government bonds and consequently an increase in long-term interest rates

Criterion on the Sustainability of Public Finances - Government deficit criterion

- The current settings of the Czech Republic's public finance parameters prevent it from satisfying the government deficit criterion in a sustainable manner
- The outlook for the period ahead suggests that the temporary decline in the deficit to 3% of GDP in 2004 cannot be regarded as sustainable
- The ongoing consolidation of public finances is aimed at gradual reducing the government deficit
- Provided that the reform continues successfully, fulfilment of the convergence criterion can be expected in 2008)

Government deficit (ESA 1995 methodology, in % of GDP)

	2002	2003	2004	2005	2006	2007	2008
Reference value	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Czech Republic	-6.8	-12.5	-3.0	-4.8	-3.8	-3.3	-2.7

Source: Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area, A joint document of the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on November 23, 2005

Note: The forecast for the Czech Republic is taken from the draft Convergence Programme of the Czech Republic (2005), prepared using the data available in September 2005. The CNB's October 2005 forecast expects a public finance deficit of 3.6% of GDP in 2005, 3.0% of GDP in 2006 and 2.8% of GDP in 2007.

Criterion on the Sustainability of Public Finances - Government debt criterion

- Given its low initial level of government debt, the Czech Republic has no problem fulfilling this criterion.
- The government debt growth in recent years largely reflects the inclusion of the majority of the indirect liabilities of the government (particularly government guarantees and the sectorisation of Česká inkasní, the Czech Consolidation Agency and their subsidiaries in the general government sector).
- The rate of growth in debt is slowing thanks to the public finance reform.
- Successful completion of the fiscal consolidation should stabilise the government debt level safely below the reference level (see Table 2.3).

Government debt (ESA 1995 methodology, in % of GDP)

	2002	2003	2004	2005	2006	2007	2008
Reference value	60.0	60.0	60.0	60.0	60.0	60.0	60.0
Czech Republic	29.8	36.8	36.8	37.4	37.1	37.9	37.8

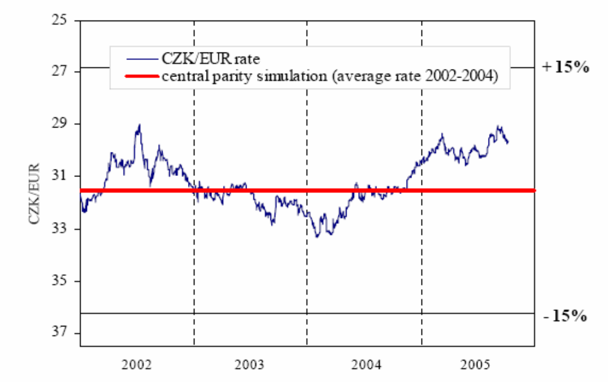
Source: Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area, A joint document of the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on November 23, 2005

Note: The forecast for the Czech Republic is taken from the draft Convergence Programme of the Czech Republic (2005), prepared using the data available in September 2005. The CNB's October 2005 forecast expects a government debt of 35.8% of GDP in 2005, 36.1% of GDP in 2006 and 36.7% of GDP in 2007.

Criterion on Exchange Rate Stability

- the Czech Republic does not participate in ERM II, so the central parity of the CZK/EUR rate has not been set yet. For this reason, the exchange rate criterion cannot be formally assessed
- the fluctuations in the CZK/EUR exchange rate over the last few years have been distinctly smaller than the hypothetical band of ±15% - however, the deviations from the average rate have been quite significant - an appreciation trend for some time
- the interpretation of the definition the criterion - not entirely clear, the assessment of fulfilment of the criterion will have to take into account other factors ⇒ difficult to say for sure whether the present situation would be assessed as compliant with the condition of movement close to the central parity “without severe tensions”

Nominal CZK/EUR rate



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Note: In the chart, an upward movement in the exchange rate means an appreciation of the koruna.

The hypothetical central parity is simulated by the average rate for 2002–2004.

Criterion on Price Stability

- the Czech Republic compliant with the criterion on price stability since 2002
- the only exception = 2004 - inflation increased temporarily ⇐ changes to indirect taxes and a simultaneous decrease in the reference value due to exceptionally low inflation in some EU countries
- according to the current forecast on which the Czech Republic's Convergence Programme is based and to the inflation outlook for EU Member States, there should be no danger of non-fulfilment of this criterion in the future, either

Harmonised Index of Consumer Prices

(average for last 12 months vs. average for previous 12 months, growth in %)

	2002	2003	2004	8/05	2005	2006	2007	2008
Average for 3 EU countries with the lowest inflation	1.4	1.2	0.7	0.9	0.9	1.3	1.3	1.3
Reference value (1st line + 1.5 p. p.)	2.9	2.7	2.2	2.4	2.4	2.8	2.8	2.8
Czech Republic	1.4	-0.1	2.6	1.8	1.5	2.2	2.0	2.1

Source: Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area, A joint document of the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on November 23, 2005

Note: The outlook for inflation in the European Union for 2005–2006 is taken from the European Commission's spring economic forecast and that for 2007–2008 from the Member States' Convergence Programmes and Stability Programmes (2004).

The forecast for the Czech Republic is taken from the draft Convergence Programme of the Czech Republic (2005), prepared using the data available in September 2005. The CNB's October 2005 forecast expects HICP inflation of 1.7% in 2005, 3.3% in 2006 and 3.1% in 2007.

Criterion on long-term interest rates

- the Czech Republic is currently compliant with the criterion on long-term interest rates and no problems are expected in this area in the future
- the forecast for interest rates on government bonds in the Czech Republic dependent on the successful completion of the public finance consolidation - any loss of financial market confidence in the outcome of the fiscal reform could very quickly pass through into a rise in the risk premium on long-term interest rates and endanger the fulfilment of this convergence criterion

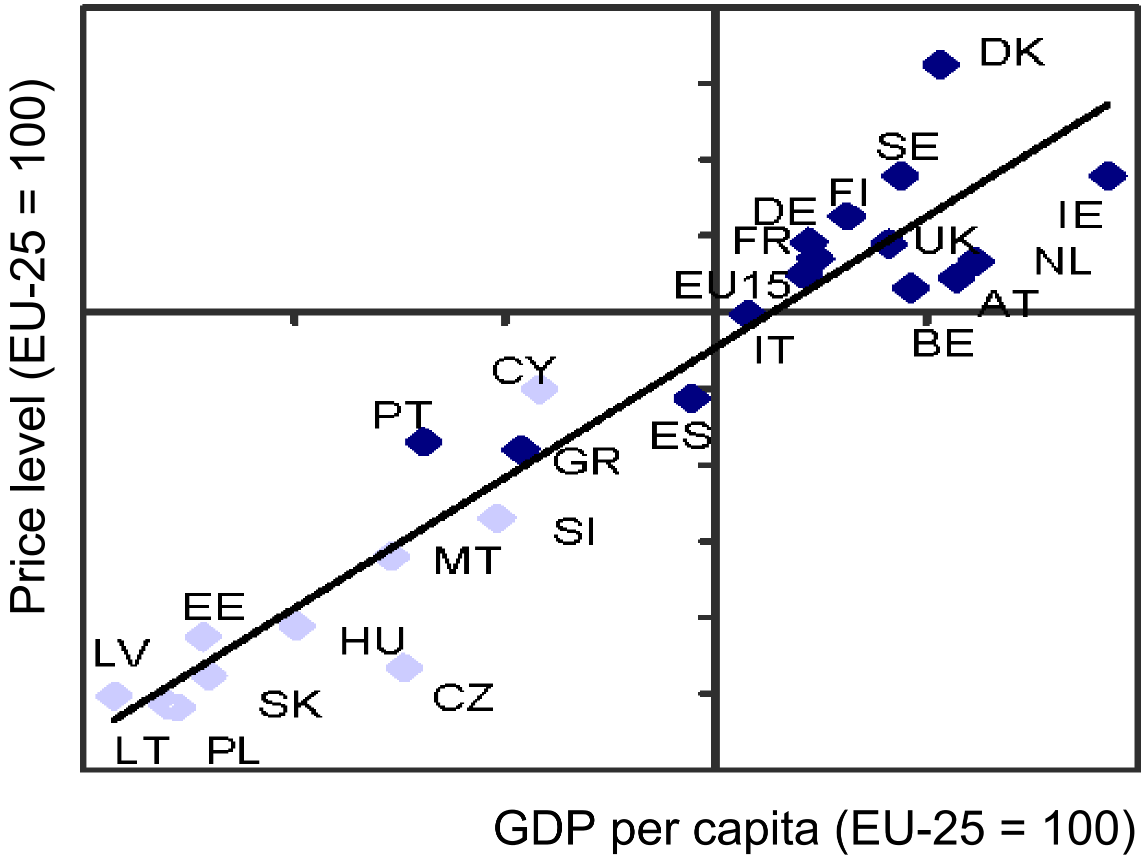
10-year interest rates on government bonds on the secondary market (average for the last 12 months, in %)

	2002	2003	2004	7/05	2005	2006	2007	2008
Average for 3 countries with the lowest inflation	4.9	4.12	4.28	3.76	3.8	4.2	4.2	4.2
Reference value (1st line + 2.0 p.p.)	6.90	6.12	6.28	5.76	5.8	6.2	6.2	6.2
Czech Republic	4.94	4.12	4.75	4.01	3.3	3.4	3.9	4.0

Source: Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area, A joint document of the Ministry of Finance of the Czech Republic, the Ministry of Industry and Trade of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on November 23, 2005

Note: As no forecast for the time horizon under review is available for the long-term interest rates of the countries that should, according to the inflation forecast, form the basis for calculating the criterion, the projection of the reference value in the table is based on the technical assumption that long-term interest rates will move in line with inflation, i.e. real interest rates will not change. The reference value in 2005–2008 should therefore be viewed as only tentative.

Inflation risk growing ? (Risk of price catching up)



Source: Centrum pro hospodářská studia VŠEM, Bulletin 07/2006

Convergence programmes - Council Regulation (EC) 1466/97

SECTION 3 CONVERGENCE PROGRAMMES

- **Article 7**

  1. Each non-participating Member State shall submit to the Council and the Commission information necessary for the purpose of multilateral surveillance of regular intervals under Article 103 in the form of a ***convergence programme***, which provides an essential basis for price stability and for strong sustainable growth conducive to employment creation.

  2. A convergence programme shall ***present the following information*** in particular on variables related to convergence:

     (a) the medium-term objective for the budgetary position of close to balance or in surplus and the adjustment path towards this objective for the general government surplus/deficit; the expected path for the general government debt ratio; the medium-term monetary policy objectives; the relationship of those objectives to price and exchange rate stability;

     (b) the main assumptions about expected economic developments and important economic variables which are relevant to the realization of the convergence programme, such as government investment expenditure, real GDP growth, employment and inflation;

     (c) a description of budgetary and other economic policy measures being taken and/or proposed to achieve the objectives of the programme, and, in the case of the main budgetary measures, an assessment of their quantitative effects on the budget;

     (d) an analysis of how changes in the main economic assumptions would affect the budgetary and debt position.

  3. The information about paths for the general government surplus/deficit ratio, debt ratio and the main economic assumptions referred to in paragraph 2 (a) and (b) shall be on an annual basis and shall cover, as well as the current and preceding year, at least the following three years.

- **Article 8**

  1. Convergence programmes shall be submitted before 1 March 1999. Thereafter, updated programmes shall be submitted ***annually***.

  2. Member States shall make public their convergence programmes and updated programmes.

Convergence programmes - Council Regulation (EC) 1466/97

- **Article 9**

  1. Based on assessments by the Commission and the Committee set up by Article 109c of the Treaty, ***the Council*** shall,..., ***examine*** whether the medium-term budget objective in the convergence programme provides for a safety margin to ensure the avoidance of an excessive deficit, whether the economic assumptions on which the programme is based are realistic and whether the measures being taken and/or proposed are sufficient to achieve the targeted adjustment path towards the medium-term objective and to achieve sustained convergence....

  2. ...Where the ***Council***, ..., considers that the objectives and contents of a programme should be strengthened, the Council shall, in its opinion, ***invite the Member State concerned to adjust*** its programme.

  3. Updated convergence programmes shall be examined by the Committee set up by Article 109c on the basis of assessments by the Commission; if necessary, updated programmes may also be examined by the Council....

- **Article 10**

  1. As part of multilateral surveillance ..., the Council shall ***monitor the implementation of convergence programmes*** on the basis of information provided by non-participating Member States ..., in particular with a view to identifying actual or expected significant divergence of the budgetary position from the medium-term budgetary objective, or the adjustment path towards it, as set in the programme for the government surplus/deficit.

  In addition, ***the Council shall monitor the economic policies*** of non-participating Member States in the light of convergence programme objectives with a view to ensure that their policies are geared to stability and thus to avoid real exchange rate misalignments and excessive nominal exchange rate fluctuations.

  2. In the event that the Council identifies significant ***divergence of the budgetary position from the medium-term budgetary objective***, or the adjustment path towards it, it shall, with a view to given early warning in order to prevent the occurrence of an excessive deficit, address in accordance with Article 103 (4), ***a recommendation*** to the Member State concerned to take ***the necessary adjustment measures***.

  3. In the event that the Council in its subsequent monitoring judges that ***the divergence*** of the budgetary position from the medium-term budgetary objective, or the adjustment path towards it, is ***persisting or worsening***, the Council shall, in accordance with Article 103 (4), make ***a recommendation*** to the Member State concerned to take ***prompt corrective measures*** and may, as provided in that Article, make its recommendation public.

Convergence Programme of the Czech Republic November 2005

Economic growth (CZK billion, increase in %)

% of GDP	2004	2004	2005	2006	2007	2008
	level	rate of change	rate of change	rate of change	rate of change	rate of change
Real GDP	2,669	4.4	4.8	4.4	4.2	4.3
Nominal GDP	2,750	7.6	5.7	6.7	7.0	7.4
Private consumption	1,343	2.1	2.3	3.5	3.6	3.6
Government consumption expenditure	592	-2.0	-0.6	-0.2	-0.5	-0.5
Gross fixed capital formation	737	7.6	2.8	3.4	4.8	7.5
Change in invent. and net acq. of valuables (%GDP)	9	0.3	-0.4	0.3	0.6	0.7
Exports of goods and services	1,938	21.9	9.5	10.2	9.8	10.0
Import of goods and services	1,950	18.4	3.9	8.8	8.9	9.8
Final domestic demand		2.6	1.8	2.6	2.9	3.6
External balance of goods and services		1.7	4.0	1.2	1.0	0.6

Prices of goods and services

% changes	2004	2005	2006	2007	2008
HICP	2.6	1.5	2.2	2.0	2.1
National CPI	2.8	1.9	2.5	2.3	2.5
GDP deflator	3.0	0.9	2.2	2.8	3.0
Consumption of households deflator	2.7	1.5	2.4	2.3	2.9

Source: Convergence Programme of the Czech Republic (Updated version), November 2005

Convergence Programme of the Czech Republic November 2005

- The Czech Republic continues to register excessive budgetary deficits, which are an obstacle on the way to fulfilling the Maastricht criteria. In its new programme declaration, the new government, formed in May 2005, asserted its strategy for reducing the budget deficits and its conscientious compliance with the Convergence Programme.
- The public finance reform approved in 2003 and implemented in 2004 contained a set of measures geared to strengthening the income side and to achieving expenditure savings. In accordance with the adopted Conception of Public Finance Reform, the government continues to reduce the public finance deficit so that the consolidated public finance deficit does not exceed 3% of GDP in 2008.
- The Czech Republic will eliminate the excessive public budget deficit within the timeframe of the Convergence Programme. In 2008, the public budget deficit should fall safely below 3% of GDP. This step is the highest priority of all in the area of budgetary policy and government policy. The programme assumes a gradual reduction in the general government deficit to 3.8% of GDP in 2006, 3.3% in 2007 and 2.7% in 2008.
- A tool for implementing the fiscal targets should be compliance with the binding expenditure frameworks - expenditure-oriented fiscal consolidation

Deficit by sub-sectors

% of GDP	2004	2005 (1)	2006 (2)	2007 (2)	2008 (2)
General government	-3.0	-4.8	-3.8	-3.3	-2.7
Central government	-3.0	-4.9	-3.5	-3.0	-2.4
Local government	-0.1	-0.1	-0.3	-0.3	-0.3
Social sec. funds	0.0	0.1	0.0	0.0.	0.0

General government deficit and debt, by sub-sector

% of GDP	2004	2005 (1)	2006 (2)	2007 (2)	2008 (2)
General government	36.8	37.4	37.1	37.9	37.8
Central government	34.2	34.6	34.3	35.0	34.8
Local government	2.6	2.8	2.8	2.9	2.9
Social sec. funds	0.0	0.0	0.0	0.0	0.0

(1) Estimate; (2) Trend values or period averages

Source: Convergence Programme of the Czech Republic (Updated version), November 2005

The new Czech state budget for 2007 not in compliance

- August 14, 2006 - the Ministry of Finance - submitted to the cabinet a draft of next year's state budget
  - a deficit at least of CZK 88bn, revenues of CZK 886.7bn - expenditures of CZK 974.7bn
  - = the public finance deficit estimated at 3.8 % of GDP next year = t**he Czech Republic would fail to fulfil the convergence programme, which sets a deficit of just 3.3 % of GDP next year**
  - 2007 draft based on an estimated growth of the economy by 5 %, average inflation of 2.8 % and unemployment rate 7.4 %

Content:

Structural convergence in new EU member states ?

	CZ	HU	PO	SL	SK
Export of G&S/GDP	71%	60%	30%	60%	76%
Export to EU	69%	75%	70%	62%	61%
Export of SITC7+8	60%	71%	54%	55%	52%
FDI stock (USD p.c.)	2,610	2,280	1,050	1,630	960
Agriculture/Employ.	5%	6%	19%	10%	6%
Industry/Employ.	31%	27%	24%	32%	30%
Construction/Employ.	9%	7%	7%	6%	8%
Services/Employ.	55%	60%	50%	52%	56%
Agriculture/GDP	4%	4%	3.5%	3%	4%
Industry/GDP	34%	29%	25%	31%	25%
Construction/GDP	7%	5%	7.5%	5.8%	5%
Services/GDP	55%	62%	64%	60%	66%

Source: Zdeněk Tůma: Czech Republic´s accession to the EMU, CEPS, Brussels, 24 June 2002