

Fiscal policy

Special Report

Higher pensions and lower taxes to boost consumption



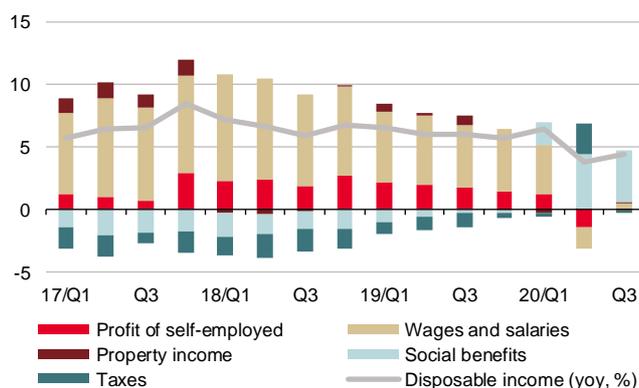
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At the turn of the year, two government measures came into force to help combat the coronavirus crisis and boost household consumption. The measures consisted of a one-time payment to all old-age, disability and survivors' pensioners and the elimination of super-gross wage and related tax adjustments. This study shows that both of these measures can have a strong impact on household consumption due to their widespread effect. According to our calculations, higher pensions should lead to a temporary increase in household consumption of almost 2%, and in the case of the tax reductions, to a sustainable increase in consumption of up to 3.4%. But given the high degree of uncertainty and the closure of the economy, the current situation might hinder consumer spending in terms of either total expenditure and/or amount spent over time.

The coronavirus pandemic and the associated closure of the economy have significantly affected households and businesses. Together with restrictive measures, the Czech government has introduced a number of support programmes to mitigate these effects. This analysis focuses on those directed to households. **The Antivirus programme in particular has a significant impact in this regard**, whereby the state compensates affected companies for a portion of – or in the case of a complete closure of operations – all labour costs.

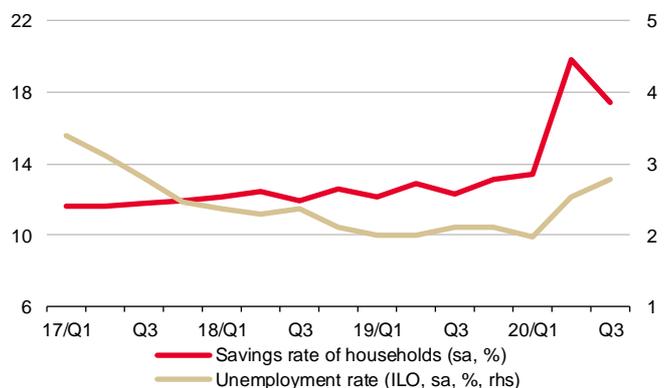
As a result, there has been no significant increase in unemployment or a decline in household income so far. This reflects the trend in gross household disposable income, which, despite the deep economic downturn, continued to grow year-on-year in the first three quarters of last year. As the chart below shows, **lower wages and salaries were offset by payments from the state in the form of social benefits**. These include, among other things, both the payment of nursing and sickness benefits, as well as compensatory bonuses to self-employed persons, who are also statistically classified as households.

Wage shortfalls were offset by income from social benefits



Source: CZSO, Economic & Strategy Research, Komerční banka

Savings rate increased more than unemployment rate



Source: CZSO, Economic & Strategy Research, Komerční banka

At the turn of the year, two other government measures came into force to support household consumption. However, in contrast to the above-mentioned Antivirus programme, the measures were designed to provide direct support to affected entities as well as to boost the income of most households.¹ This is a one-off financial payment to all persons receiving a retirement, disability or survivor's pension, with the elimination of the super-gross wage, together with an implicit reduction in the personal income tax rate and an increase in the basic taxpayer rebate (collectively referred to as the tax package).² **All these measures have led or will lead to a significant increase in income and, due to their already mentioned widespread effect, have the potential to significantly influence household consumption and the economy as a whole.**

The government made a one-time CZK5,000 payment in the first half of December last year to all persons receiving one of the above types of pensions. The payment was the same for all pensioners regardless of the pension they normally receive. According to the latest data from the Czech Social Security Administration (CSSA), 2.9m people in the Czech Republic received some type of pension in the third quarter of last year. 83.4% of those were old-age pensioners, 14.6% disabled pensioners and 2% entitled to a survivor's pension.

Table 1 – Percentage increase in quarterly pension due to a one-off payment

	As a % of the total number of pensioners	Average quarterly pension	Impact of one-time payment
Old-age pensioners	83.4%		
of which with early retirement	22.5%	CZK38,772	12.9%
of which with a regular pension	60.9%	CZK43,344	11.5%
Disabled pensioners	14.6%		
for 1st degree disability	6.0%	CZK22,140	22.6%
for 2nd degree disability	2.7%	CZK25,608	19.5%
for 3rd degree disability	5.9%	CZK38,181	13.1%
Survivors	2.0%		
widows	0.7%	CZK28,608	17.5%
widowers	0.2%	CZK25,620	19.5%
orphans	1.1%	CZK22,821	21.9%

Source: CSSA, Economic & Strategy Research, Komerční banka

Table 1 offers an even more detailed breakdown and also includes the average quarterly income of one pensioner in any given category. This income is equivalent to three times the average monthly pension paid in respective category in the third quarter of last year.³ The last column of the table contains the percentage increase in quarterly income resulting from the one-off December payment. **Taking into account the weight of each group of pensioners, pensioners' quarterly income increased by an average of 13% in the last quarter of last year.** The volume of paid pensions thus increased by almost CZK15bn in the fourth quarter, which is also the impact that the measure had on the state budget last year.

Pensioner households generally have a high propensity to consume and, according to the latest CZSO data for 2018, spent 82% of their income on consumption. They had the same

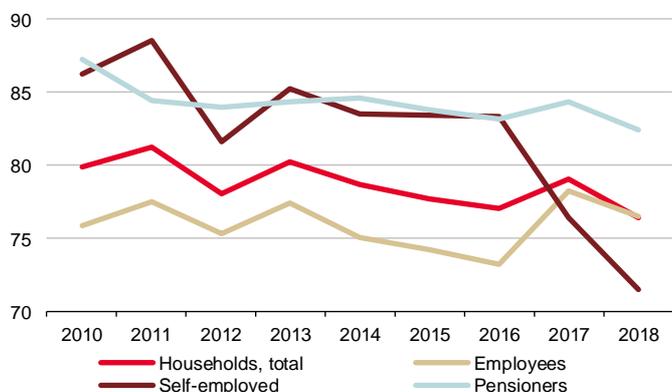
¹ Of the c.4.5m Czech households in 2019, there were 2.2m employee households (49% of the total) and 1.5m pensioners (33%).

² The personal income tax rate remains 15%, but since 1 January, the tax liability will be calculated on the basis of gross wages, not super-gross wages. Income that is above four times average wages will be taxed as of 1 January at a higher rate of 23%, which will replace the so-called solidarity tax surcharge.

³ The quarterly conversion is used to align the time period with national accounts data, which are monitored on a quarterly basis.

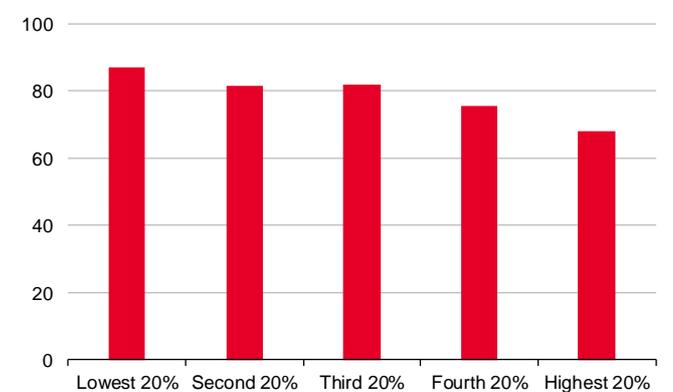
propensity to spend in previous years as well, as shown in the chart below.⁴ **According to our estimates, pensioners spent CZK12bn of a total of CZK15bn**, which is almost 2% of total household consumption in the third quarter of last year. If we relate this volume to total GDP last year (assuming a full-year decline of 6%), the CZK12bn is about 0.2%.

Propensity to consume by type of household (%)



Source: CZSO, Economic & Strategy Research, Komerční banka

Propensity to consume by household income level (%)



Source: CZSO, Economic & Strategy Research, Komerční banka

While payments to pensioners present only a temporary increase in income, elimination of super-gross wage and related tax adjustments will lead to a sustainable increase for a large portion of Czech households. According to the government’s plan, the lower tax burden should apply at least this year and next. Due to the above-mentioned tax adjustments, the average net wage should thus increase by 7.7% from January this year under otherwise unchanged conditions.⁵ The percentage increase at the individual income group levels differs only slightly. In the case of minimum wage income, i.e. CZK15,200 gross since January of this year, the increase is 7.9%. On the other side of the income scale, a gross salary of CZK130,000 per month will see an increase of 7.5%.

With average growth in net wages and salaries of 7.7% from 1 January, total disposable household income should rise by nearly CZK30bn year-on-year thanks to tax adjustments every quarter this year.⁶ According to the latest CZSO data for 2018, employee households’ propensity to consume is 77%. As shown in the chart above,⁷ **low-income households have a higher propensity to consume than high-income households.** According to 2016 data, 20% of the lowest income households spent 87% of their net income on consumption, while the top 20% spent only 68%.⁸

If the average propensity to consume remains 77% this year, the government’s tax adjustments should lead to an increase in household consumption of approximately CZK23bn each quarter. Relating this amount to total household consumption in the third quarter of last year, the increase is considerable at 3.4%.⁹ In comparison with our GDP forecast

⁴ Due to the change in the method of collecting household expenditure data in 2017, the propensities may not be fully comparable between 2010-16 and 2017-18. The propensity to consume is calculated as the share of household consumption expenditure in their net money income.

⁵ The calculation is based on the average gross monthly wage in the third quarter of last year, which was CZK35,402, and in terms of tax rebates includes only the basic rebate per taxpayer (in the increased amount valid since 2021).

⁶ The amount of CZK30bn is based on the total volume of net wages and salaries paid in the third quarter of last year. The calculation of this volume assumes that their share in the volume of gross wages and salaries recorded in national accounts is about 75%.

⁷ This graph includes all households in the Czech Republic, not only employee households.

⁸ Nothing more recent than 2016 data is available for this breakdown.

⁹ The impact on household consumption in the first quarter of this year will be dampened by the fact that households will not receive a higher payment for January until February.

for the whole this year (assuming a 6% decrease in 2020 and a roughly 3% increase in 2021), the increase in consumption resulting from lower income taxes (about CZK90bn for the full year) accounts for 1.6% of GDP. The willingness of households to spend additional money should also be supported by the above-mentioned fact that the current crisis has not yet led to a decline in disposable income.

The present situation, however, is still highly uncertain on the economic growth front, which may in turn be reflected in a partial preference for savings over consumption. We witnessed this last year, when the savings rate of Czech households rose to a record level of almost 20% in the second quarter. After the pandemic restrictions ended, the savings rate declined slightly in the third quarter, as shown in the chart on the first page, but still remained above normal values. Table 2 therefore includes alternative calculations of the impact of tax changes that allow for a lower propensity to consume.

Even if a lower propensity to consume of only 60%, or even 50%, is taken into account, the increase in overall household consumption is still significant at 2.6% or 2.2%, respectively. The impact on annual GDP (using the same economic assumptions as above) is summarised in Table 2. The spillover of higher household income to consumption may be hindered by the continuing closure of the economy, and so the positive effects may occur with a delay (the same holds true for the one-off pension payment mentioned above).

Table 2 – Impact of lower taxes on household consumption by propensity to consume

Propensity to consume	77%	60%	50%
Increase in household expenditure – quarterly	CZK23bn	CZK18bn	CZK15bn
Increase in total household consumption – quarterly	3.4%	2.6%	2.2%
Impact on full-year GDP in 2021e	1.6%	1.3%	1.1%

Source: Economic & Strategy Research, Komerční banka

Note that the present study only examines the short-term effects of government income support measures on household consumption. The results show that the measures can have a significantly positive impact on household consumption. At the same time, however, they cause a significant increase in government debt (of c.CZK90bn annually), while losses on the revenue side of the state budget related to lower personal taxes are not offset on the expenditure side. **If the tax reduction were permanent, the negative consequences arising from the unsustainable increase in public finances would most likely outweigh the positive impacts.** Therefore, the tax cuts are likely only temporary (as the government has stated), or they will have to be accompanied by a comprehensive adjustment in the entire tax system or a reduction in state expenditures.

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