

## HOW WOULD THE TAX CHANGES IMPACT HOUSEHOLDS AND PUBLIC BUDGETS

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LIBOR DUŠEK AND PERT JANSKÝ

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### **Abstract**

The study presents a quantitative evaluation of proposals for tax changes, both the current government proposal and other reform scenarios. The current government proposal, which refers to a value added tax (VAT) rate harmonization at 20 percent and a reduction of social security contributions paid by the employer by 1.8 percent, has the following long-term impacts:

1. The real income of an average household will decrease by 1 percent or CZK289 per month (which means app. CZK127 per person in an average household).
2. Pensioners will not be affected by the VAT harmonization, because it's fully compensated by the mandatory pension valorization.
3. The real income of households of employees and self-employed will decrease by app. 1.5 percent and of the unemployed by 2.1 percent. In these households the real income of the poorest fifth will decrease by 2.5 percent and of the richest fifth by 1 percent.
4. Exceptions proposed by the government, such as a continued 10 percent VAT rate on items such as bread, fish etc., will mitigate the impact of the VAT increase on average households to only 0.26 percent (CZK60 per month).
5. Short-term impacts are more negative than long-term impacts. In the short-term the real income of an average household will decrease by 2.3 percent, while in the long-term the benefits of pension valorization and lower social security contributions will kick in.
6. Deficit of public budgets will decrease by CZK30 billion, which consists of the increase of VAT revenues by CZK47 billion (after including mandatory pension adjustment and increased prices of government purchases), CZK2 billion from other areas including savings on labor costs in the public sector but lower social security contributions by CZK19 billion.
7. These CZK30 billion exceed the anticipated transformation costs of proposed pension reform by app. CZK12 billion (if as much as 50 percent of people sign up for the pension reform, the transformation costs increase to CZK 18 billion).
8. About CZK13 billion will be re-distributed from the state budget to other parts of the public sector.
9. Over long-term, the harmonization of VAT rates alone would reduce the real income of average households by 1.57 percent (CZK425 per month) and individual income groups would be affected much more evenly than in combination with the reduction the social security contributions.
10. The proposal of NERV (VAT rate harmonization to 19 percent and reduction of social security contributions paid by employers by 5 percent) would have a nearly neutral effect on the real incomes of average households, but richer households would end up better off and poorer households worse off. The deficit of public budgets would grow slightly by CZK5.5 billion.

The analysis is based on data derived from Household Budgets Statistics of the Czech Statistical Office, which monitors 300 income and expense items of 3000 households. Using insights on tax adjustment impacts on prices and salaries derived from economics, we calculate changes in expenses, incomes and social security contributions due to these tax adjustments for each household. The estimated impacts on public budgets take into consideration a wide spectrum of mechanisms through which these tax adjustments influence the budget (for example, how income taxes and corporate taxes or public sector costs of employee salaries will be influenced).

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[Download](#) the complete study (in Czech only).

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