8 Changes in the Institutional Framework for Implementing Fiscal Policy

The public finance reform implemented in 2004 was a fundamental change in the legal and institutional framework of public finances. The government's subsequent steps focus on gradually achieving this according to the time schedule for the institutional part of the reform and preparing additional measures geared to the identified challenges for public finance management.

8.1 Carrying Out the Public Finance Reform

Transformational institutions

In line with the public finance reform and in accordance with the previous Convergence Programme, the process of preparing the steps for terminating the activities of certain "transformation institutions" (sometimes referred to off-budget funds) and selected state extra-budgetary funds has continued. This will not only simplify and increase the transparency of overall budgetary management, but it will also create substantial operational savings.

Preparations for terminating the National Property Fund (execution of privatization) and transferring the remaining activities to the state, under the management of the Ministry of Finance, are coming to an end. During 2006, Česká inkasní will be terminated. This institution was entrusted with the technical implementation of a part of the programme for stabilising and consolidating the banking sector. On 1 January 2006, the State Fund for Soil Fertilisation will be dissolved by law. Its rights, obligations and property will be transferred to the Ministry of Agriculture.

Another step towards increasing the stability and transparency of public finances is to terminate the Czech Consolidation Agency, whose successor will again become the state under the administration of the Ministry of Finance. Preparations are in progress, and according to the adopted timetable, this institution should be terminating without liquidation by 31 December 2007. All of its subsidiaries will be liquidated by this date as well. Moreover, the government decided to terminate the Land Fund (entrusted with privatization and restitution of land) on 31 December 2009. Parliament, though, will still need to approve the agency's termination by law.

Strengthening the role of the medium-term expenditure frameworks

Integration of the government's extra-budgetary funds has also contributed to increasing the transparency and stability of public finances through the medium-term expenditure frameworks and binding expenditure ceilings.[20] To further strengthen the role of the medium-term expenditure frameworks, the binding principles should also be implemented on the heading level of the state budget and state funds, as well as considering the possibility of introducing sanctions for not complying with the expenditure limits of the budget headings.

[20] *For more information, see Act No. 218/2000 Coll., on Budgetary Rules.*

Meeting the fiscal targets also requires compliance with fiscal discipline at the regional level. Therefore, it is necessary to incorporate regional government authorities into the medium-term budgetary process. Closer coordination of the budgetary policy of the central government and regional government authorities, including introducing effective monitoring and assessment of indebtedness and debt service, with the option of penalising municipalities with excessive debts, helps to reduce the level of risk for meeting the set fiscal targets. It is, therefore, important to promote communication between central government and regional government authorities. For this purpose, the Public Finance Committee was established through the advisory body of the Ministry of Finance.[21]

The rules for regional and municipal government administration must ensure more effective disposition with entrusted funds and a sustainable debt position for local governments. The level of fiscal autonomy must also correspond to the scope of responsibility for this level administration. In line with this principle, the level of fiscal autonomy of regional and municipal governments will increase even further. On 1 January 2005, new tax revenue sharing was introduced, through which the dependency of regions and municipalities on subsidies from the state budget was reduced. The measure was conceived as fiscally neutral for the state budget. The impact was offset by reducing the subsidies to local budgets as well as by shifting a part of the sources of the State Fund for Transport Infrastructure from the revenues from mineral oil excise taxes to the state budget.

8.2 New Challenges

Public private partnerships (PPP)

As most transitional economies, the Czech Republic is in the process of preparing its first PPP projects. The Act on Concession Agreements and Concession Management (the Concession Act) is now passing through the Chamber of Deputies. The aim of this act is to create a corresponding legal framework for engaging the private sector in provision of goods that have so far been exclusively provided by the public sector. The government will continue to use its prudent approach to state guarantees and the creation of implicit government obligations, including obligations arising in connection with public private partnerships.

Generally, PPP projects are costly and long-term in nature and therefore may significantly affect the development of the government deficit and debt. A large part of the projects are expected to be implemented on the regional or district level, which could cause a noticeable increase in their liabilities in future years. Along with the Concession Act, other related legislation is being deliberated in the Chamber of Deputies as well, such as an amendment to the Act on Budgetary Rules and on budgetary rules for regional government and municipalities, which extends the mandatory content of the medium-term outlook for monitoring obligations arising from concession agreements throughout their duration.

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[21] *The regional government authorities are represented in the Public Finance Committee by the Association of Regions of the Czech Republic and the Alliance of Municipalities and Districts of the Czech Republic. The central body of the Alliance of Regions of the Czech Republic is the Council of the Association of Regions of the Czech Republic made up of the heads of the regions. These regional heads may adopt binding resolutions of a strategic nature after consultation in their regional councils.*

An integrated state treasury system

The government has approved its intention to create a state treasury. The preparation phase of the “Integrated State Treasury System” project is taking place at this time. The aim of this new state treasury system is to create an effective instrument for administering state finances, ensuring the effective management of state financial operations and access to reliable information on state revenues and expenditures in real time. In addition, the budgetary processes and accounting data should be centralised and a fully integrated double-entry accounting system should be introduced globally for the entire general government. The consolidation of data obtained from accounting should be simplified, the controls should be automated, and administration of the government debt and liquidity should be perfected. The project will also introduce a single-account state treasury system. The project aims should be completed in 2011, and the pilot operation of selected sub-projects will most likely be launched during 2006.

Integration of the programming and budgeting of European and national resources

Co-financing from the structural funds and the Cohesion Fund will become an important resource for the National Reform Programme policies[22]. The Czech Republic is preparing additional steps for maximizing absorption of resources from the structural funds and the EU Cohesion Fund, especially increasing the absorption capacity of public administration and effective utilisation of these resources. This allows a transition over to integrated programming of public expenditures and introducing efficient and result-oriented budgeting in state administration along with the related control and assessment mechanisms. This involves, in particular, integrating the programming of European and national funds, including incorporation of the resources of the structural funds and the Cohesion Fund into the national budgetary process.

The Czech Republic has already implemented certain measures for simplifying and speeding up the system of financial flows from the structural funds and the Cohesion Fund to end recipients. It is also preparing a system in which the comprehensive allocation to the end-recipients (i.e. the European and national part) will be paid from state budget after carrying out the relevant controls. The payment authority will then refund the resources corresponding to the European part of co-financing to the revenue account of the state budget headings. This system will be gradually introduced starting from 2006 and should be fully functional on 1 January 2007.

[22] *The National Reform Programme was created to be fiscally neutral, and in this way, its consistency with the Convergence Programme and the Czech Republic’s obligations arising from the procedures in respect to an excessive deficit has been secured.*