

## 7 Changes to the Institutional Framework for Fiscal Policy

In 2004, the process of reform measures was launched in the Czech Republic. This process introduced to the budgetary process the medium-term horizon and measures aimed at increasing the motivation of budgetary units to more effectively deal with public resources. The legal and institutional framework for public finance reform created conditions for meeting the fiscal consolidation targets and increasing the transparency of public finances. Improvements are gradually being made to this framework, which reflect the actual problems of public finances.

### 7.1 Changes to Budgetary Legislation

#### Reserve funds

Introducing unlimited transfers of accumulated budgetary resources to the reserve funds of the budgetary units should contribute to an increase in the economic efficiency of public resources. Therefore, since the end of 2004, the state budgetary units have been able to draw not only on budget expenditures up to the end of the budget year, but also in future periods. The difference between the adjusted expenditure budget for each year and the actual expenditures of a given year is carried over to the reserve funds to be used in future years above and beyond the budgeted expenditures.

The current method of drawing on accumulated resources in the reserve funds causes state budget performance to worsen in the year that these funds are recorded due to transfers to the reserve funds of the budgetary units realised via expenditures. Therefore, during the year of the drawdown, these resources from the reserve funds are transferred to revenues and also used by way of expenditures, i.e. the state budget balance is not affected. In the current state, expenditures in the budgetary year and revenues in the year the expenditure is realised are artificially increased. As a result, a distorted picture is given of the state budget balance recorded using the national methodology.

This distortion of state budget performance will be eliminated starting in 2008. The approved measures will help to lower expenditures that are transferred to the reserve funds in the second half of December by the budgetary units. Transfers of this kind will no longer take place. Instead, claims to accrued expenditures will be generated on the basis of accumulated funds. These claims will no longer be covered by the transfers from the reserve funds during the year of the drawdown, so there will be less of a need to issue government bonds, and as a result, it will create savings relating to the lower costs of debt service generated from the budget's deficit performance.

Allocated expenditures transferred to the reserve funds will be classified as "profiling", including, for example, co-financed expenditures from the EU budget, expenditures for research and development or expenditures for investment programmes, and as other "non-profiling", which is an insignificant part of the transferred expenditures. In general, the budgetary units may use the transferred profiling expenditures only in compliance with the original purpose. In the event of a massive accumulation of unused expenditures, the

## 7 Changes to the Institutional Framework for Fiscal Policy

government is authorised to restrict them under the budgetary legislation. The budgetary units will keep records of the claims to the accumulated expenditures.

In view of the fact that the accumulated resources transferred to the reserve funds have so far been higher than the expenditures from them each year, the volume of these resources have increased substantially. Until now, the budgetary units could use these expenditures to cover their extra expenditures. As a result, it was very difficult to predict the impact of these expenditures on the final economic results.

**Table 7.1: Transfers to and from the reserve funds**

in CZK million	Year	Year	Year	Year
	2004	2005	2006	2007 <sup>(1)</sup>
<b>Transfers from RF and fund of state guarantees</b> <i>(decrease of state budget revenues)</i>	4 325	43 676	46 892	54 900
<b>Transfers to RF and state guarantees fund</b> <i>(decrease of state budget expenditure)</i>	29 038	68 936	57 090	46 162
Balance improvement (+), worsening (-)	24 713	25 260	10 198	-8 738
<i>RF and state guarantee fund balance at the end of year</i>	32 337	58 584	70 232	61 494

(1) Estimate

In addition to the above-mentioned measures valid from the beginning of 2008, the government has implemented other measures to start eliminating this problem in 2007 as well. A government resolution was passed that set out the maximum amount to be used from the reserve funds for 2007 (except for drawing on funds intended for pre-financing projects co-financed from the EU budget, investment programmes, eliminating flood damages, and social benefits). In addition, a part of the reserve funds was used to increase the expenditures of the budget headings of the Ministry of Defence, the Ministry of Health and the Ministry of Transport. These measures did not fully eliminate the possibility of making transfers to and from the reserve funds, however, they did partially reduce the volume of the reserve funds. Furthermore, the process of setting the real fiscal targets was simplified to some extent. In the ESA95 methodology, transferred funds from the reserve funds are not treated as revenue and transfers to the reserve funds as expenditures. Expenditures realised from these funds are counted in the expenditures of the given year.

### 7.2 Ending the Activities of the Czech Consolidation Agency

The government continues to gradually integrate and terminate the so-called off-budget institutions, which were one of the main sources of fiscal risk in the 1990s and often reduced considerably the transparency of overall public finance performance.

By the end of 2007, one of the largest transformation institutions, the Czech Consolidation Agency (CKA) will be terminated by law. The agency was involved in resolving a wide range of tasks related to the transformation process. Its activities will be terminated without liquidation. The legal successor of CKA will be the Czech government represented by the Ministry of Finance, which will take over the agency's rights and obligations on the day of its termination.

CKA's portfolio will be divided into three groups according to the quality of assets. Assets having a strategic interest for the government and the residual assets of CKA will be transferred to the Ministry of Finance. The bad quality assets will be transferred to CKA's

subsidiary company – SPV, which will be sold by the end of 2007. Prior to termination, CKA will prepare a detailed summary of its economic results for the entire period of its operations and will submit it to the government.

### 7.3 Simplifying the System of Tax Administration

A draft proposal, which the government has taken into consideration, for combining the collection of taxes, customs and premiums for public insurance should help to improve the tax administration system. The tax and customs authorities for the collection of taxes and customs duties should be gradually integrated. This should come into effect on 1 January 2010. In the other phases of this project, consideration will be given as well to integrating the collection of social security and health insurance payments. These measures should significantly reduce the administrative burden for tax and insurance payers, who would only need to deal with one authority. Upon implementation of the above measures, legal regulation, the organisational structure, the manner of financing and the information systems for the collection of taxes and customs would be harmonised.

As a measure to reduce the administrative burden, approval was given to cancelling the duty to use cash registers with accounting programs and other related obligations. In addition, expanding the principle of binding assessments (i.e. the duty to provide expert opinions) will contribute to reducing the administrative burden and to strengthening the legal security of entrepreneurs.