

7 Changes to the Institutional Framework for Fiscal Policy

7.1 Medium-Term Horizon of the Budgetary Process

In the first half of this decade, the Czech Republic carried out a series of reform measures that introduced a medium-term horizon to the budgetary process. Medium-term fiscal targets were established, and the composition of medium-term expenditure frameworks was started (from 2004, see previous programmes for a detailed description). This contributed to the formulation of a medium-term expenditure policy for the state budget and state funds. The government regularly submits information on the functioning of these instruments together with budgetary documentation to the Chamber of Deputies of the Parliament in the course of approving the state budget.

The compilation of the expenditure frameworks forms an integral component of budgetary legislation today and also incorporates a government obligation to explain any possible non-fulfilment thereof. Nevertheless, in the past expenditure limits have been increased beyond the scope of adjustments permitted by law.

While none of the reform measures implemented as from the beginning of 2008 contain steps aimed at reinforcing the binding nature and enforceability of fiscal regulations, they nevertheless explicitly declare the principle of not exceeding the expenditure frameworks as one of the main fiscal instruments for fiscal consolidation. Adherence to the expenditure frameworks is strongly dependent on public review and the provision of transparent information. The Ministry of Finance, therefore, regularly evaluates the adherence to these frameworks in its publication “Fiscal Outlook of the Czech Republic”.

7.2 Reserve Funds

From 2008, the possibility for transferring unused resources into reserve funds came to an end. The creation of reserves and their drawing as budgetary units to cover extra expenditures had greatly distorted the general government balance, making it difficult to formulate budgetary policy and adhere to defined fiscal targets. The impact of executed cash transfers, moreover, disrupted the otherwise efficient state debt policy and caused disproportionate growth in the costs of debt service.

This replacement of cash transfers to reserve funds with claims will lead to more effective financing of the state budget deficit. As a result, the adopted amendment to the budgetary regulations will enable the government, at its discretion, to reduce the amount of claims arising. By the end of 2008, undrawn resources in reserve funds of state organisational units will be composed primarily of resources intended for expenditures co-financed from the EU budget.

7.3 Local Government Institutions

In addition to the aforementioned measures implemented in the past at the central government level, a new procedure has been prepared for monitoring and evaluating the economic performance of municipalities and the semi-budgetary organisations they establish.

The local government sub-sector represents a significant segment of the general government sector. Nevertheless, the state may intervene in the finances of municipalities only in a very limited manner. The new monitoring procedure will proceed based upon a system of mutually linked indicators inspired by financial analysis used in the business sphere. Particular attention is given to the so-called “monitoring indicators” – credit risk and overall liquidity. These are supplemented by a set of indicators that support the objective evaluation of the status of municipal finances.

Limits have been created for the monitoring indicators to identify the enhanced risks associated with the operations of municipalities and their semi-budgetary organisations. Municipalities whose economic performance is found to be unsatisfactory will receive a letter from the Ministry of Finance and be requested to provide explanations for such situations. A list of these municipalities also will be sent to the relevant higher regional autonomous entities. Information on the results will be submitted to the government. All data sources necessary for calculating these indicators will be openly accessible on the website of the Ministry of Finance. Monitoring of the finances of individual municipalities should be implemented for the first time in 2008.

7.4 Transformation Institutions and Autonomous Government Agencies

Following the termination of the activities of the National Property Fund and Czech Consolidation Agency, the activities of the company Česká inkasní, which in the past carried out, for example, the transformation of Československá obchodní banka (ČSOB), were terminated in the first quarter of 2008. Its sole function was the unblocking of insolvent and irrecoverable receivables and the financial restructuring of selected entities.

Midway through 2008, the government also approved terminating the activities of the State Cultural Fund of the Czech Republic, whose activities were limited from its inception by a shortage in its own financial resources. Thus, the fragmentation within the government sector is gradually being reduced and expenditure centres with insufficient resources for financing their activities are gradually being dissolved.

7.5 Simplification of the Tax System

In addition to a gradual reduction in the tax burden, one of the main goals of the public finance reform is simplification of the tax system. This should involve the gradual integration of the collection of taxes, customs and premiums for public insurance.

The fundamental principles of the upcoming changes stem from the recommendations and conclusions of a technical mission of the World Bank carried out in 2008. A single, integrated system of authorities should be created that will take over the current tax and customs

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competences as well as the authority to collect compulsory social security payments and contributions to the state employment policy and compulsory health insurance.

The tax and customs administrations should simultaneously undergo dramatic modernisation. The ultimate aim is to integrate the administration of all taxes, the administration of customs duties and the collection of public insurance payments within a single institution. The unification of tax return forms and payment of all taxes and insurance premiums to one account should improve the situation for citizens. A specialised tax and customs authority also should be created for large and specific taxable subjects.

Unification of the collection of taxes, customs and insurance premiums at a single location will greatly simplify tax-related administration for taxpayers, reduce the bureaucratic burden and improve the taxpayer's perception of compulsory payments. As a result, the system of taxes, customs and insurance premiums overall will be better arranged and the accessibility and quality of services for the public will be improved. Electronic communication with clients should also be strengthened. This will reduce direct administrative costs connected with the collection of tax revenues, as well as indirect, so-called induced administrative costs to taxpayers. The integration of tax and customs authorities should occur from 1 January 2010, and that for the collection of taxes and premiums for public insurance from 1 January 2012.

7.6 Measures for Regulating and Managing Fiscal Risks

Recently, there has been great progress in building methodological support within the public-private partnership (the so-called PPP) process. The Ministry of Finance has prepared and, in co-operation with external agencies, is still preparing a range of methodological manuals. Some of these have already been published on the Ministry's web pages (e.g. Presentation of PPP Projects in State Budget Documentation, Methodology for Evaluating the Quantitative Aspects of Value for Money in PPP Projects, Managing Risks in PPP Projects, and others). A number of other methodological supporting documents are under preparation.

The methodological materials are accompanied by a series of seminars and lectures for employees of ministerial departments and representatives from higher regional autonomous entities and important municipalities.

Within the framework of budgetary documentation for the state budget, the Ministry of Finance has also begun, in the interests of maximum fiscal prudence and transparency, to present its calculations on the long-term fiscal impacts of the pilot PPP projects in preparation (including those not yet approved) on the performance of the state budget and state funds.

7.7 The State Treasury

Implementation of the state treasury project approved by the government should help improve the management of public finances and financial risks. The aim of the project is to create a fully automated, integrated information system that will be focused on supporting the processes and activities of the state treasury.

The implementation schedule was approved with a target for operation starting in 2010. In the first phase, the organisational units of the state and the semi-budgetary organisation will be

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added to the system. The activities of the state treasury will consist in directed planning, record keeping, collecting state revenues and executing payments; immediate accounting for any movements that occur when dealing with state assets and liabilities; and implementation of automated financial and management controls for dealing with state budget funds and reporting on state finances. The results of a tender for two subsystems of the integrated information system for the state treasury are already known.

7.8 Programme Budget Procedure

The Czech Republic endeavours in the long term to take into account the suitability and effectiveness of outlays made in the budgetary process with the aim of its optimisation. Adjustments to the current system of programme financing for reproducing assets and an introduction of output and target orientated budgeting for all state budget expenditures should serve to that purpose. Control and evaluation mechanisms will also form a part of these efforts.

Budgeting by way of expenditure blocks will be founded on the unambiguous establishment of goals that should be achieved by the given activities and are measurable with the help of pre-defined indicators. These goals will be established for the budgetary year and for at least another two successive years.

At the current time, amendments are being prepared to the legal standards for transforming the current programme financing and elaborating the medium-term outlook for the state budget, which should become effective as of 1 January 2009. A pilot version of the target-oriented budgeting methodology is expected to be tested as early as 2009 during preparation of the budget in the chapter of the Ministry of Education, Youth and Sports, specifically in the section on regional education. This example will be subsequently used as a methodological aid for other chapters of the state budget.