

## **MULTIANNUAL FINANCIAL FRAMEWORK IN THE CZECH REPUBLIC**

### **1. General characteristics of the situation in field of the multiannual financial framework in 2011. Impact of particular multiannual frameworks on annual budget**

There is an almost fourteen year old tradition of multiannual financial framework in the Czech Republic. In 2000, Act No.218/2000 Coll., on budgetary rules and on change of other related legislation (Further “Act on Budgetary Rules”) was approved, which, in Article 4, contained regulation on medium-term outlook. The aim of the lawmakers of this Act was to shift to a medium-term horizon for budget procedure, to make it possible to analyse bearing capacity of the impact of approved state policies and particular acts in terms of mid-term sustainability in a balanced development of financial management. Medium-term outlook should serve as the basic document for setting aims and objectives of budgetary policy over a determined period of time.<sup>1</sup> Similar conclusions were claimed by Marková, when she stated that: “by adopting laws governing the budgetary rules of the state and municipalities in 2000, the medium-term outlook in the Czech Republic became the basic document of the aims and objectives of fiscal policy for a longer period”.<sup>2</sup>

In 2011 a rule was applied, that medium-term outlook be listed for a two-year period directly following the year for which the state budget was put together.<sup>3</sup> The medium-term outlook should have contained expected revenue and expenditure of the state budget and state funds for those years to which it related. The presumptions and intentions that formed the bases upon which revenue incomes and expenses were assumed and planned, should also have been included. The Act also specified

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1 See Explanatory report on Act No.218/2000 Coll., On Budgetary Rules and on Change of Other Related Legislation.

2 H. Marková, Rozpočtový proces, in: Bakeš, Milan. Finanční právo. 6. upr., Praha 2012, p. 128.

3 Compare also with H. Marková, R. Boháč, Rozpočtové právo. Praha 2007, p. 188-190.

the range of medium-term outlook so as it should contain assumptions for the basic indicators of national economy development, mainly: the expected increase or decrease of gross domestic growth and consumer prices; aims and objectives of government concerning income, expenses and balance of the state budget and state funds, intended changes of law and other legislation; amount of medium-term expenditure frameworks and their subdivision according to chapters and state funds; total income and expenses of the state budget; total income and expenses of state funds; income and expenses of particular chapters of the state budget, income and expenses of particular state funds, and expenses on programmes where the amount of state budget participation was approved by the government; expenses on programmes and projects co-financed by the European Union budget according to particular chapters and state funds; obligations of individuals and legal persons guaranteed by the state on behalf of its organizational units, and an overview of state obligations arising from the approved concession contracts. Where the calculation of medium-term outlook results in a state budget deficit, an explanation of the anticipated method of financing should also be included.<sup>4</sup>

Medium-term outlook is elaborated by the Ministry of Finance together with chapter administrators, local government units and state funds, and is put to government together with the state budget proposal. Details of the data to be transmitted for processing medium-term outlook were established by the Decree of the Ministry of Finance No. 415/2008 Coll., which set the range and structure of data used for detailing medium-term outlook of the state budget.

In 2004 the medium-term expenditure framework was adopted as another tool for long-term planning together with medium-term outlook by Act No. 482/2004 Coll., by which Act No. 218/2000 Coll., On Budgetary Rules and on Change of Other Related Legislation, was amended. Contrary to medium-term outlook, which contains a detailed analysis of expected incomes and expenses of the state budget for the particular years it is set for, the medium-term expenditure framework is expressed only by one number for each year representing sum of expenses, or on number for each year it is approved for. This division was essential, because the figures of the medium-term expenditure framework are definite (for government, when it submits the draft law on the state budget for approval or the Chamber of Deputies proposal on resolution of medium-term expenditure framework) whereas medium term outlook figures are not binding.<sup>5</sup> Recently, deadlines for works on elaboration of the state budget proposal, medium-term outlook and medium-term expenditure frameworks, have been established in law.<sup>6</sup>

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4 Art. 4 sub. 1 to 3 Act on Budgetary Rules.

5 See Explanatory report on Act No.218/2000 Coll., on Budgetary Rules and on Change of Other Related Legislation.

6 See art. 8b Act on Budgetary Rules.

The medium-term expenditure framework for 2011, was composed of total expenses of the state budget and state funds for each year to which the medium-term outlook applied, e.g. the two following years.<sup>7</sup> Expenses for the realization of state guarantees<sup>8</sup> and repayable financial assistance<sup>9</sup> were excluded from the figures for medium-term expenditure in the framework. The medium-term expenditure framework was set by the Chamber of Deputies in a resolution to the government draft law on state budget. It is necessary to add, that expenses of the state budget in the draft law, are set by the Ministry of Finance in terms of medium-term expenditure framework amount, which is part of the resolution of the Chamber of Deputies to the draft law for the current year. This amount was stated as a figure for the year following the current year and that figure could not be exceeded.<sup>10</sup> For purposes of determining the total amount of expenses of the state budget, the Ministry of Finance had to use the figure stated in the resolution of the Chamber of Deputies, which by that time was one year old.<sup>11</sup>

The predicted expenditure given in the medium-term expenditure framework for the first year of medium-term outlook, had to respect the amount stated in the resolution of the Chamber of Deputies for the previous year. This amount could be adjusted to cover expenses that could not be presumed while setting this figure. This covers expenses caused by a significantly different development of customer prices than expected or incurred by law on the budgetary allocation of taxes, if it resulted in an increase or decrease of expenses in the state budget and if such impacts had not been included into sum during setting it. Furthermore, those were expenses of total amounts of income from the European Union budget and from financial mechanisms, which were counted in different amount while setting the sum, expenses in total amount of 2 per mile to reflect the influences not encountered during the determination of the amount, and last but not least, expenses caused by abnormal situations which could not reasonably have be foreseen.<sup>12</sup>

In the event of a situation arising where the amount of the medium-term expenditure framework for the first year of medium-term outlook differs from that given for the same year stated in the resolution approved by the Chamber of Deputies for the previous year, the government is required to explain justify this difference. The same applies to the medium-term expenditure framework for the first year

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7 For more see H. Marková, R. Boháč, *Rozpočtové právo*. Praha 2007, p. 190-191.

8 If the guarantor contracts, guarantee statements, warranty papers, or laws that set the state's collateral duty became effective 30<sup>th</sup> April 2004, with the exception of expenditure to meet the guarantor's obligations to creditors state government organizations Railway Infrastructure Administration by Law No. 77/2002 Coll., on Czech Railways, state organization Railway Infrastructure Administration and amending Act No. 266/1994 Sb., the Railways Act, as amended, and Act No. 77/1997 Coll., on State Enterprise, as amended, as amended by Act No. 179/2003 Coll.

9 Art. 8a sub. 1 Act on Budgetary Rules.

10 Art. 8 sub. 1 Act on Budgetary Rules.

11 Explanatory report on Act No. 482/2004 Coll., by which Act No. 218/2000 Coll., On Budgetary Rules and on Change of Other Related Legislation, is amended.

12 Art. 8a sub. 2 Act on Budgetary Rules.

approved by the Chamber of Deputies in the previous year. If this amount differs from the total amount of state budget expenses given in the state budget proposal. The justification for changes is presented to the Chamber of Deputies together with the government draft law on state budget for the next year.<sup>13</sup>

Both medium-term outlook and the medium-term expenditure framework have an impact on creating the state budget. The state budget should be based on medium-term outlook, expenses indicators on programmes or on projects co-financed by the European Union budget, are binding for elaboration of the draft law on state budget.<sup>14</sup> The total of expenses incorporated in the state budget should be based on the medium-term expenditure framework.<sup>15</sup>

An instrument for multi-annual budgetary planning at local level is budgetary outlook, which has existed in the Czech Republic since 2004. This instrument is part of core financial law for local governments, which is Act No. 250/2000 Coll., on budgetary rules of regional budgets (further „Law on Budgetary Rules of Regional Budgets“). Even the lawmakers of this Act were awarded of too short period of financial year for the economy financed from local budgets.<sup>16</sup> That is why, they incorporated a rule into the Act, that the financial economy of local governmental units and unions of municipalities respect their annual budget and budgetary outlook<sup>17</sup> and further, that elaboration of the annual budget of local governmental units and union of municipalities be based on budgetary outlook.<sup>18</sup>

Budgetary outlook is an auxiliary tool serving the medium term financial planning of economy development, which can be used by regions, municipalities, and unions of municipalities. It is put together by virtue of concluded contractual relationships and commitments usually for a period of 2 to 5 years, following the year for which the annual budget is set. Financial insight contains a primary data summary on income and costs, mainly in long-term commitments<sup>19</sup> and claims, on financial sources and needs for the realization of long-term objectives.<sup>20</sup> Financial insight enables local government units to create conditions for long-term actions, which exceed the framework of a single financial year.<sup>21</sup>

The regulation of multiannual planning at local government unit level is quite austere. The reason for this is that elaboration of budgetary outlook was not originally required, it should have only served mainly for local government for better planning of financial resources exceeding more than one year, nevertheless since

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13 Art. 8 sub. 1 a art. 8a sub. 4 Act on Budgetary Rules.

14 Art. 5 sub. 5 Act on Budgetary Rules.

15 Art. 8 sub. 1 Act on Budgetary Rules.

16 Explanatory report to the Act No. 250/2000 Coll., on budgetary rules of regional budgets.

17 Art 2 sub. 1 Law on Budgetary rules of Regional Budgets.

18 Art. 4 sub. 3 Law on Budgetary rules of Regional Budgets.

19 For long-term liabilities their impacts on the self-governing cell or a union of municipalities throughout the duration of the commitment are stated.

20 Art. 3 Law on Budgetary rules of Regional Budgets.

21 H. Marková, Rozpočtový proces, in: Bakeš, Milan. Finanční právo. 6. upr., Praha 2012, p. 129.

2009 its elaboration has been obligatory. Since 2009, the rule has been incorporated into the Act on Budgetary Rules of Regional Budgets, that if a local governmental unit, union of municipalities, town district of the capital Prague or The Regional Council of Cohesion Region does not integrate financial insight, it is considered an administrative offense<sup>22</sup> punishable by a fine of up to 1.000.000 CZK.<sup>23</sup> However, the law does not determine a form for this document, it being left up to each individual local authoritative body to choose which form it will use for budgetary outlook. Budgetary outlook also does not have to be approved with the budget, although from a practical viewpoint this is recommended.

## **2. Did the former system of multiannual financial planning satisfy the requirements of Council directive 2011/85/EU of 8 November 2011?**

The former system of multiannual financial planning (in 2011) was not significantly different from the system applied nowadays. Regarding the basic condition specified in Directive 2011/85/EU on requirements for budgetary frameworks<sup>24</sup> setting out least at three years long fiscal planning horizon, and then the Czech Republic met this condition in the past as it does nowadays. Medium-term outlook is always prepared for two years, following the year for which the state budget is compiled thus creating a financial plan for a three yearperiod. Some problem is to be found in the fact, that medium term outlook is not binding for setting the state budget for the following year. However, the medium term financial framework, which is part of The Chamber of Deputies' resolution, is binding. If the figures relating to both differ, the government will has to provide a detailed explanation of the changes needed and introduce them to the Chamber of Deputies.<sup>25</sup>

The implementation of other provisions of Directive 2011/85/EU on requirements for budgetary frameworks, should have been done through legislation, the bills having been prepared ready to be introduced to the Chamber of Deputies in 2013. This included the following legislation:

- Constitutional law on fiscal responsibility<sup>26</sup>;
- Act on rules of fiscal responsibility<sup>27</sup>;

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22 Art. 22a sub. 1 letter a) Law on Budgetary rules of Regional Budgets.

23 Art. 22a sub. 5 Law on Budgetary rules of Regional Budgets.

24 The Council directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

25 See art. 8a Act on Budgetary Rules.

26 Government proposal of Constitutional law on fiscal responsibility. Available from: <http://www.psp.cz/sqw/historie.sqw?T=821&O=6>.

27 Government proposal of Act on rules of fiscal responsibility. Available from: <http://www.psp.cz/sqw/text/tiskt.sqw?O=6&CT=1097&CT1=0>.

- and The Law on amendment of certain acts in connection with the adoption of the constitutional law on fiscal responsibility and the act on rules of fiscal responsibility<sup>28</sup>.

However, because of a political development in the Czech Republic, the approval procedure for the above mentioned legislation was at first prolonged and later delayed as the result of a political crisis which led to dissolution of the Chamber of Deputies and the announcement of early elections. The new Chamber of Deputies was formed following elections in October 2013 but a government majority was not established until January 2014. At that time it was clear that this legislation could not be adopted by the end of 2013 in the form required by Directive 2011/85/EU. Moreover, the future of the proposed legislative changes still remains unclear, as the newly formed government has not so far commented on whether it will pursue approval of the bills as drafted, or whether it will apply completely different solutions. In view of this, much of the proposed legislation will not become effective before 1 January 2015, due to the time required for its activation.<sup>29</sup>

The transitional government of the Czech Republic was informed about weaknesses in the implementation of Directive 2011/85/EU and the possible consequences of incorrect or delayed transposition at the hearing on 30 October 2013<sup>30</sup> and commented on the situation on 6 November 2013.<sup>31</sup>

### **3. Which steps were taken between 2012-2013 towards implementation of Council Directive 2011/85/EU?**

A few partial changes were made in the field of multiannual financial planning in the Czech Republic in 2011-2012. One of the most significant changes was that made in 2012 in connection with the adoption of Act No. 501/2012 Coll., by which Act No. 218/2000 Coll., on budgetary rules and on change of other related legislation (budgetary rules) was amended and some other legislation changed. This amended Act newly sets an obligation, that the state organizational units will gather data related to fulfilment of terms and obligations when processing medium-term

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28 Government proposal of the Law on amendment of certain acts in connection with the adoption of the constitutional law on fiscal responsibility and the act on rules of fiscal responsibility.

29 Materiály na jednání vlády 30. října 2013 [online]. Ministerstvo financí České republiky [cit. 2.2.2014]. Available from: <http://www.mfcr.cz/cs/legislativa/materialy-na-jednani-vlady/2013/materialy-na-jednani-vlady-30-rijna-2013-14978>.

30 Information on the progress of the implementation of Council directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and the possible consequences of a late or incorrect transposition.

31 Resolution of the Government of the Czech Republic of 6 November 2013 nr 841 about Information on the progress of implementation of Council directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and the possible consequences of a late or incorrect transposition.

outlook for the financial system.<sup>32</sup> Medium-term outlook will be compiled according to budgetary structure<sup>33</sup>, and therefore it is unnecessary to be included in the law's content. Furthermore, there is an approximation of methodological approaches used in the quantification of medium-term expenditure frameworks, focusing primarily on ESA95 methodology. The Ministry of Finance's obligation to lead works on medium-term outlook compilation was also established in the law.<sup>34</sup>

However, as the authors of this Act stated in the Explanatory Memorandum accompanying the legislation, the adopted amendment does not address the transposition of Directive 2011/85/EU on requirements for budgetary frameworks, since this transposition should be ensured by another law.<sup>35</sup> Concerning changes at local governmental level, so far none have been implemented in the area of multiannual planning.

Decree No. 415/2008 Coll. establishing the scope and structure of the base for development of medium term outlook for the state budget, replacing Decree No. 133/2013 Coll., establishing the scope and structure of data for the preparation of the draft law on the state budget, a draft medium-term budget outlook and the deadline for their submission.

In addition to these changes, which directly relate to multiannual financial planning in the Czech Republic, many more partial changes required by the Directive 2011/85/EU on requirements for budgetary frameworks of the particular legislation.<sup>36</sup>

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32 The financial system is an information system of public administration controlled by the Ministry of Finance, where different operations are made and where data necessary for compilation of the state budget and medium-term outlook are gathered.

33 Budget composition means the uniform classification of income and expenditure, which is applied in the budgets of government departments in monitoring implementation of the state budget, while tracking the reserve fund of government departments utilisation, at the movements of the budgets of state funds; at the movements on the accounts of state financial assets, moving on accounts for debt management in a planned and actual movements on the accounts of budgets and other monetary funds, municipalities, counties, regional councils and voluntary associations of municipalities except foreign funds means; fund for pooled funds and fund for business activities. For more see Decree No. 323/2002 Coll., on the budget structure, as amended

34 See Zákon č. 501/2012 Sb., kterým se mění zákon č. 218/2000 Sb., o rozpočtových pravidlech a o změně některých souvisejících zákonů (rozpočtová pravidla), ve znění pozdějších předpisů, a některé další zákony; a dále Důvodová zpráva k zákonu č. 501/2012 Sb., kterým se mění zákon č. 218/2000 Sb., o rozpočtových pravidlech a o změně některých souvisejících zákonů (rozpočtová pravidla), ve znění pozdějších předpisů, a některé další zákony.

35 Concerning above mentioned set of law.

36 For more see L. Chaloupka, Upevnění národního fiskálního rámce – postup při implementaci směrnice 2011/85/EU [online]. Ministerstvo financí České republiky [cit. 2.2.2014]. This is a presentation from a seminar on the topic „Current economic and social issues in Czech Republic and European Union“. Available from: <http://www.mfcr.cz/cs/o-ministerstvu/vzdelavani/konference-a-seminare/2013/rok-2013-podzimni-seminar-aktualni-ekono-15118>.

#### **4. Possible problems with the implementation of the Council Directive 2011/85/EU in the member states**

Directive 2011/85/EU will provide a definite benefit to the Czech Republic. It will reinforce the existing system of fiscal responsibility and tighten sanctions for non-compliance with established rules with regard to the budgetary surveillance framework of the European Union to avoid excessive government deficits. Directive 2011/85/EU introduces completely new solutions in many areas for the Czech Republic (fiscal framework for all government institutions, the establishment of an independent fiscal council<sup>37</sup> etc.), and possibly it will determine the implementation of rules towards unification of data within the European Union and the minimum requirements for fiscal frameworks of the member states. The rules in certain member states, not excluding the Czech Republic, have thus far frequently differed.

Concerning problems with implementation of the Directive 2011/85/EU, as stated above, there were many of them, the largest being of a political nature, when in the process of passing laws transposing the Directive, the Chamber of Deputies was dissolved and the work suspended for several months. Another problem can be seen in the fact that the Directive concerns many different areas, legislations and subordinate legal acts and its transposition cannot simply be done through the amendment of several pieces of legislation; in some cases it is necessary to find new solutions, whether in the form of approval of new laws or making major changes to existing laws. It takes time.

On the positive side it could be stated that existing practice, mainly in area of prognosis of the Ministry of Finance, largely corresponds to the qualitative requirements of Directive 2011/85/EU. Many requirements have already been met by the executive power but as yet have not been incorporated into legislation and, moreover, have been executed by the executive power beyond the scope of existing legislation. The crucial problem, however, is their formal enshrining in legislation of the Czech Republic.<sup>38</sup>

One of the main problems to be faced in the immediate future concerns the date of implementation of the Directive 2011/85/EU is the requirement to implement the introduction of changes into the law in the shortest possible time (the deadline date for implementation of 31 December 2013 having already expired), while maintaining a time scale sufficient to enable the individual entities effected by the new rules to be adequately prepared for their introduction. Paradoxically, another big problem may be a change in political representation of the Czech Republic. The existing work

37 See for example Articles. 5–8 of Council directive 2011/85/EU of 8 November 2011, on requirements for budgetary frameworks of the Member States.

38 See F. Cvengroš, Implementace Směrnice Rady EU o požadavcích na rozpočtové rámce, Kapitola III – Prognózy [online]. Ministerstvo financí České republiky [cit. 2.2.2014]. This is a presentation from a seminar on the topic „Selected macroeconomic and fiscal issues“. Available from: <http://www.mfcr.cz/cs/o-ministerstvu/vzdelavani/konference-a-seminare/2012/rok-2012--podzimni-seminar-11762>.



on implementation of the Directive has been carried out under the supervision of the previous center-right government<sup>39</sup>. After early elections a majority was gained by parties that were not represented in the previous government and the question remains as to whether the current government will be willing to build on the past work of a previous government composed mainly of political opponents.

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39 Aside from the transitional government of the caretaker cabinet, which did not have a mandate strong enough to allow promotion of fundamental changes? The position of this government is also evidenced by the fact that it failed to gain the confidence of the Chamber of Deputies and its legitimacy was then called into question.

## **WIELOLETNIE RAMY FINANSOWE W REPUBLICIE CZESKIEJ**

Praca przedstawia wieloletnie ramy finansowe w Republice Czeskiej. Pierwszy rozdział opisuje wieloletnie ramy finansowe w Czechach w 2011 r., a zatem w roku, w którym została zatwierdzona Dyrektywa Rady 2011/85/UE z 8 listopada 2011 r. w sprawie wymogów dla ram budżetowych państw członkowskich na poziomie centralnym jak i lokalnym. Następnie została przeprowadzona analiza stanu wcześniejszego, biorąc pod uwagę wymagania tej dyrektywy. Ostatnie dwa rozdziały dotyczą zadań, które zostały wykonane od 2011 r. w odniesieniu do wdrażania dyrektywy, jak i ustalenia najistotniejszych problemów w tej kwestii.

Słowa kluczowe: Republika Czeska, ramy budżetowe, wieloletnie ramy, średnioterminowa prognoza, średnioterminowe ramy wydatkowania, prognoza budżetowa

Keywords: The Czech Republic, budgetary framework, multiannual framework, medium-term outlook, medium-term expenditure framework, budgetary outlook