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DIPLOMOVÁ PRÁCE

The Budgetary Institutions and the Analysis of the Budgetary Situation in the Selected Countries

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Prohlášení

Prohlašuji, že jsem diplomovou práci vypracovala samostatně a použila pouze uvedené prameny a literaturu

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Abstrakt

Práce se zabývá možnými důsledky vlivu rozpočtových institucí na hospodaření s rozpočtovými prostředky v České a Slovenské republice. Druhá kapitola rozebírá teorii rozpočtování, nastiňuje hlavní příčiny nadměrného využívání rozpočtových prostředků a nejčastěji aplikovaný proces, který můžeme sledovat při tvoření rozpočtového zákona na daný rok. Třetí kapitola velmi stručně shrnuje hlavní problémy rozpočtových pravidel na evropské úrovni. Hlavní důraz mé práce se soustřeďuje na dvě země Evropské unie, Českou a Slovenskou republiku, a jejich instituce a fiskální situaci. Práce navazuje na studii Holgra Gleicha, který potvrdil hypotézu, že existuje přímý vztah mezi rozpočtovými institucemi a hospodařením s rozpočtovými prostředky, a provedl ekonometrickou studii na toto téma pro léta 1994 - 1998. V mé práci jsem se zaměřila na období let 2000 - 2003 a hodnocení situace v rozpočtových pravidlech v České a Slovenské republice. Hodnotící analýzu a porovnání s výsledky Gleichovy studie jsem provedla ve čtvrté kapitole. Část pátá shrnuje výsledky práce.

Abstract

This paper discusses the possible impact of budget institutions design on the fiscal performance in the Czech Republic and Slovakia. The second chapter treats the theory of budgeting, outlines the main sources of excessive budgeting and the most common way of budget process in European countries. The third part of the work briefly concludes the main problems of the budgetary rules on the European level. The emphasis of the paper is on the Czech Republic and Slovakia and their fiscal situation and related institutions. The paper modifies the work of Holger Gleich who followed the hypothesis that there exists the relation between fiscal performance and national budget institutions and accomplished the econometric survey on this topic for the period 1994 - 1998. The purpose of our paper was to extend the work of Gleich and point our look to two selected economies in the time period of 2000 – 2003. Chapter four of the paper deals with the public finance situation and relevant budget institutions in these countries in this period. At the end we complete our research of the quality of budgetary institutions from the fiscal discipline and centralization point of view. Part five concludes.

Content

4.7. Evaluation of Institutional Arrangements Leading to Fiscal Discipline

4.8. Comparison of Gleich's analysis to the our findings

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PROJECT OF THE THESIS

Date of final exam: Summer Semester 2004-2005

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Title: **The Stability and Growth Pact and the Budgetary Situation in the Selected Countries**

Aim:

In unified Europe the need of co-ordination of fiscal policies of individual member states of European Monetary Union led to implementation of institutional framework and rules, the so called Stability and Growth Pact, which is meant to enforce the EMU member states to keep the budget discipline even after entering EMU.

At the beginning of my diploma thesis I tend to outline the origin and spirit (intent) of the establishment of the Stability and Growth Pact. In the second part I proceed with the critics of the mechanism itself and actual contemporary problems with the budget discipline in the member states of EMU. The following part deals with the budgetary situation in the Czech Republic and the Slovak Republic and the national fiscal laws in these two particular countries. The main aim is to prove or reject the hypothesis that there is some connection between the nature of national fiscal acts and the height of budget deficits in these two selected countries.

Outline:

1. Introduction and the characteristics of the Stability and Growth Pact.
2. Critics of its shortfalls and demonstration of current problems of maintaining the budgetary discipline in the number of EMU countries.
3. Budgetary situation in the Slovak Republic and the Czech Republic

3.1. The development of budgetary situation in two selected candidates for EMU, concretely the Slovak Republic and the Czech Republic,

3.2. The national fiscal acts in these countries.

3.3. Attempt to find the influence of the nature of these particular fiscal laws on the current budgetary situation in these candidates for EMU.

4. Conclusion.

Literature:

Brunila, A., Buti, M., Franco D.: *The Stability and Growth Pact*; Palgrave, 2001

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European council – ECOFIN Meeting: *Implementation of the Stability and Growth Pact*, 14492/1/03 REV 1 (en) (Presse 320) 15, 25 November 2003

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European Economy no 3/2003: *Public Finances in EMU*, Directorate General for Economic and Financial Affairs

European Economy no 3/2002: *Public Finances in EMU*, Directorate General for Economic and Financial Affairs

European Economy no 3/2001: *Public Finances in EMU*, Directorate General for Economic and Financial Affairs

I attach the other literature later.

Consultant:

Author:

1. Introduction

The problem of the excessive governmental borrowing and the consequent increasing indebtness of the state sector is a widespread problem in the European countries. They were challenged to consolidate their finances and put the debt bellow 60 % and lower and maintain the budget deficit bellow 3 % to become members of monetary union. Even after accession to EMU there were fiscal rules introduced on the European level that should coordinate the fiscal policy of the member state of the monetary union. However, there is still a substantial variation among the European economies in the terms of debt levels, some of them exceed the "magic" boundary of 100 % (Italy, Belgium) others were able to get back bellow the 30 % (Ireland) or even use creative accounting to join European Monetary Union (Greece). Why is the rule of "close to balance or in surplus" or numerical targets set in the Stability and Growth Pact not a great success in the fiscal policy field? The answer lies in the national budgetary rules and institution that create the budget process of the individual fiscal policies. In his respect we have a closer look at two of the Central and Eastern countries that joined European Union only recently and are committed to join common currency area in a near future.

Different authors put different emphasis on the role of the quality of budget institutions and rules created on national level on the performance of public finances. We are convinced that the relation here exists and is relatively strong.

This paper focuses on the comparison and subsequent evaluation of the budget procedures that serve as a budget formation framework in the Czech Republic and the Slovak Republic. Its ambition is to show that there is the difference between these two public policies which may cause the evident divergence in the trend of public finances.

The launch of the paper discusses the theory of the budget rules and institutions, the numerical rules, procedural rules and their problems; and proceeds with the introduction of the budget process that is followed in the Central and Eastern Europe countries.

Another part deals with the budget rules enacted on the European Union level and briefly summarized the possible origin of the unsuccessful working of these regulations.

The fourth chapter treats the political development in 1990's. These countries show a somewhat different evolution mainly from the second half of the 1990's when there political reversal occurred in both economies. The year 1998 onward constitutes the centre of our attention in political and fiscal policy point of view. From this breaking point, the selected countries show an obvious divergence in the field of both examined areas of political leadership and of public policy trends. The restrictive public policy in the Slovak Republic is opposite to the expansive policy in the Czech Republic.

This paper is based on the analysis made by Holger Gleich in his doctoral thesis in University in Bonn. In his paper he studies the relation between fiscal institutions and budget deficits and debts in the Central and Eastern European Countries in 1994 – 1998. We modified and extended his findings with deeper interest in two selected countries. We updated the research and worked with the more recent time framework of 2000 – 2003.

The analysis and evaluation of the Czech and Slovak fiscal budgeting constitutes the last part of our paper.

2. Theory of Budget Procedures and Budget Institutions

Before we hold forth on the description of the budget rules in the Slovak Republic and the Czech Republic, we clarify the purpose and different kinds of budgetary institutions in general.

There is variety of definitions of budgetary institutions. Budget institutions consist of procedural rules and balanced budget laws[1]. The definition says that the *budgetary institutions are all the rules and regulations according to which budgets are prepared, approved and carried out. (...) Such institutions shape the effect political fundamentals have on fiscal choices and outcomes; at the same time the effectiveness of institutions depends on the political fundamentals* (VON HAGEN, 1998).

The theory of budget institutions tries to answer the question of the influence of the budgetary institutions on budget balance and generally on fiscal policy outcome.

2.1. The Budget Institutions

Budgetary institutions diverge from country to country and in time. There exist in fact two kinds of budget institutions: **procedural rules** and **numerical targets**.

2.1.1. The Balance Budget Law

The balance budget law is the most typical type of numerical target and has the attribute of the simplest fiscal rule. There are more reasons why this rule is not optimal to

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[1] See Alesina, Perotti (1996), Abstract

ensure fiscal discipline. One of them is explained by the stabilisation function of the fiscal policy. In accordance with the Keynesian theory, the fiscal policy should play an active role and work as follows: when the economic cycle occurs in recession, tax cuts and expenditures increase should be realized by means of of government borrowing. It is also the argument of the tax smoothing theory of the budget deficits (Barro, 1979). Tax rates ought to be remaining on one stabilised level and automatic stabilisers left to smooth the economic cycle. Deficits are allowed when there are extraordinarily high requests for spending e.g. in times of war, natural catastrophes (floods, hurricanes) and when the revenues are low e.g. in times of depression.

As a result, is seems that the balances budget rules lack some form of flexibility. There is a more space for flexible decisions and acting in case of procedural rules.

2.1.2. The Procedural Rules

Procedural rules are set of rules that prescribe how the budget is being shaped during the budgetary process from its planning phase to its implementation by bureaucracy and consequent financial control.

Two issues are underlying in a topic of procedural rules.

1. **Degree of the transparency** of the budget (connected with the problem of creative accounting, off – budget liabilities etc.)
2. The **voting procedures** that lead to the formulation of the budget (the scope of rights and power of Minister of Finance - or Prime Minister, voting procedures in the Parliament)

First of all we have a closer look at the problem of **transparency of the budget**. In modern economies the budget is very complex and may be artificially excessive. It is the politicians' incentive to hide the real liabilities and taxes and overestimate spending.

According to the fiscal illusion theory the typical voter underestimates taxation and overestimates spending, which decreases the politicians' responsibility and effectiveness of the budget process. There is a clear advantage of the fully informed politicians to confounded taxpayer. Very common is the politics of the loose fiscal policy and spending before elections[2].

There are two ways how to deal with this problem. Either to establish a certain principles to be followed or establish institutions, which verify the correctness of the budget.

The deception in the question of transparency for the voters lies in some tricks. They are the following:

a) Too optimistic forecasts of the effect of the budget of the different fiscal policies,

b) Overestimation of the growth of the economy i.e. overestimation of the tax revenues; at the end of the year the politicians claim that the unpredictable development of the economy caused the excessive deficit

c) Off –budget items, i.e. keep some items away from national budget

d) The politicians use strategically the budget projections; due to inflating the baseline they appear conservative in the eyes of the taxpayers by claiming they are fiscally conservative without having to create real costs for the electorate

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[2] It is generally considered as the "political business cycle."

e) Strategic use of the multi-year budgeting [3]

We turn our attention to the second characteristics of the procedural rules, the **voting procedures.** They set up whom and when has the influence on the final budget design.

In this place we come to the cardinal reason for occurrence and prevalence of excessive spending, the so called **Common Pool Resource (CPR) problem,** which is important to outline.

The CPR problem lies in the activities of the government that are aimed at specific groups of citizens while the costs of the project pay all the taxpayers. This is mostly evident when the political representatives act in for some geographical area, district. The voters of the constituency call for more projects for higher price because they do not bear the absolute cost of this project. There is a tendency to demand more spending from the common source and the budget deficit is naturally increasing. This is analogical to the situation when the politicians represent some social groups (farmers, entrepreneurs). Different styles of fiscal governance solve this problem in a different manner (see below).

Another feature which contributes to the excessive spending is **reciprocity.** It is a cooperative game between representatives from the different districts or representing different social groups and interests that collaborate in the repeated voting. The representative of one group or interest vote in favour of another one anticipating the same in the following voting in his/her favour.

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[3] See Alesina, Perotti (1996) pp. 25, 26

Before we introduce how the different political systems cope with the coordination failures, we clarify the terms centralisation and fragmentation of the budget process that is important for our analysis in the sub – chapter 4.6.

The **centralisation of the budget process** means the coordination of individual spending decision – makers *to take comprehensive view of the budget* (VON HAGEN, 1998). The **fragmentation** on the other side means that the spending ministers internalize only their part of the costs of the decisions they make. The degree of budget process centralisation depends on the institutions that play role in it. We briefly outline what adds to centralisation in description of each of individual budgetary stages in sub – chapter 2.2 which is about the budget process.

Now, we turn our attention to **Hallerberg's** institutions, which cope with the common pool resource problem. He recognises four types of institutions, in his terminology "forms of fiscal governance": fiefdom, delegation, commitment and mixed. The party system composition plays a decisive role which type of governance is likely.

Table 1: Forms of fiscal governance

Forms of fiscal governance	Their characteristics
Fiefdom	Does not solve the CPR problem
Delegation (Hierarchical)	Giving the Finance Minister (or Minister of Economy, Prime Minister) major decision-making power, i.e. centralisation of a budgetary power
Commitment (Collegial, Contract)	Group of decisions makers enters an agreement i.e. the fiscal contract, that satisfies the budgetary rules, bargaining on fiscal objectives that are to conduct budget planning
Mixed (Intermediate)	Combines the delegation and commitment

	approach, i.e. the authorised major decision – maker together with the agreement on the fiscal contract play their role in budget process; used in minority governments

According to the **fiefdom governance** approach, the budget process consists of aggregating the budget bids of the individual ministries into the budget. The spending is usually higher than in the other forms of budget governance. When decision-making is decentralised, the players bear the CRP difficulty. Greater the division of the cabinet into diverse cabinet posts, the larger the CRP problem occurs. The typical future of this kind of governance is that the planning about the size or composition of the budget or deficit into the future makes no sense. The politicians simply ignore such multi – annual budgetary planning.

Delegation governance gives the finance minister the responsibility to coordinate the structure of the budget and in general behaviour of the policy (the size of budget deficits etc). He represents the will of the taxpayers and may well avoid the lobby of different sectors. He may have the ability to monitor other ministries as he usually has the staff trained in accounting, budgeting and auditing and these economists are able to find the tricks the various ministries try to put into their budget propositions.

What rules strengthen the power of the Finance Minister compared to other ministers? There are two stages of budget process when common pool resource problem is relevant and thus where the power of the Minister of Finance is important: when the budget is being deliberated and when the budget is being put into practice. The Finance Minister should have privileged rights in both periods.

The success of the delegation approach depends crucially on the party formation of the government. The delegation can hold when there are either two parties or one party in the government. It is much more efficient in the one-party government (or similarly in the government where the political parties are close to each other ideologically, or are anticipating to run together in the future elections). In this case the Minister of Finance holds the similar spending preferences as his party ministers. Moreover, it is relatively simple to dismiss undisciplined minister from the same political party.

On the other side, the two party governments are more complicated for delegation governance when the Minister of Finance is from one party and the spending ministers are also from the other one. It is not probable that the Minister of Finance will monitor and punish the spending ministers from his party in the same way that the ministers from another one. The principal agent problem here is evident.

According to Alesina, Perotti (1996) delegation institutions are more likely to impose fiscal control, circumvent large and long – lasting fiscal deficits and debts and realize fiscal corrections in times of shock and unanticipated events more flexibly and rapidly.

Commitment governance marks out with the fiscal contract that the parties negotiate between each other. Thus they internalize the tax externality and consider the absolute tax burden not only on their party but on the whole coalition.

The commitment governance model is likely in the countries when there is traditionally a coalition i.e. multi-party government with the parties that run against each other in the elections.

There exist two kinds of the coalition contracts. In the first one, the fiefdom model, the parties just consult the distribution of budget.

The second one, the so called commitment to contracts, involves the detailed negotiations for every ministry. The coalition partners negotiate the multi-annual plans which are likely to be equal to fiscal contracts. The question here is what happens if the contract is violated by one of the coalition partners.

The last type of governance here described, **mixed governance** is typical for minority governments. The minority government is one that needs the help of opposition parties in parliament to pass the legislation. As explained above, also in this case the delegation to the strong central leader is possible under assumption of the closeness of ideology of the partners in coalition. Moreover, it is efficient to include the selected opposition parties in the budget talks. The government dialogues with the opposition are totally identical to the same negotiations under the majority governments and reach the fiscal agreement with them.

2.2. The Budget Process

Different sources of literature distinguish among variety of phases of the budget process, how the budgets are being prepared. We focus on these (Gleich 2002)[4]:

a) *the formulation of the budget proposal* (the budget preparation stage)
b) *legislative approval* (by parliament)
c) *the implementation of the budget* (budget can be supplemented)

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[4] Hallerberg (2003) recognises also the planning phase, when government make forecasts about the revenues, and spending, economic growth and it can last for several years as is in the case of preparation a multi-year budgeting plan.

d) *budget control stage* (revision of the final accounts, presenting the final report to the parliament)

We concentrate on the first three stages of the budgetary process.

2.2.1. The Budget Preparation Stage

The contributors to the budget preparation stage are Prime Minister, Minister of Finance, and spending ministers. How the budget preparations phase looks like and the quality of coordination depends on the interplay between these performers.

The Finance Minister internalizes the whole cost of spending which lies on the average taxpayer. On the contrary, the spending ministers are the bureaucrats who are trying to maximize their budgets. The coordination failures arise due to the excessive decision of spending ministers with diverse jurisdiction about spending on their ministries. The coordination failure can be eliminated by delegation approach and commitment approach.

The most common sequence of actions in the preparatory stage looks as follows[5].

First of all the spending ministers are asked to prepare their budget bids and they are given the time limits for their presentation. In this period of time, the budget circular is being dispersed. The parts of the circular comprise technical matters and the estimates of the macroeconomic forecasts. It can state numerical objectives on main budgetary parameters as highest deficit, absolute amount of spending and sketch the intended concerns of the actual budget. The application of the fiscal goals differentiates various budgetary procedures. Targets can range from the balance budget rule, rule that bans deficits to be larger than the amount of capital expenditures (golden rule) and other.

The goals are determined by the degree of centralisation. In a planning process the centralisation is largest when the Prime Minister and Minister of Finance set the fiscal targets on the whole, somewhat smaller when all cabinet bargain on them (again delegation vs. commitment approach).

Secondly, when the individual ministries (usually without consultation with other ministries or Ministry of Finance) create their budget proposals, the Ministry of Finance prepares the whole budget draft. In this period the relative power of the Finance Minister to other ministers is crucial as the ministers try to propose their "best possible" budgets. Usually, the Minister of Finance examines the budget requirements and holds bilateral debate with spending ministers to detect probable give-and-take behaviour or divergence from the fiscal objective. If the centralisation is higher, the central player can make any modification to the draft budgets without consultation. On the contrary, in the event of low centralisation and "weak" central performer, the Ministry of Finance can only gather the proposals and put them together.

To reconcile the spending demand of the ministries with the general policy objectives also depends on the centralisation, it is of greater success if the Minister of Finance or the Prime Minister have prevailing role in it.

The preparatory stage ends when the cabinet accepts the budget draft and proposes it to the Parliament.

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[5] See Gleich (2002) pp. 28 - 33

2.2.2. The Legislative Approval

The Parliament encompasses the right to approve, rebuff or amend the proposal. Mostly, the dialogue starts with the broad-spectrum discussion followed by the first vote on the main parameters of the budget such as revenues and expenditures. Then the deliberation begins, when the ministries justify their budgets in front of the parliamentary committees. The work on support, rejection or revisions is coordinated by the budget committee which poses some prerogative rights.

The next step includes the parliamentary votes on the budget. It is important in this part not to leave the amendment process unrestricted. Spending ministers have inclinations to underestimate the impact of fiscal externalities[6]. The rules that increase fiscal discipline should be adopted in this stage of budget process.

The rule for ensuring the fiscal discipline in amending phase may have the form of offsetting any revenue decline or expenditure enhancement with the opposite measure.

Another or supplementary step is to protect the governmental proposal by set of additional rules e.g. vote of confidence.

The third option is to impose some time deadline, limitation that would force the parliament to adopt the budget in some legally given period. The power or time opportunity for strategic bargaining is lowered.

The structure of the Parliament also matters. In the case of bicameral Parliament, there are three players in the game (two chambers and the government) of bargaining. The number of interactions and thus the potential violation of the discipline are enhanced

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[6] The burden of costs of their programs is born by all current and maybe future taxpayers.

relative to the unicameral Parliament composition or Parliament where one chamber has greater rights compared to the other one.

After voting on the budget, the Parliament sends the president its approved budget. The president may have veto right, either to the entire budget or to its parts. In the event the veto is used, the proposal is given back to the Parliament. To make the veto ineffective, the two-thirds vote, majority of all deputies or simple majority may be necessary.

2.2.3. The Implementation of the Budget

Responsibility in this stage of budgetary process bears the executive division of government and starts with the signature of the president.

The centralisation is strengthened when the Finance Minister has rights to control and monitor the spending flows. Commitment role of the budget is disobeyed if the budget is not obligatory to follow. The additional changes to the budget may be approved on the different levels of the hierarchy (from law in the Parliament to spending ministers' adoption). More rigid this stage and more hierarchical process there is required, the higher fiscal discipline is apparent.

The other threat to the budget worsening is the case of negative fiscal shocks. Here the response and mainly the flexibility of responses matters. It ranges from the lowest when all the cabinet is obliged to accept measures to reverse the negative development of finance (underperformance of revenues or expenditures boost) to the highest when the Ministry of Finance has the prerogative right to turn over negative situation.

The complete budgetary process is demonstrated in the Table 2.

Table 2: The budgetary process phases

<u>The formulation of the budget proposal</u>

I. Spending ministries prepare their budget bids and the circular is disseminated

II. Ministry of Finance prepares the whole budget draft

III. Cabinet adopts the draft budget and proposes it to the Parliament

<u>Legislative approval</u>

I. First vote of the annual budget in the Parliament

II. Spending ministers justify their budget bids

III. Parliamentary amendments of the draft budget

IV. Parliament sends the approved final version of the budget to the President

V. President may veto » sent back to the Parliament for the reapproval

<u>Implementation of the budget</u>

I. President signs the annual budget law

II. Executive division of the government looks after the implementation with the compliance with the budget law.

<u>Budget control stage</u>

I. Revision of the final accounts

II. Final report presented to the Parliament

3. The Budgetary Rules on the European Union Level, Maastricht Treaty and the Stability and Growth Pact

A lot of countries have adopted the fiscal rules in the recent decades[7]. EMU fiscal rules are the combination of the Maastricht Treaty rules and Stability and Growth Pact rules. The Maastricht Treaty was signed on 7th February 1992 and it was designed to determine the accession criteria for the future members of the European Monetary Union and to encourage countries to economic convergence. The core of the rules lies in the numerical targets, namely the ratio fiscal deficit of the general government budget to GDP must not exceed 3% and the ratio of the public debt to GDP must not go beyond 60 %. The monetary union which was established by introducing the common currency in 1999 had solved the problem of fluctuating exchange rate and led to increase of the trade among the European countries.

Stability and Growth Pact includes the Excessive Deficit Procedure. The reason for these rules was to pursue the fiscal discipline in the member states of EMU after the accession, as well. The rules of the Pact require the medium – term balanced position of the public finance to allow the automatic stabilizers operate within the boundary of 3 % of GDP. Throughout the years when the economy shows the expansion, the upswing in the cycle improves the budgetary situation and the stabilisers lead to fiscal surpluses, while during the recession the fiscal stability tend to deteriorate. Thus, over the economic cycle, the budgetary pose is close to balance.

The Pact involves a set of **procedures** to ensure this development.

They are the following:

1. EMU member states are obliged to submit a **medium – term stability program** that is basis for the surveillance exercised by the Council of Ministers. This program is updated every single year.
2. When there exist a deterioration from the budgetary target, the Council addresses a **recommendation** to the concerned member state
3. When the deficit of the member state surpasses the limit of 3%, the **excessive deficit procedure** is activated. The Council of Ministers sends a recommendation to the concerned member state to take the steps to eliminate the excessive deficit. If this does not happen in the term of 2 consequent years, the Council put sanctions against the member states. The table bellow presents the height of financial fines in case of the infringement of the fiscal discipline.

Table 3: Schedule of fines

Size of Deficit (% of GDP)	Amount of fine (% of GDP)
3%	0.2%
4%	0.3%
5%	0.4%
6% and above	0.5%

Source: BALDWIN – WYPLOSZ (1998)

Any fiscal rules should fulfil some criteria to be successfully implemented and work in accordance with their role in economic policy. In compliance with the Kopits and Symansky (1998), the good-quality fiscal rules should be *well – defined, transparent,*

[7] Among others there are these evident and persuading examples: in New Zealand Fiscal Responsibility Control Act of 1994, in Australia Budget Honesty Act of 1996, in Canada the Fiscal Spending Control Act, in the United Kingdom the Code for Fiscal Stability whose part is the well-known golden rule and others.

simple, flexible, adequate relative to final goal, enforceable, consistent and underpinned by public finance reforms reform (BUTI, M – EIFFINGER, S – FRANCO, D, 2003)

Table 4: Criteria of ideal fiscal rules

Ideal fiscal rule	EU fiscal rule
Well – defined	++
Transparent	++
Simple	+++
Flexible	++
Adequate relative to final goal	++
Enforceable	+
Consistent	++
Underpinned by structural reforms	+

Legend: +++ very good, ++ good, + fair

Source: BUTI, M – EIFFINGER, S – FRANCO, D (2003)

There have been many surveys of different quality and of different view written on the topic of Stability and Growth Pact. The most critics of the fiscal rules on the EU level considers their:

- **Lack of differentiation** (it rises from the variance in debt levels, as the stabilisation of debt ratios does not imply the same degree of budget balance)
- **The Pact is not adapted for the New Member States of EU** (catch – up of the economies, Balassa effect)

- **The figures of 3 % deficit and 60 % debt are artificial,**
- **The Pact works asymmetrically**
- **The Pact discourages public investments**

- **The Pact focuses on short term commitments and disregard structural reforms** (BUTI, M – EIFFINGER, S – FRANCO, D, 2003) **and others**

Why the European fiscal policy rules do not work as they were suggested to? The answer and the core of the problem lie in the national fiscal policy rules of the individual EU states. The Stability and Growth Pact plays a role of a coordinator of national policies to ensure the fiscal discipline. The fiscal rules and related institutions are made up on the national level. Our intention is to focus in more detail on two newly accessed countries, the Czech Republic and the Slovak Republic.

4. The Transition and the Budget Process in the Czech Republic and the Slovak Republic

Until 1989, Czechoslovakia *enjoyed a low level of debt, sound government finances and macroeconomic stability* (JURAJDA, METHERNOVA, 2004).

The earliest years of the transition from the strictly communist regime and planned economy to a capitalist structures and free-market economy were influenced by the extraordinary politics in which Slovak "Public against Violence" and Czech "Civic Forum" enjoyed support due to their participation in removing communism from power. The Czechoslovak Federation Republic was established and its budgetary situation was strong despite the burden of the reforms that were under way.

The Federation saw the privatization of small-to-medium companies and price and trade liberalization, decentralization of wage setting and opening to trade in the world in the environment of devaluation, fixed exchange rate and stringent monetary policy. The Federation disintegrated, and on the 1st January 1993 the independent Slovak Republic and the Czech Republic gained sovereignty. The split of the Federation was supported by the political leaders on the both sides of the borders. One can find this named the Velvet Divorce.

4.1. The Czech Republic's Transition Path

The Czech Republic was established on 1st January 1993 as the Czech – Slovak Federation ceased to exist. After the dissolution, the Czech Republic seemed to be in a better economic situation.

The unemployment rate was significantly lower in the transition period (around 5 percent) and the GDP per capita also showed the more encouraging number (approximately 10 thousand US$ compared to 7 thousand US$ in Slovakia[8]).

Until 1998, the pro-market program under the Vaclav Klaus (CVK resigned in 1997) leadership in the centre – right government was characteristic for the extensive privatisation of almost all state owned assets excluding banking sector. Lower fraction of hard-machinery industry and of agriculture production and army contributed to faster adjustment to requirements of the world market. Together with the more flexible labour market, more favourable political situation and inclusion in accession talks with EU this was reflected in better economic indicators.

The public policy thanks to balanced official budgets and small public debt were not attracting interest in this phase of transition and were *characterised as "conservative" fiscal policy* (MATALIK, I – SLAVIK, M, 2004). Despite these positive outcomes, there occurred intentions to strengthen the positive trend by legislative measure in the form of balanced budget request, but finally it was not buttressed by the Parliament. The fiscal policy was playing a role in putting market – oriented legislative and technical framework into practice.

The public finance deteriorated mostly from the second half of 90's mostly due to the contingent liabilities. As is stated in (BEZDĚK, DYBCZAK, KREJDL, 2003) (...) *Czech fiscal policy has been implemented in a dualistic way. On the one hand, there are "official" fiscal statistics, and on the other hand some fiscal operations have been*

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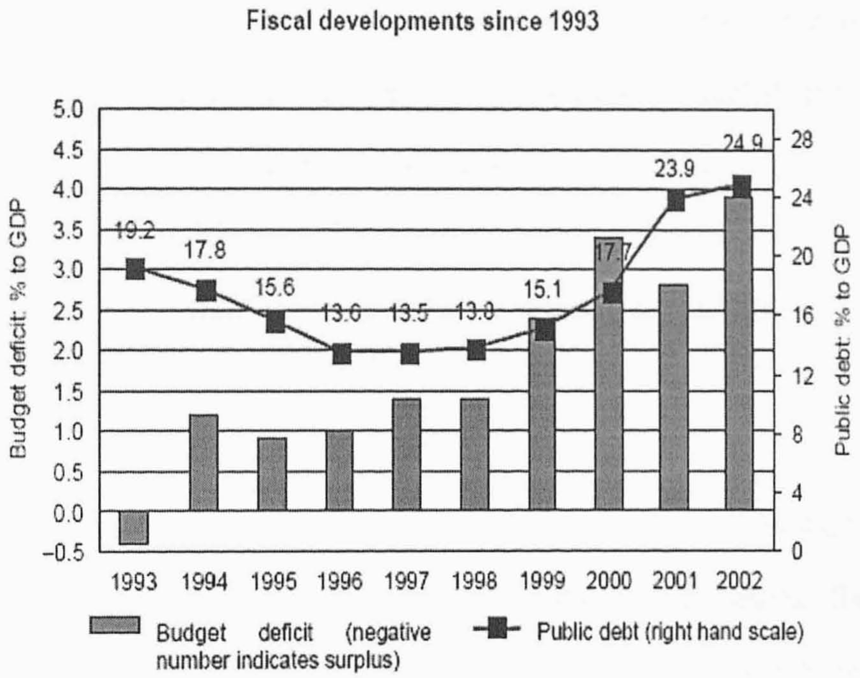
[8] See Jurajda, Methernova (2004) pp. 5

realized outside the official scope of fiscal policy. The amount of the fiscal deficit is not negligible (on average about 1.5% GDP a year).

Assistance in banking sector was part of restructuralization in other eastern block countries as well, but the difference in the Czech Republic was that the deficit and debt did not reflect this fact. These amounts were kept in the "transformation agencies[9]" accounting books.

Graph 1: Fiscal development in the Czech Republic from 1993



Source: MATALIK, I – SLAVIK, M (2004)[10], GFS approach

[9] *Transformation agencies are Czech consolidation agency (ČKA), Česká finanční (ČF), Konpo and Česká inkasní (ČI). They became an important quasi – budgetary instrument of the government in the 1990's. They have been used mostly to improve the performance of the banking system, with the aim of preparing banks for consolidation and privatization. Another branch of transformation agencies is business sector restructuring. The importance of transformation agencies has been constantly increasing (...)*(BEZDĚK, DYBCZAK, KREJDL ,2003)

[10] The analysis is usually complicated by the difference in accounting methodology used. These figures were obtained from IMF applying GFS approach.

Only in past years the government started to uncover the losses of these agencies and they rapidly contributed to increase of public deficit and debt[11].

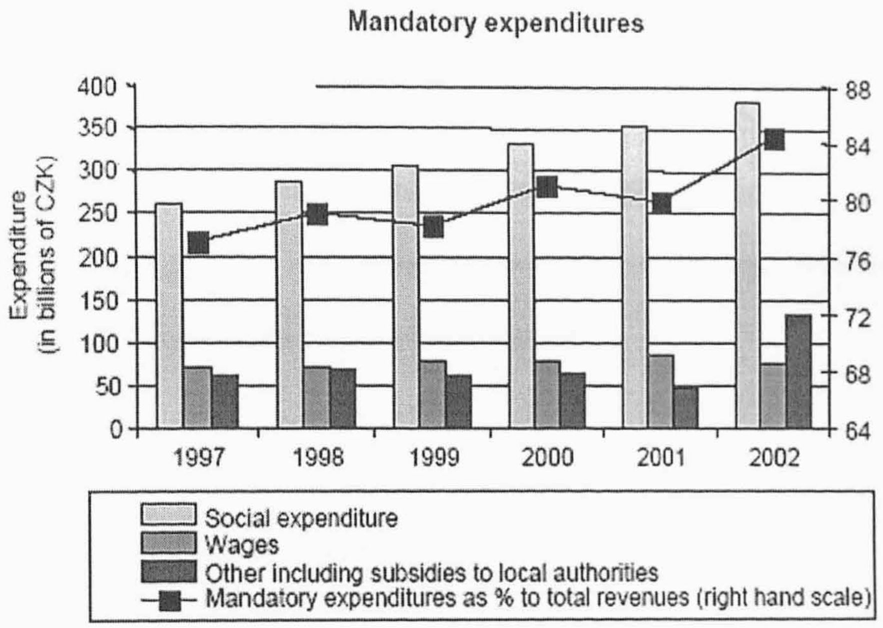
The trend of fiscal policy development from the establishment of the Czech Republic is outlined in the Graph 1. The deterioration of the fiscal position is evident, both public debt and budget deficit are mounting from the breaking year 1998.

In 1998 the Czech Republic faces the change of the government when the power was shifted from the centre – right party to left – wing welfare state proclaiming Czech Social Democratic Party (CSSD). They created minority government with the support of Civil Democratic Party (ODS). The Social – Democrats fuelled growth by high expenditures. As highlighted above, the illusion of low debt was created by the wide usage of off – budget liabilities. The power of Ministry of Finance was declining *and led to further fragmentation of government budget structure* (MATALIK, I – SLAVIK, M, 2004).

Since 2000 when the deficit peaked at around 5 % level, it increased steadily. It was mainly consequence of the enhancing of mandatory expenditures. The mandatory expenditures are social expenses like unemployment benefits and other kinds of benefits, pensions and others. From the Graph 2 we can observe the increasing trend of mandatory expenditures that exceed the level well above 80 % of budgetary revenues.

[11] They are sometimes called "hidden debts" i.e. debts collected apart from the governmental sector.

Graph 2: The rising tendency of the mandatory expenditures in the Czech Republic



Source: MATALIK, I – SLAVIK, M (2004)

The year **2002** did not see the change on the field of the ruling party. The Social Democrats entered the coalition with two rather smaller center – right parties; Christian Democratic Union – Czech Peoples Party (KDU - CSL) and Freedom Union (US).

The first fiscal policy reforms were implemented in 2003, effective since 2004. There seems to be shortage of political will to carry out unpopular and painful reforms, the reason is political agenda against the conviction of the ruling coalition. Moreover, the current government has only a small majority in the Parliament *that makes the ruling party vulnerable to capture by lobbyist groups often composed by a handful of its own MPs.* (JURAJDA, S – METHERNOVA, K, 2004)

4.2. The Budget Process in the Czech Republic

The Constitutional Act of the Czech National Council No. 1/1993 Coll. was signed on the 16^{th} December 1992. It states that the Czech Republic is a parliamentary republic. The chief of the state is President, who is the commander-in-chief of the armed forces, grants amnesty and pardons, has the right of veto on legislative acts, (with the exception of constitution). The president is voted by Parliament.

The Parliament in the Czech Republic has the legislative power of the state and consists of two chambers, is bicameral. The Lower House, Chamber of Deputies includes two hundred deputies voted for four years, and the Upper House, the Senate has eighty-one members that are elected for six years period (the third of senators are voted every two years). The Senate discusses all legislatures except for the Act on the State Budget. Parliament can overrule the veto of the President with a simple majority of all representatives of the Chamber of Deputies.

On the 1^{st} January 1991 came the **Budgetary Act No. 576/1990** Coll. to force. It was approved by the Czech National Council on 20^{th} December 1990. It cancelled the Act No. 163/1989 on budgetary rules of the Czechoslovak-Socialist Republic. The law comprised the creation, position and the function of the state budget, the state balance accounts the budgets of the municipalities and District Offices. It established the principles of the management with the budgetary sources and the control of the management. The law establishes the revenues and expenditures of all levels of the budget (state, local) and adjusts the management of the state funds of the Czech Republic.

It contains 10 parts with the main principles of the budget management. The first part included the basic notions (the revenues of the state budget, the expenditures, the concept of the draft of the budget law, provisional budget, etc. the second part contemplated the management of the budget as the budgetary proceedings, budget reserves of the republic. The third part considers the state funds, the fourth one the concept of the final account, the state financial assets and obligations, the fifth part deals with the budgetary control, the sixth part with the budgets of the municipalities, its principles, revenues expenditures etc. the seventh part reflect the budgets of District Offices, the eight one the violation of the budgetary discipline the ninth one the budgetary and contribution organisations and the last part concludes the law with the joint, temporary and concluding provisions.

This act went through the number of amendments that are present in the Table 7.

Table 5: Amendments to the Act No. 576/1990 until the adoption of the Act No. 218/2000

Law of the Czech National Council of December 20, 1990 No. 576 on the rules for the management of the budgetary means of the Czech Republic (Budgetary Rules of the Republic)	
The law is in force until	**The amendment (Act No.)**
31st December 1991	579/91
14th April1992	166/92
30th June 1992	321/92
31st December 1992	10/93
14th July 1993	189/93
23rd April 1995	57/95
31st December 1995	154/95 a 160/95
14th July 1997	160/97
31st March 2000	360/99

This Act was valid until 2001 when the new Act on Budgetary Rules was converted into a new Budget Law.

The budget year in the Czech Republic is identical to the calendar year and **the budgetary process** comes about in the following way.

- ✓ **In April** of the year proceeding the budgetary year, the Ministry of Finance sends to the spending ministries circular setting guidelines for the drawing up the budget process. From the year 1998 the circular contains the macroeconomic and revenue forecast and from this information derived expenditure and revenue targets, budget balance targets and expenditure upper limits of the ministries and other state institutions that oversee the budget chapter.

- ✓ **In June**, the spending ministries send the budget bids to the Ministry of Finance and during this period the Ministry updates their forecasts for the revenue according to the development of economy in the first half of the current year and sets the goal for the budget balance.

- ✓ In the months of **July and August**, spending ministries debate over their budget requirements in mutual consultations. The board of economic ministers argues about the annual budget before the cabinet receives the whole text of the draft. The governmental cabinet is by and large liberated to adjust the draft recommended by the Ministry of Finance; it cannot change the budget requests of the two chambers of the parliament, the constitution court and the supreme audit office. If it suggests changes to the draft budgets of these organisations, then the Budget Committee decides by the 15th September on these figures. Together with the state budget **<u>the medium-term budgetary outlook</u>** (according to the Act. No 218/200 Coll., i.e. in efficacy from 2001) is proposed to the cabinet for adoption. The medium term – budgetary framework includes the hypothetical revenues and expenditures of the state budget and the state funds for the individual years and presumptions and goals that are basis for these hypothesized revenues and expenditures The medium term budgetary outlook incorporates:

1. intended development of the basic indicators of the national economy, particularly declining or increasing of GDP and consumption prices
2. targets of the government concerning revenues, expenditures and the balance of the state budget and state funds primarily the intended amendments of the existing law
3. sum of state budget revenues and expenditures
4. sum of state funds revenues and expenditures
5. revenues and expenditures of the individual budget chapters
6. expenditures on projects and programmes that were approved by the government
7. expenditures on projects and programmes that are co-financed by the European Union budget according to the chapters and state funds
8. overview of the obligations of the physical persons and corporate bodies that are guaranteed by the state
9. if the medium-term budgetary outlook proposes the budget deficit, it includes the way of financing it as well.

10. as far as the guaranteed credits are concerned, the medium-term budgetary outlook includes the planned time schedule of repayments.

The medium-term budgetary outlook is scheduled for the **2 years** following the forthcoming budgetary period.

- ✓ **By 30 September,** the cabinet comes to a decision on the ultimate form of the annual budget draft and proposes it to the Parliament together with the medium-term budgetary outlook.

If the state budget is **not passed** by the beginning of the budget year, budget is governed by a provisional budget bill given in to the Chamber of Deputies by the government. The provisional budget expenditures per month are identical with one twelfth (1/12) of the previous budgetary year absolute amount of expenditures (with effect from 2001). Until 2001, in compliance with the Act No. 576/1990 Coll., the budget had been managed according to draft budget.

Box 1. Rules of Procedures of Chamber of Deputies

The rules of procedure of chamber of Deputies are ruled by the Act. No 90/1995 Coll. The part Thirteen which includes §101to §106 informs about the legislative approval of the state budget.

According to this binding rule, the Government is obliged to give in the budget proposal to the chairman of the chamber of Deputies sooner than 3 month before the start of a fiscal year. In this context it means until the end of September of the year preceding the fiscal year. Simultaneously, the draft must be "on the table" at least fifteen days before the first reading takes place.

The Chairman advances the draft to the Budget Committee.

The first reading of the act is launched by the Finance Minister, followed by the Budget Committee. The content of the first reading is basically focus on the discussion about general budgetary parameters like revenues, expenditure and budget balance, the relation to the municipalities and higher territorial self-governing units, etc.

The Chamber of Deputies either approves the fundamental "design" of the budget or returns it back to the Prime Minister. In the case that the crucial parameters are accepted, they can not be changed throughout the following stages of budgetary process. In the latter event, the new proposal from the government must be put forward within 30 days.

After approval of the basic information, the Chamber decides on the individual chapters. Committees discuss them and move their decisions forward to the Budget Committee in period longer than 30 days. The committees discuss their chapters, it the change in the chapter of another committee is required, and they must ask for if the committee to which the chapter is assigned.

The Budget Committee makes a statement and adopts the resolution on the chapters of the draft and moves it on to the Chamber of Deputies.

The *second reading* focuses on the debate on the Budget Committee resolution and amending proposals are taking place.

The *third reading* of the draft may be initiated no earlier than 48 hours after the second reading has been accomplished and a discussion is pursued. The only things which may be proposed are modification of a technical parts, grammatical mistakes and mistakes in writing or print.

At the closing of the third reading, the Chamber of Deputies votes on amending suggestions and other proposals to the act. It decides whether it will approve the draft act on the state budget.

4.3. The Slovak Republic's Transition Path

As the Czech Republic, the Slovak Republic was founded on the 1st January 1993. It continued a complicated transformation from the centrally – planned to market – based economy. In comparison to the Czech Republic, the nature of the privatization was different, *the Slovak government sold enterprises in management buy-out deals and direct sales that lacked transparency* (JURAJDA, METHERNOVA, 2004)[12].

The unemployment rate never declined below 12 percent. The income per capita was lower in the Slovak Republic (7 thousand US $ in PPP).

After the split eastern part of former Federation experienced the populist government under the leadership of authoritarian Prime Minister Meciar, Vladimir and the ruling party Movement for a Democratic Slovakia (HZDS). This leader was anti reformist and was pursuing the irresponsible fiscal policy; public debt and deficit have ascended. The growth in the Meciar period was due to high government expenses and

[12] Why was the privatization of formerly state-owned companies so complicated in both economies? The answer on this question lies somewhere among the lack of experience, lack of proper and well-functioning institutions, asset stripping ("tunnelling") and weak protection of investments. New owners of the former state companies were the dispersed shareholders with minority rights, the owners rights were badly and weakly defined a most of them were local owners which borrowed the money from state-owned banks to pay for the share in the formerly state-owned companies. This was connected with very easy access to bank credits with the shortage of payment discipline which lead to accumulation of "bad loans".

over-borrowing, not dynamic economic activity. The economic growth was pursued mostly by the expenditures from the government budget to huge public infrastructure investments initiated in 1996. The fiscal deficit peaked on level about 5 % GDP in 1997 and 1998.

Generally, the Slovak Republic lagged after Czech Republic in pursuing reforms in the transition period. This is illustrated in Table 6.

Table 6: The degree of political and economic liberalisation during transition

	Economic Liberalisation[13]		Political Liberalisation	
	Czech Republic	**Slovakia**	**Czech Republic**	**Slovakia**
1989	0	0	0.17	0.17
1993	0.52	0.49	0.92	0.58
1997	0.6	0.56	0.92	0.67
2000	0.63	0.59	0.92	0.92

Source: JURAJDA, S – METHERNOVA, K. (2004).

The most of foreign assistance was targeted into the NGO sector. This period is also typical for widespread stripping of assets and wide corruption.

[13]The economic liberalization index ranges between 0 (centrally planned economy) and 1 (liberal market economy). It is the average of 8 sub-indexes of progress in reforms (European Bank for Reconstruction). JURAJDA, S – METHERNOVA, K. (2004).

The break even – point came in **1998** when the head of the government became pro –reform centre – right Prime Minister Mikulas Dzurinda. The coalition consisted of wide left – right spectrum of parties. SDK was established in July 1998 as a five party coalition: Christian Democratic Movement (KDH), Democratic Party (DS), Democratic Union (DU), the Social Democratic Party of Slovakia (SDSS) and the Green Party of Slovakia (SZS). *The SDK leader Dzurinda formed a coalition government with three SDK parties (KDH, DS and DU) and three non-SDK members* (GREGOR, 2004) – Party of the Democratic Left (SDL), Party of the Hungarian Coalition (SMK) and Party of the Civil Understanding (SOP). In November 2000, the Prime Minister composed the Slovak Democratic and Christian Union (SDKU).

The fiscal position of the country was in this time in a poor condition left after Meciar era of "economic development". In the first ruling period (1998 – 2002) the government focused on attraction of FDI inflow to the economy and sold major banks. To attract FDI, the corporate income tax rate was decreased from 40 % to 29 % which lead to reduction of governmental revenues. These were not offset by retrenchment of expenditures (that rose as a result of bank restructuring expenses) which naturally ended up in deterioration of public finances at end of the election period.

The current Cabinet (from **2002** elections) is headed by Mikulas Dzurinda with pro – reform coalition of 4 center – right parties - Alliance of New Citizen (ANO), Christian-Democratic Party (KDH), Slovak Democratic and Christian Union (SDKU) and Hungarian Coalition Party (SMK). The public finance reform and deficit reduction was attained due to other reforms taking place mostly in 2003 (social benefits reform, pension reform, public finance management reform, educational reform, tax reform).

4.4. The Budget Process in the Slovak Republic

Slovakia is a parliamentary republic. Its Constitution was signed on 3rd September 1992. The head of the state is President, who serves as a supreme commander of the armed forces, can grant pardons, and has the right to return legislation to Parliament. In January 1999, the constitutional amendment to permit the direct election of the president by citizens of Slovakia was approved.

The leader of the government is Prime Minister, the legislative power holds the National Council of the Slovak Republic which comprises 150 seats and is unicameral. Parliament can override the veto of the president with a simple majority of the representatives present. Deputies are elected for four - years' periods on the basis of proportional representation.

Since 1995, when the **Act on Budgetary Rules No. 303/1995 Coll.** was signed, the budgetary process looks as follows[14].

As in the Czech Republic, the budgetary year is identical to calendar year.

- **In January-February** of the year preceding the budgetary year, the Ministry of Finance prepares approximate calculations of the growth of the fundamental budgetary parameters (revenues, expenditures, balance) according to the macroeconomic projections for the recent and forthcoming year. Consequently, the cabinet is being informed about them, but does not decide on the fiscal targets.

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[14] There was a new Budgetary Act signed on 23rd September 2004, Act No. 523/2004 which came to force at the day of promulgation, with the exception of some paragraphs, that came to force on 1st January 2004. This bill is not the subject of our survey.

- In spring months of **March – May**, the Ministry of Finance propones the draft of the budget objectives. This is a long-lasting process of consultations with the spending ministers, cabinet committees (Economic Council of the government and the Council of Economic Ministers) and representatives of the local governments (the Association of Towns and Municipalities),

- **In May** the Ministry of Finance distributes the circulars with the order how to prepare the budget requests.

- **In June**, the cabinet decides on the revenues, expenditure, balance, spending ceiling and other fiscal parameters and the Ministry of Finance revises and updates the revenue, economic growth and other macroeconomic indicators projections.

- In summer, in **July and August**, the spending ministers hand over their budget requirements.

- The bilateral negotiations between the spending ministers and Ministry of Finance on the compliance of the bids with the limits on spending take place in **September**.

- In **October**, the annual budget proposal is reasoned by the Council of Economic Ministers and the Economic Council of the Government.

- Essentially until the deadline of **15th October** (until 2001 this deadline was 15th November) when the cabinet puts the final version to the National Council, unresolved chapters and figures are being discussed in the cabinet.

The Slovak Republic agreed upon medium – term fiscal scenarios included in the **Joint Assessment of Medium Term Economic Policy Priorities** in 2000. This step was legally underpinned by the amendment to the Budgetary Rules Act No 503/1995 Coll. since year 2002.

Box 2. Rules of Procedure of National Council of the Slovak Republic

The rules of procedure of National Council of the Slovak Republic are ruled by the Act. No 350/1996 Coll. from 24th October 1996. The part Ten which includes §67 to §97 informs about the legislative approval of the acts in the Council, § 87 regulates the adoption of the budget law.

The draft of the budget act must be "on the table" at least fifteen days before the first reading takes place.

The Chairman advances the draft to all committees except for mandate committee, immunity committee and committee for inconsistency of the functions.

The first reading of the act is launched by the Finance Minister. The content of the first reading is basically focus on the **discussion** about general budgetary parameters like revenues, expenditure and budget balance, the relation to the municipalities and higher territorial self-governing units, etc. It is possible to submit amendments of the budget and complements. The National Council can either return the draft to the submitting party or deliberate it in the second reading.

The National Council on the proposition of the Chairman stipulates the time for debate on the annual budget draft in the committees. This time period must not be shorter than 30 days since assignment.

The *second reading*. The committees evolve the report on the deliberations in the second reading comprising the suggestion if the draft should be approved. The report includes proposed amendments or complements, if there are any. The proposals must be justified and precisely defined. The mutual report of all committees is distributed to all Members of Parliament and to the submitting party. The Council can debate on the draft no sooner than 48 hours after acquirement of the mutual report of the committees. After the debate, the vote on the amendments and complements is taking place.

The *third reading*. If there did not occurred any amending or complementing propositions in the second reading, the Council initiates the vote on the draft budget as a whole. If there did occurred the amendments in the second reading, the third reading concerns the enactments that were proposed to be amended. The Member of the Parliament can suggest only the grammatical or technical corrections to the text of the draft in the third reading.

The approved act is distributed to the President and he/she can veto the whole act or only a particular part of it. If the act is returned to the National Council, it can overrule it by the majority of the present representatives.

4.5. Fiscal Performance in the Czech Republic and the Slovak Republic in years 2000 - 2003

There is a strong divergence in the fiscal policy performance between the observed economies evident from the following two tables and the graph.

The unfavourable trend of the public finance in the Czech Republic is caused by low efficiency of allocation of resources (inefficient social system), rising of mandatory expenditures (generous social system), inclusion of the transformation institutions in the budget and weak will to pass the reforms that are against the political agenda of the social - democratic party (tax reform and social security reform including the pension scheme). The Slovak evolution of deficit in the period 2000 – 2003 is due to the fact that the governmental tax revenues reduction caused by gradual decrease of the tax rate to the unified one of 19 % was accompanied by the substantial cuts in public expenditures (caused by social benefit reforms, new labour legislation that increased the employment rate, pension reform etc), wage bill and general services. Moreover, their roles in the direction of the course of the fiscal performance have the budget institutions that evolved during the transition period. The comparative analysis of the budget procedure in the Czech Republic and the Slovak republic takes place in the subsequent sub – chapter 4.6.

Table 7: The Czech Republic's critical fiscal policy indicators (in mil. CZK and % GDP)

The Czech Republic critical fiscal policy indicators (in million CZK and % GDP)

	2000	2001	2002	2003
Government deficit (-) (in mill. CZK)	**-78 500**	**-137 000**	**-163 000**	**-319 600**
Government deficit (-) (in % GDP)	**-3.7**	**-5.9**	**-6.8**	**-12.6**
Government expenditure	**42.1**	**45.0**	**46.9**	**54.5**

(in %GDP)				
Government revenue (in %GDP)	38.5	39.1	40.2	41.9
Government debt (in mill. CZK)	**392 200**	**586 200**	**696 500**	**956 100**
Government debt (in % GDP)	18.2	25.3	28.8	37.8
Primary balance (in % GDP)	**-2.8**	**-4.8**	**-5.2**	**-11.3**
GDP in market prices	2 150 100	2 315 300	2 414 700	2 532 400

Source: EUROSTAT

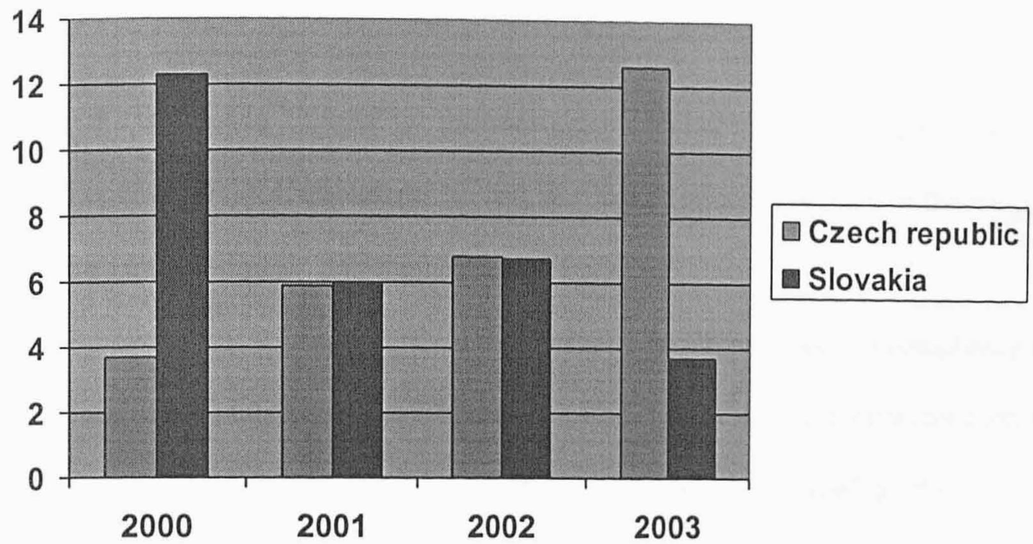
Table 8: The Slovak Republic's critical fiscal policy indicators (in million SKK and % GDP)

The Slovak Republic critical fiscal policy indicators (in million SKK and % GDP)

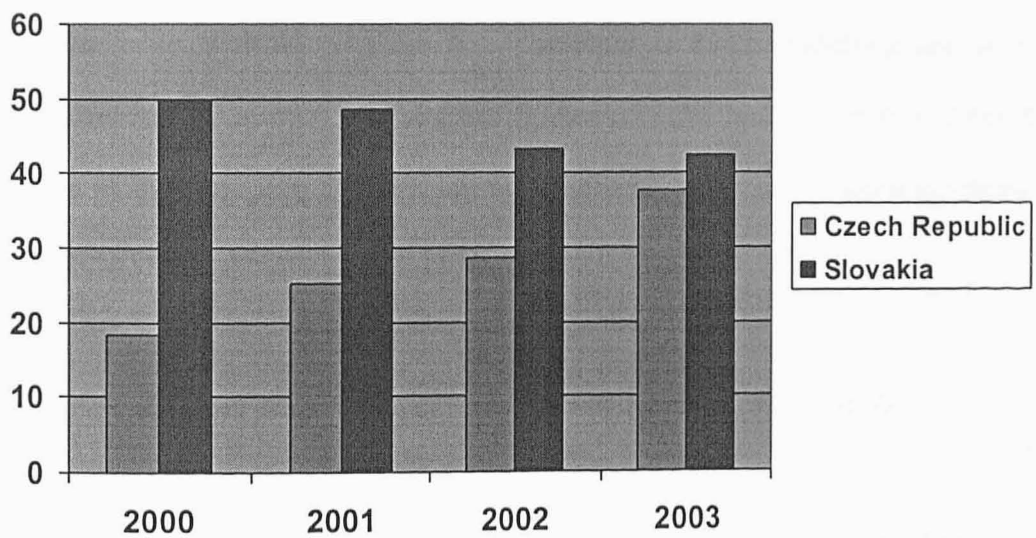
	2000	2001	2002	2003
Government deficit (-) (in mill. CZK)	- 114 962	- 60 579	- 62 674	- 44 742
Government deficit (-) (in % GDP)	- 12.3	- 6.0	- 6.7	- 3.7
Government expenditure (in %GDP)	59.9	51.5	50.9	39.2
Government revenue (in %GDP)	47.6	45.5	45.2	35.4
Government debt (in mill. CZK)	465 906	492 186	475 387	511 770
Government debt (in % GDP)	49.9	48.7	43.3	42.6
Primary balance (in % GDP)	- 8.2	- 2.0	- 2.1	- 1.2
GDP (in market prices)	934 079	1 009 839	1 098 658	1 201 196

Source: EUROSTAT

Graph 3: Trends in Czech and Slovak fiscal policies - Deficit[15]



Graph 4: Trends in Czech and Slovak fiscal policies - Debt



[15] The positive altitude of the graph indicates the level of the deficit since 2000 till 2003.

4.6. The Comparison of Slovak and Czech Budgetary Institutions in years 2000 – 2003

In the tables 9 to 15 there are presented characteristics of the budget process in two selected countries, the Czech Republic and Slovakia. Some of the steps in the budgetary stages are same or similar, some are different.

The budgetary arrangements are concentrated into three groups in compliance with three stages of the budget process. The tables 9 – 15 include different steps that contribute to the final version of the annual budget act and they are divided to the groups of characteristics that create the individual stages of the process. These tables include summary of information obtained from the different sources of literature.

The table 9 deals with the new phenomenon in the budgeting and it is the construction of the multi – annual fiscal frameworks that were initiated in 2000 at the stimulus of the European Commission in compliance with the accession strategies and were further deepened and legalized in both sample countries.

Table 9: The budget preparation stage - THE MEDIUM – TERM FISCAL FRAMEWORKS

The budget preparation stage THE MEDIUM – TERM FISCAL FRAMEWORKS	
The Czech Republic	The Slovak Republic

1. The multi annual budgetary framework according to the Budget Law, Act No. 218/2000 Coll. (this measure valid from 2004).	1. Amendment to the Budget Law, Act No. 503/1995 Coll. from 2002 where was multi annual budgetary framework legalised and made severe[16]
2. The Czech government together with the European Commission agreed upon medium – term fiscal scenarios included in the Joint Assessment of Medium Term Economic Policy Priorities in this particular year.	2. The Slovak government together with the European Commission agreed upon medium – term fiscal scenarios included in the Joint Assessment of Medium Term Economic Policy Priorities in this particular year.
3. This framework **is not** basis for the annual budget act (it has indicative function) and is updated every year with the further year estimations (the logrolling approach).	3. This framework **is** basis for the annual budget act and is updated every year with the further year estimations (the logrolling approach).
4. When there deviation from the target occurs, this **is not** mentioned in the multi – annual framework.	4. When there deviation from the target occurs, this **is** mentioned in the multi – annual framework.
5. The fiscal framework is projected for the period of 2 years from $\mathbf{t \rightarrow t + 2}$.	5. The time framework for assessment of the situation is $\mathbf{t - 1 \rightarrow t + 3}$.
6. The multi – annual planning covers the central government and social funds. It is formulated in the Budget Agency and Budget Department of Ministry of Finance.	6. The multi – annual planning covers the central government and is originated in different departments of Ministry of Finance.

[16] However, the Ministry of Finance has been producing Midterm Financial Outlook from 2000.

7. The debate and consequent approval of the outlook takes place in the government jointly with draft budget act. Before 2002 the Coalition agreement contained only verbal policy intentions and after 2002 it consists of numerical medium – term informative goals.	7. Multi – annual targets are adopted before annual budget drafting is initiated at the beginning of the budget process. The statements encompass verbal plans.
8. The government established off – budgetary funds, but they **are not** included in the medium term fiscal framework.	8. The extra – budgetary funds **are** part of the medium term fiscal planning.
9. The annual goals in framework provide as a non – binding point of reference. The binding part covers annual expenditure ceilings.	9. As in the Czech Republic, the framework is not obligatory to follow with the exception of annual expenditure ceilings (but the budget chapter can surpass the expenditure boundary with the permission of the Ministry of Finance, as is legalised in the Budget Act)
10. The estimations in the multi – annual planning include absolute amount of nominal spending and revenue.	10. The estimations in the multi – annual planning contain total spending as a percentage of GDP, complete nominal spending and revenues, budget balance and debt in relative terms as a percentage of GDP and expenditure targets for spending class.
11. Accounting practices are **different** in	

preparing the multi – annual programme and annual budget act. The responsibility for the programme lies on the Ministry of Finance.	11. The accounting regulations are **similar** in preparing the multi – annual programme and annual budget act. The responsibility for the programme lies on the Ministry of Finance.

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004) + own evaluation

Table 10: The budget preparation stage - THE POSITION OF FINANCE MINISTER

The budget preparation stage

THE POSITION OF FINANCE MINISTER

The Czech Republic	The Slovak Republic
12. The Finance Minister has the role of agenda setter, proposes the multi – annual targets in the Cabinet and his/her powers are legally underpinned in the Budget Law.	12. The Finance Minister has the role of agenda setter, proposes the multi – annual targets in the Cabinet and his/her powers are legally underpinned in the Budget Law and Constitution.
13. The Finance Minister proposes multi – annual targets and cabinet accordingly adopts them.	13. Minister of Finance prepares projections for future developments, discusses them with the spending ministers and as a result he/she suggests multi – annual targets and cabinet adopts them.
14. The discussion in the cabinet considers, as in the Slovak Republic, absolute amounts	14. The discussion in the cabinet considers absolute amounts of spending, particular

of spending, particular budgets for individual ministries, spending for specific projects, general budget guidelines etc.	budgets for individual ministries, spending for specific projects and others.
15. The disagreements between Finance Minister and spending ministers are resolved initially bilaterally between Ministry of Finance and spending ministers, afterwards also within the cabinet.	15. The disagreement between Finance Minister and spending ministers are resolved initially bilaterally between Ministry of Finance and spending ministers, afterwards at the level of state secretaries and after all in the cabinet.
16. Neither the Finance Minister no Prime Minister have veto power to countermand the cabinet. In conclusion, the budget requirements are being prepared by individual ministries.	16. Neither Finance Minister nor Prime Minister has veto power to override the cabinet. At the end, the ministries prepare their budget requests.

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004)

Table 11: Legislative approval - PARLIAMENT

Legislative approval

PARLIAMENT

The Czech Republic	The Slovak Republic
17. The Chamber of Deputies cannot propose the annual budget draft on its own; it has the right to amend it after the government had proposed it.	17. The National Council of the Slovak Republic cannot put forward the annual budget draft on its own; it has the right to amend it after the government had proposed it.

18. There **are** limitations to the scope of amendments; the budget deficit must stay stable.	18. There **are no** limitations to the scope of amendments.
19. Amendments **can not** be the reason of governmental fall.	19. Amendments **can** be the reason of governmental fall.
20. The legislative approval of the budget is initiated by the discussion **in the Budget Committee.**	20. The legislative approval of the budget is initiated in **standing committees.**
21. The vote on the total budget and the main parameters of the budget happens **in the first reading (top – down process).**	21. The vote on the total budget happens at the end of the Council legislature process, **in the third reading (bottom - up process).**
22. The government **has right** to influence voting in the Chamber of Deputies. The government modifies its draft budget for the vote on the key budget parameters in the first reading and can choose if to take amendments of the Chamber into the account.	22. The government **has no right** to control the voting process of the National Council in the maters of the annual budget act.
23. There **is not** any formally given time limit to approve the budget bill (the informal one is end of the year).	23. There **is** a time limit formulated to be the end of a calendar year.
24. If the budget bill is not passed in the dead line, 1/12 of the previous year budget expenditure is used as the basis for the state	24. If the budget bill is not passed in the dead line, the budget draft is used instead of the bill until the budget act is adopted.

finance. Till 2001 it was the same procedure as in the Slovak Republic.	
25. The Parliament **can** be dissolved if the budget is not approved in appropriate time limit.	25. The Parliament **can not** be dissolved if the budget is not approved in appropriate time limit.
26. Lower House – Chamber of Deputies has exclusive budgetary approval rights, the Upper House – Senate is not involved.	26. The unicameral system exists in the Slovak Republic.

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004)

Table 12: Legislative approval - PRESIDENT

Legislative approval PRESIDENT	
The Czech Republic	**The Slovak Republic**
28. President can veto the total budget proposal or some particular parts. Then, the budget is returned to the Chamber of Deputies[17]	28. President can veto the budget proposal or some particular parts of it. Then, the budget is returned to the National Council.
29. The Parliament can override the President decision by majority of all Members of Parliament (200).	29. The Parliament can override the President decision by majority of all Members of Parliament **present**.

[17] See Constitutional Act No. 1/1993 Coll. of the Czech National Council of 16th December 1992, Article 50, Part (1) and (2); see Act No. 90/1995 Coll. of 19 April, 1995, Rules of Procedure of Chamber of Deputies, Article 98 Part (2)

30. The President is elected **by Parliament.**	30. The President is elected **in direct elections** (since 1999)

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004) + own evaluation

Table 13: The implementation of the budget - MONITORING

The implementation of the budget MONITORING	
The Czech Republic	**The Slovak Republic**
31. The implementation is supervised by the Ministry of Finance	31. The implementation is supervised by the Ministry of Finance and Supreme Audit Office.
32. As far as **expenditures** are concerned, the eye is kept on central government, individual ministries, specific budget chapters, social sector and regional governments. They are scrutinized independently.	32. As far as **expenditures** are concerned, the eye is kept on central and general government and individual ministries.
33. As far as **receipts** are concerned, the eye is kept on total revenues and revenues distinguished according to source.	33. As far as **receipts** are concerned, the eye is kept on total revenues and revenues distinguished according to source.
34. The public reports on implementation and fiscal outcomes are published **monthly.**	34. The public reports on implementation and fiscal outcomes are published **quarterly**.
35. The Central Bank (CNB) has no role in	

examination; it publishes independent surveys on budget results.	35. The Central Bank (NBS) has no role in examination; it publishes independent surveys on budget results.

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004)

Table 14: The implementation of the budget - UNEXPECTED SHOCKS AND TRANSFERS OF THE FUNDS

The implementation of the budget **UNEXPECTED SHOCKS AND TRANSFERS OF THE FUNDS**	
The Czech Republic	**The Slovak Republic**
36. When the negative shock occurs, i.e. when the expenditures unexpectedly increase or revenues decline, the spending must be constrained. The Budget Law says: the change of revenues or expenditure is allowed **without the change in the deficit.** Only in case the tax income is lowered, **the deficit worsens.**	36. If expenditures increase, the **expenses can outreach the revenues** in any of the budget chapter **under approval of the Finance Minister**. When revenues decrease the government may allow Finance Minister to impose constraint on the use of budgetary resources.
37. In the event of positive fiscal shock, when the revenues increase the unused	37. When expenditures decline or revenues increase, unused resources in the

[18] Since 2001, ministers can relocate expenditures within their relevant chapters in limitation of 5 % of respective chapter's expenses and 10 % of an expenditure item of this chapter's budget (the Budget Committee can raise the latter percentage).

[19] The Budget Law in force from 2001 enables the chapters to remove max. 2% of their expenditures into the subsequent year (there are exceptions). The previous budget bill of 1990 also tolerated transfers in between years.

resources can be used with **the approval of the Parliament.** If expenditures decline, the balance simply improves.	contemporary budgetary year are transferred to the next budgetary period (except for expenses on salaries and levies) with the approval of Finance Minister[20].
38. The reserve has cabinet at disposal. Its level reaches at least 0.3% of absolute value of budget expenditures.	38. There exists a budgetary reserve for unexpected development of state finance.
39. **The funds can be transferred** either between individual chapters or into the following budgetary period, they must be authorized by the **cabinet** and exceed limits must be approved by the Parliamentary Budget Committee[1819].	39. The transfers between chapters are required to be **agreed by the Finance Minister and cabinet.** The removal of the financial funds to the next year is constrained. The law declares the transfer to January of the consequent year to pay salaries, fees owed in December of the current year.
40. The Finance Minister **can not** block expenditures in the current year.	40. The Finance Minister **can** block expenditures (in some cases he needs approval from National Council) in the current year.

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004)

Table 15: The implementation of the budget - RELATION TO LOCAL GOVERNMENTS

[20] These finances are removed to the special account to be applied on the same programme as they were

The implementation of the budget

RELATION TO LOCAL GOVERNMENTS

The Czech Republic	The Slovak Republic
41. The reform of sub – national governments system was taking a place. In Act No. 218/2000 Coll. which cancelled the Act No. 576/1990 Coll. of the Budgetary Rules, is stated that there are no limits to borrowing of the lower levels of the government. They can accumulate debt and budget deficit and their borrowing is controlled by the central government and can impose penalties to the municipalities.	41. If the local governments want to borrow in excess of their level of revenues they must ask for permission the Ministry of Finance. Fiscal decentralisation reform means increase municipalities' revenues and expenditures share in general government finances.

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004)

4.7 Evaluation of Institutional Arrangements Leading to Fiscal Discipline

We have chosen for the evaluation the arrangements that we regard important from the fiscal discipline point of view. We tried to choose those variables that are different from each other in the Czech Republic and Slovakia. We use the kind of criteria evaluation according to the Gleich (2002) survey. The qualitative characteristics of the

intended in the current year.

budget institutions in countries are translated into the numerical values. The scale of values is 0 – 4, higher the points higher is the contribution of the relevant variable to the quality of budget process; or in other words, each budgetary arrangement that leads to enhancement of fiscal discipline gains higher value.

Wherever possible we use the values compatible to Gleich, otherwise, we have chosen the scale according to our assessment of the variable's importance.

In Table 16 – 18 there are the comparative analyses of the institutional arrangements in the Czech Republic and Slovakia. Each variable is assigned with the numerical value and the interpretation and justification of the evaluation can be found in the text following the tables.

Table 16: The evaluation analysis of the budget process arrangements in the Czech Republic and the Slovak Republic; the Budget preparation

The budget preparation stage

The Czech Republic	Value	The Slovak Republic	Value
1. The multi – annual budgetary outlook **is not basis** for the annual budget draft.	1	The multi – annual budgetary outlook **is basis** for the annual budget draft.	3
2. The deviation from the target **is not mentioned** in the framework.	1	The deviation from the target **is mentioned** in the framework.	3
3. Projection period is t → t+2	2	Projection period is t - 1→ t + 3	3
4. It contains **general government and social funds.**	4	It contains **general government and social funds.**	4
5. The discussion and adoption of	2	The discussion and adoption of the	4

the framework takes place **jointly with the approval of the budget draft.**		framework takes place **before the approval of the budget draft.**	
6. The off – budget funds are **included** in the outlook.	4	The off – budget funds are **included** in the outlook.	4
7. The expenditure ceilings can be increased with **the offset measure on the revenues side.**	3	The expenditure ceilings can be increased with **approval of the Finance Minister**.	3
8. The estimations in the framework include: nominal level of spending and revenue.	2	The estimations in the framework include: nominal level of spending and revenue + **relative level of spending (% GDP), balance and debt (both % GDP), expenditure targets for spending groups.**	2
9. Accounting practices **make a distinction** in the outlook and the budget draft.	4	Accounting practices **are similar** in the outlook and the budget draft.	1
10. The **Finance Minister proposes** targets → **government adopts** them. After this the spending departments set up their budget bids.	3	The **Finance Minister discusses targets with spending ministers** → he proposes the targets → **government adopts** them.	3
11. Disagreements resolved firstly **bilaterally** in negotiations between	2	Disagreements resolved firstly **bilaterally** in negotiations between	3

spending ministers and Finance Minister, subsequently at the **governmental level.**		spending ministers and Finance Minister, subsequently in the **level of state secretaries** and finally at **the governmental level.**	

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004) + own evaluation

Table 17: The evaluation analysis of the budget process arrangements in the Czech Republic and the Slovak Republic; the Legislative approval

Legislative approval			
The Czech Republic	**Value**	**The Slovak Republic**	**Value**
12. Amendments to the draft **are limited, deficit cannot worsen.**	4	Amendments to the draft **are not limited.**	0
13. Amendments **cannot cause** the fall of government.	2	Amendments **can cause** the fall of government.	2
14. The legislative approval initiated in the **Budget Committee.**	4	The legislative approval initiated in the **standing committees.**	2
15. The vote on the total budget **in the first reading (top – down process).**	4	The vote on the total budget happens **in the third reading (bottom - up process).**	4
16. The government **has right to influence** voting in the Chamber of Deputies.	4	The government **has no right to influence** voting in the National Council.	0
17. In case the budget is not approved in the current year, the **budget draft** had been used **until**	1	In case the budget is not approved in the current year, the **budget draft** is being used.	4

2001, since **then the 1/12 of the previous year expenditures** are being used.			
18. The Chamber of Deputies **can be dissolved** if the draft is not adopted in time limit.	4	The Chamber of Deputies **can not be dissolved** if the draft is not adopted in time limit.	2
19. **Bicameral system,** but the Upper House is not involved in budget approval.	4	**The unicameral system.**	4
20. President can veto the budget draft, and then the majority of **all members of the parliament** are needed to overrule it.	2	President can veto the budget draft, and then the majority of **all members of the parliament present** are needed to overrule it.	3
21. President is elected **in Parliament.**	2	President is elected **in direct elections.**	1

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004) + own evaluation

Table 18:The evaluation analysis of the budget process arrangements in the Czech Republic and the Slovak Republic; the implementation of the budget

The implementation of the budget

The Czech Republic	Value	The Slovak Republic	Value
22. Responsibility of the implementation lies on **Finance Minister.**	4	Responsibility of the implementation lies on **Finance Minister and Supreme Audit Office.**	4

23. Control: **central government, individual ministries, budget chapters, social sector, local governments.**	3	Control: **central government, individual ministries.**	2
24. The public reports on fiscal outcomes **published monthly**.	3	The public reports on fiscal outcomes **published quarterly.**	2
25. When the negative shock occurs, i.e. when the expenditures unexpectedly increase or revenues decline, the spending must be constrained. The Budget Law says: the change of revenues or expenditure is allowed **without the change in the deficit.** Only in case the tax income is lowered, **the deficit worsens.**	4	If expenditures increase, the **expenses can outreach the revenues** in any of the budget chapter **under approval of the Finance Minister**. When revenues decrease the government may allow Finance Minister to impose constraint on the use of budgetary resources.	1
26. In the event of positive fiscal shock, when the revenues increase the unused resources can be **used with the approval of the Parliament**. If expenditures decline, the balance simply improves.	1	Act on Budgetary Rules states that any of **unused resources** in the current year **can be transferred to the subsequent year under the approval of the Finance Minister**. They should be used on the **same purpose** as they were determined in the current year.	4

27. The funds can be transferred, they must be **authorized by the government** and **exceed limits must be approved by the Budget Committee.**	4	The transfers between chapters are required to be **agreed by the Finance Minister and government.** The removal of the financial funds to the next year is constrained.	4
28. Finance Minister **cannot block** expenditures.	0	Finance Minister **can block** expenditures, if approved by the Parliament.	4
29. There are **no limits** to borrowing of the lower levels of the government. **They can accumulate debt and budget deficit** and their borrowing is controlled by the **central government and can impose penalties** to the municipalities.	1	If the local governments want to borrow in excess of their level of revenues they must ask for **permission the Ministry of Finance.**	4

Source: Acts on Budgetary Law in the Czech Republic and Slovakia, Gleich (2002), Ylaoutinen (2004), Medium – term budgetary frameworks (2004) + own evaluation

In this place we come to the justification of our evaluation of variables from the fiscal discipline and centralisation point of view.

The first eleven criterion of the quality of the budget institutions in the Czech Republic and the Slovak Republic refers to the budget preparation stage. The very

recent feature of this part of budget process is the phenomenon of multi – annual fiscal targeting[21]. The legal base for the Czech multi – year framework was authorised only recently in the Act No. 482/2004 Coll. – amendment to the existing Act on Budgetary Rules with effect from 7th September 2004. This authorisation is part of the Public Finance Reform Concept. The Slovak Republic framework was legalised in 2002 in the amendment of the Act on Budgetary Rules No. 503/1995 Coll.

1. The first criterion in our analysis refers to the **interrelation between multi – annual fiscal targets and annual budget draft**. It is recommended that there exists the relation between two documents as the fundamental meaning of the outlook is to influence and steer the decision – making in annual budget preparation. However, the outlook has in both countries indicative and informative function with only expenditure limits binding (which is expected to change in the near future in the direction of more obligatory function of the outlook). There exists this relation in the Slovak Republic, while the Czech Republic opposite is true. Therefore we evaluate this criterion with three points for Slovakia and one point for the Czech Republic.

3. As far as the **time framework of the projection** is taken into account, it should in our opinion cover more years than in our sample countries. The emphasis of the projection is on the long – term goals that exceed one electoral term and are independent from the political business cycle. In this case, however, it would be no longer medium –

[21] The beginning of the multi – year planning has its roots in the pre – accession strategy of the New Member States applying for the membership in EU. The fiscal surveillance started in 2000 with Joint – Assessment of Medium Term Economic Policy Priorities. Their successors are PEPs (Pre – Accession Programmes) was the part of the Pre – Accession Fiscal Surveillance Procedure. All of them have informative function and were criticize for the lack of links to individual economies budget institutions.

term but long – term budgetary framework. We evaluate the Slovak Republic with three points and the Czech Republic with two points.

4. The **social funds** constitute a high ration of public finances in both countries. The inclusion of social funds in the Slovak and Czech economies contribute to the picture of the real state of state finances. The Czech Republic and Slovakia are assessed with four points.

5. In our view, the outlook should be **adopted before the budget process itself.** Also according to YLAOUTINEN (2004) *earlier in process the finance minister suggests or sets the targets, the larger his/her influence in steering the budget process probably is.* In our case of two selected countries, we regard this early procedure as more discipline encouraging. Therefore the Slovak Republic is assessed by four points and the Czech Republic by two points.

6. As is the case of social funds, the **off – budget liabilities** constitute a high portion of public finances. They are part of the outlook in both countries, which again contributed to the increased transparency and completeness of the document. The table below illustrates the year 2004 projection of the structure of the public debt by sub – sectors in the Czech Republic. The economies therefore obtain the highest score of four points.

Table 19: Structure of Public Debt by Sub – sectors in the Czech Republic

	2003	2004	2005 *	2006 *	2007 *
General government	39.7	40.5	41.8	43.2	44.0
Central government	37.1	37.7	39.0	40.3	41.0

Of which: CKA	*6.0*	*4.0*	*2.3*	*1.3*	*0.6*
State guarantees	*10.5*	*9.8*	*8.7*	*7.9*	*7.3*
Local governments	2.6	2.8	2.8	2.9	2.9
Social security funds	0.0	0.0	0.1	0.1	0.1

* forecast

Source: Ministry of Finance of the Czech Republic

7. As far as **expenditures** are taken into account, they constitute the only binding parameter in the medium – term budgetary framework. They can be increased above this **ceiling** in the budget draft in both of examined countries. It may happen with the approval of the Finance Minister in Slovakia and with the simultaneous realization of the offsetting measure, which increases revenues that finance relevant expenditures, in the Czech Republic. Both proceeding impose constraint on the partisanship regarding budget expenditure limits set in the outlook. There is a more room for manoeuvre in the Slovak Republic, which depends on the Finance Minister. He is considered to be strong in Slovakia and is responsible for the budget proposal. We evaluate both sample countries with three points.

8. The **medium - term targets cover** only nominal levels of spending, revenue and budget balance (in % GDP) in the Czech Republic, while they are extended by relative level of debt and spending (as a %GDP) and expenditure targets for spending categories in Slovakia. As far as the outlook has and suggestive function in budgetary preparation phase, the scope of target makes, in our opinion, not a big difference in enhancing fiscal discipline. The points for counties are two for both.

9. The difference comes when we have a closer look in **accounting practices** used in both documents. They differentiate when compare annual budget draft and the medium term budgetary outlook for the Czech Republic. This distorts the informative goal of the outlook; as a result we assess Slovakia with four points and Czech Republic with one point.

At this point we compare the position of the Finance Minister in the budget decision – making stage.

10. **Finance Minister's role in setting the annual targets**[22] is very important. In neither of the two countries his authority is so strong that he can propose the targets without the approval of the cabinet. The order of steps differs, when the Slovak Finance Minister discusses the targets with the spending minister and afterward puts them forward for adoption into the government. In the Czech Republic, the spending ministers make their budget requests after the targets proposed by the Finance Minister are adopted by the government. The succession of steps is considered to be more prone to fiscal discipline in the Czech Republic as the Finance Minister proposes targets for approval without discussion with the spending ministers who push through their targets usually requiring larger budgets.

We evaluate the Slovak Republic procedure susceptible to discipline harming as there is a threat that the spending ministers put through larger budgets.

[22] We use the definition of YLAOUTINEN (2004): *annual targets refer to targets used in the beginning of the annual budget process to guide the annual budget making.*

On the other hand, we take into consideration the political orientation and conviction of the liberal Slovak Finance Minister[23]. Therefore we assess both economies by three points.

11. In the matter of **conflicts regarding the spending**, in the Czech Republic, the disagreements are resolved in the bilateral level among Finance Minister and spending ministers first, when no solution is reached, the whole cabinet is involved in the reconciliation. In the Slovak Republic, before the problem is submitted to the government, the unresolved issues are deliberated in the state secretaries' level.

The cabinet - level negotiations stand for the most decentralized form. According to Jurgen von Hagen (1998) the fiscal discipline in the first stage of budgetary process is warranted by the high degree of centralisation. *(...) Elements of centralisation must at this stage foster consistent setting of such guidelines* (spending and deficit targets) *and assure that they constrain executive decision effectively. A key element here concerns the way conflicts among members of the executive are resolved through the budget process. Uncoordinated and ad hoc conflict resolution involving many actors simultaneously promotes log – rolling and reciprocity* (VON HAGEN, 1998).

The highest centralisation here is achieved if the conflicts are solved by Prime Minister. This is neither in the Slovak budget preparation stage nor in the Czech one a reality. The both countries conflicts are tried to be solved on bilateral level, which constitute relative high degree of centralisation and only after the failure they proceed to the multilateral negotiations. Therefore we estimate the Slovak Republic procedure a little

[23] We evaluate the Slovak Finance Minister as stronger in his pro – reform initiatives and pushing the bunch of reforms in the republic in recent years. The strength of Finance Minister and related will to reform variety of areas in economy result from the unfavourable political situation that held back the economic progress in the period 1994 – 1998. The Czech Finance Minister is less reform oriented as his political categorization and conviction is in contrast with the necessity of radical reforms in the Czech Republic.

more centralised as there is a possibility to resolve the conflict on the state secretaries' level before it gets to the government.

In this place, the legislation body gets the proposal of the budget adopted by the cabinet and decides about rejection, adoption or amendments to the draft. The next ten criterions compare the procedures in this phase of the budget process.

12. As far as the authorisation stage of budget process is concerned, the Parliament in both countries cannot propose the budget proposal itself without the involvement of cabinet. What differs is the **scope of parliamentary amendments** allowed to the budgetary draft. In Slovakia there are no restrictions for the kind or size of amendments. On the contrary, in the Czech Republic the deficit is not allowed to change its value, i.e. any increase of expenditures must be balanced with the same or higher increase of revenues. The rules in the Czech Republic ease the solution of the common pool resource problem through bargaining, as decision – makers are enforced to deal openly with each other on their interests. Therefore we assess the Czech Republic with the highest points, while the Slovak Republic has zero points.

13. The **governmental fall** is a form of punishment in multi – party coalitions. The Parliament (his committees) is a watchdog over the cabinet ministries and usually the chair of the committee comes from the different party than the Finance Minister. HALLERBERG (….) states that *it is unlikely that a prime minister in a multi – party coalition can easily dismiss individual ministers who violate the* (fiscal) *contract if they come from the different party. Moreover, this solution is ineffective anyway so long as the root cause of the problem is the party and not the individual minister. (...) The*

effectiveness of such threat (of governmental fall) *depends of ability of current coalition members to find alternative partners to replace any defectors.* On the other hand, in another source of literature on this topic (YLAOUTINEN, 2004) we realize *that the parties supporting the government may refrain from defeating the budget proposal for fear of political crisis. They also argue that if the government can choose what is at stake in a budget vote, it achieves a strategic advantage. The government can then effectively change the budget vote into a vote for or against the government.* This punishment tool exists in the Slovak Republic. However, this fiscal discipline enforcing tool is not very useful as it is not that unproblematic to find an alternative party to replace the defecting party in the coalition. Therefore we assign the both economies by two points.

14. The fourteenth criterion deals with the beginning of the approval in the Parliament. The **legislative approval is initiated** in all standing committees in Slovakia while in the Czech Republic it takes place only in the budget committee, which adds to centralisation in the legislative approval stage. We assess the Czech Republic with higher points (four to two in Slovakia).

15. This criterion says about the order of the voting in the Parliament. The Czech Republic is one of the few countries in the Central and Eastern Europe[24] that use the top – down **procedure in the Parliamentary voting**[25]. This increases the power of government vis-à-vis the Parliament but does not automatically leads to the positive results on the size of the budget. As an example, Ferejohn and Kreibhel (1987)[26] research resulted in the

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[24] The other one is Bulgaria, see Ylaoutinen (2004) pp. 30
[25] Top – down approach means that the Parliament votes on the absolute size of the budget at the beginning of the approval process and only afterwards on the composition of the budget.
[26] The results of the research were achieved under the perfect information assumption: each legislature knows that each legislature knows etc. the perfect information about distribution of their preferences.

finding that the timing of voting about the budget does not make any difference in final size and composition of the budget. The logic behind is *that rational legislators should be forward looking: for example, when voting on the first item of the budget, they will calculate how their first vote will affect the final outcome both in terms of size and composition. Conversely, when voting on the size first, rational legislators can compute how a certain size will then lead to a certain composition in the following vote (...) thus at the first vote, the legislators can compute the final voting equilibrium* (ALESINA, PEROTTI, 1996). Before this study was done, it was generally believed that the top - down procedure leads to lower deficits and size of the budget.

In our opinion, the legislators are not completely rational and have not perfect information about the preferences of other legislators, thus the Ferejohn and Kreibhel's assumption does not hold in reality.

The Slovak Republic follows the bottom – up approach[27]. We assess the Czech Republic procedure with the same score as there was not econometrically proved that the top – down approach leads to significantly favourable results in terms of following the fiscal discipline.

16. In the Slovak Republic the government has no right to influence the budget approval in the National Council, in the Czech Republic the opposite is reality.

In Parliament there are much more decision – makers involved in the voting procedure, thus the process is considerably fragmented. The common pool resource problem is even more obvious when the parliamentary voting on the budget is not steered

[27] Bottom – up procedure means that the decision – makers first of all decide on the spending requests. Consequently the total size of the budget is determined as a residual.

by the executive body.[28] The Slovak Republic gains zero point in this respect and Czech Republic four points.

17. This criterion deals with the budget that is used in the case that the budgetary act is not adopted in proper time, the so called **provisional budget**. In Slovakia the draft budget is used in this particular case, while in the Czech Republic 1/12 from the previous budgetary period expenditures is used is indicator of spending limits. The procedure was different before the Act on Budgetary Rules from year 2000 came into force. In compliance with the Act No. 576/1990 from 20th December 1990 that was in force until 2001 the budget proposal to the Parliament had been used as a provisional budget.

The government position is stronger if the draft budget is applied. *This strengthens the government's proposal – making power over the parliament because the government does not 'loose' anything even if the budget fails the deadlines* (YLAOUTINEN, 2004). In the case of previous year's budget *the government might be more willing to agree to compromise solutions deviating from a prudent fiscal policy stance if it is more impatient than the parliament to secure agreement on a budget* (GLEICH, H. 2002). In this sense, we assess the Slovak Republic procedure with four points, while the Czech Republic with one point.

18. The threat of the **dissolution of the Parliament** if it does not succeed to pass the budget bill in appropriate time is fiscal discipline enhancing. It increases the power of the government in comparison with the Parliament. The Czech Republic, which has this measure legalized is evaluated by four points, on the other hand the lack of it in the second sample country leads to two points.

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[28] See von Hagen (1998) pp. 12

19. In the Parliaments where both houses have budgetary rights, finding a compromise causes delays and leads usually to more spending than in unicameral system. The relative bargaining power of the cabinet here is weakened.

The Czech Republic has bicameral **parliamentary system**, but the Upper House is not involved in the budget process at all, it equals the unicameral system in Slovakia in the matters of the fiscal discipline. Both countries are assessed by the highest score

20. When we take a closer look at the **President's role** in the budget approval, we observe that in both economies the President has a veto right over the whole budget (or some particular parts of it) adopted by Parliament and can return it mutually with his objections to the legislative body.[29]

The Presidents in both countries are not responsible neither for macroeconomic development nor public finance, so they may have inclination to use veto right for some specific interest and enforce higher spending for some projects. As GLEICH (2002) claims, *the decision making process is more fragmented and therefore less conductive to aggregate fiscal discipline the stronger is a president's power and potential effort to veto the budget.*

The Parliament in the Slovak Republic can overrule the President's veto by the majority of all members of the Parliament present. In the Czech Republic it is the majority of all Members of the Parliament. This stands for the stronger position of the Czech

[29] See Constitutional Act No. 1/1993 Coll. of the Czech National Council of 16th December 1992, Article 50, Part (1) and (2); see Act No. 90/1995 Coll. of 19 April, 1995, Rules of Procedure of Chamber of Deputies, Article 98 Part (2)

President relative to Slovak President in terms of parliamentary votes needed to overrule his decision.

We assign this criterion by three points for Slovak Republic and by two points for the Czech Republic.

21. In the event when the President is elected by citizens, which is the case of Slovakia from 1999, he is declared to have *constitutional powers over certain policy issues* (GLEICH, 2002) and is more independent from the other legal institutions. Therefore we assign the Slovak Republic by one point and Czech Republic where the President is elected by the Parliament by two points.

The last set of eight criterions is about the budget execution, its monitoring and reporting in the relevant budget year.

22. In the Czech Republic, the **responsibility for the implementation** of the budget in the relevant budgetary year lies on the Finance Minister. They check the inflow and outflow of resources an can impose cash limits. In the Slovak Republic this role is divided between Finance Minister and Supreme Audit Office with prerogative rights of Finance Minister. We evaluate the centralisation of the controlling and monitoring function over the budget performance as highly prone to fiscal discipline, both countries have in this respect four points.

23. The **control** over budget execution is **focused on** the general government and individual ministries in Slovakia, extended by individual budget chapters, local governments and social funds in the Czech Republic, which increase the transparency of

the budget process in this stage. As a result, the Czech Republic has three points and Slovakia two points.

24. The **public reports** on attained fiscal outcomes are published every month in the Czech Republic and every three month in the Slovak Republic. The reports again enhance the transparency of the budget implementation; hence the points are three to two for the Czech Republic.

25. **Negative unexpected shocks** are underpinned by the formal rules in the Czech Republic. The Act on Budgetary Rules claims, that when revenues decline this must be offset by the limits on spending without the adjustment of the deficit. Only in case the tax income is lowered, the deficit deteriorates. In Slovakia there are not formal rules legalized, if expenditures increase, the expenses can exceed the revenues in any of the budget chapter under approval of the Finance Minister. When revenues decrease the government may allow Finance Minister to impose constraint on the use of budgetary resources.

The Czech Republic has four points, and the Slovak Republic one point.

26. In the event of **positive fiscal shock,** the spending of unused resources must be approved by the Parliament in the Czech Republic and the Finance Minister in Slovakia. In both cases there are imposed constraints on the spending of these resources, which is judged as satisfactory for the fiscal discipline. What differs is the degree of centralisation of the approval process which is lower in the Czech case. We evaluate the Slovak procedure with four points, and the Czech one with three points.

27. According to VON HAGEN (1998), *the centralisation requires (...) that transfers within chapters are authorised by the finance minister, and that broader transfers require authorisation from parliament. The same applies to transfers of funds between different fiscal years.* In both countries the scope of the **funds carryover** either between chapters or between individual fiscal years is constrained. The countries are thus assessed by four points each.

28. In this place we come to the position and rights of the central player in the implementation phase. The Finance Minister in the Slovak Republic can **block expenditures** in the unanticipated specific events that appear during the year, the Czech Finance Minister does not have this authority. This provision adds to the quick decision – making in the situations where the delay is costly. The eastern part of former Federation thus acquires four points, the other one zero.

29. There are no limits to excessive borrowing of the **local governments** in the Czech Republic; the punishment is executed ex – post in the form of penalties to the municipalities. The Slovak municipalities are obliged to ask for approval the Minister of Finance to increase the level of local budget expenses above the level of their revenues. The Slovak Republic has four points compared to one in the Czech Republic.

The last step comprises the creation of the indexes[30], one for overall institutional framework (INDEX) and three for individual budget stages (PREPA, LEGIS, IMPLE). They are simple mean of the variables that we used in the previous analysis to describe the individual phases of the budget process. The indexes are computed in the table

$$PREPA = \frac{1}{11}\sum_{i=1}^{11} v_i$$

$$LEGIS = \frac{1}{10}\sum_{I=12}^{21} v_i$$

$$IMPLE = \frac{1}{8}\sum_{I=22}^{29} v_i$$

$$INDEX = PREPA + LEGIS + IMPLE$$

PREPA ....Index describing the preparation stage in the budget process

LEGIS .... Index describing the authorisation phase of the budget process

IMPLE ....Index describing the implementation phase of the budget process

INDEX ....Index describing the overall budget process

v_i .... Value we assigned the sample countries variables with

Here are shown results of our calculations presented in the table 20.

Table 20: the PREPA, LEGIS, IMPLE AND INDEX computations

	The Czech Republic	The Slovak Republic
PREPA	2.545	3.000
LEGIS	3.100	2.200
IMPLE	2.500	3.125
INDEX	**8.145**	**8.325**

[30] See Gleich (2002) pp. 48

From the grades it is evident that the budget institutions in the recent years reflect the fiscal performance of the countries. The Czech Republic shows the lower score in the overall evaluation index which may explain the deterioration of the public finance in the recent period. The strength of the Czech budget process is in the legislation approval mainly due to better position of the government vis-à-vis the Parliament. The Slovak budget process assessment prove better results in both preparatory and implementation stage. When the budget is planned the better results are obtained mainly owing to better connection between annual and multi – annual planning and sequence of the adoption of the medium – term benchmark. The monitoring period of the budget process is of better-quality thanks to the strong role of the Finance Minister.

4.9. Comparison of Gleich's Analysis to our Findings

While comparing with the Holger Gleich's results of the survey covering the period 1994 – 1998 one must realize the different legal basis for the budget formation in the Czech Republic and number of amendments to the existing laws on budgetary rules in both Slovakia and the Czech Republic. The comparison to the Gleich's to our findings is shown in the table below[31].

Table 21: The comparison of Gleich's analysis (1994-1998) to our survey (2000-2003)

Gleich (1994 – 1998)	Our findings (2000-2003)
Preparation stage: no budget targets are determined in the Czech Republic. In	Budget targets are determined in the multi-annual and annual basis in both economies.

[31] We highlighted the difference in the variables in the compares surveys.

Slovakia only annual targets.

The conflicts over the budget in the government are resolved firstly in the senior cabinet committee then in the whole council of ministers and cabinet.	The conflicts resolved firstly in the bilateral level btw. Finance Minister and spending ministers then on the cabinet level (in Slovakia also on the state secretaries level)
In the legislation approval stage: no restrictions on the parliamentary amendments to the proposed budget draft.	In the Czech republic, the amendments to the draft are limited, deficit cannot exceed its proposed level, and in Slovakia the situation is same as in the previous period.
President is elected in the Parliament.	President is elected in the direct elections by citizens.
In implementation phase: in Slovakia, the revenue windfalls can be used to increase expenditures if the balance does not change without the approval of the Parliament.	The finance minister must approve the usage of unexpected windfall of revenues. They must be used on the same purpose if transferred to the following budget period.
The cabinet can block expenditures in both countries.	The Finance Minister can block expenditures in Slovakia.

As regarding the evaluation and comparison to other CEEC in the considered period the both countries in Gleich's survey are approximately in the middle of the spectrum of evaluated countries[32].

The disassembling on the sub-indexes shows somewhat interesting results of the Gleich's analysis. *The Czech Republic has for example the highest score for the sub-index*

[32] Estonia shows the highest score in overall index INDEX, followed by Latvia and Slovenia. Bulgaria, Hungary, Poland and Romania are evaluated with the lowest INDEX score. See Gleich (2002) pp. 48

LEGIS, but ranges among the lowest in the ranked countries on the sub-indexes PREPA and LEGIS (GLEICH, 2002). This distribution of "strengths" in budget formation process could be observed also in our findings in the Czech Republic, but evidently on the lower extend.

5. Conclusion

This paper deals with the institutional arrangement of the budget processes in general and in the two selected European countries in more detail. The budget institutions are all rules and regulations according to which the budget is prepared, approved and executed. They are of two kinds, the procedural rules and the numerical targets. Our attention is turned at the procedural rules in theory and consequently in the surveyed countries.

We have a closer look at the common pool resource problem which plays the decisive role in the excessive spending and the role of budget process centralisation which solves this problem. There are four types of fiscal governance, which treat with the centralisation of the budget process in different way; namely fiefdom, delegation, contract and mixed governance.

The second chapter also introduces the most common budget process in European countries, which has four phases: preparation of the budget, approval in the Parliament, carrying out of the budget and subsequent audit of the state finances. In every stage of the process there are real threats of pushing through the excessive spending; its scope depends on the implemented institutions.

On the European level there was introduces the coordination of the national fiscal policies in the 1990's. Maastricht Treaty applied the burden of numerical targets on the national economies that were forced to consolidate their state finances to join the European monetary Union. The Stability and Growth Pact followed to maintain the favourable trend in the European fiscal policies after the entry into the common currency area. The multi – national budgetary rules have a couple of shortcomings that resulted in the failure of the pact.

The most important part of the paper is the fourth chapter that map the situation in the two economies that passed the transition from the centrally planned to market based economy.

They became the member of the European Union and their budget institutions are relatively new. The political situation in the Czech Republic and Slovakia was changing during 1990's and this was reflected in the fiscal position as well. The Slovak Republic in 1998 was left with the poor state of public finances and its consolidation started with the new government. In opposite, the Czech public finance showed very favourable results until the breaking year 1998 when the social – democratic party won elections. From this point in time the expenditures raised with the extremely high speed and its negative trend is threatening the accession to the monetary union.

The budgetary institutions also vary to substantial extend in the compared countries and we evaluated them according to the degree of centralisation and fiscal discipline enhancement point of view. The results are comprised in the INDEX that is the sum of the sub - indexes PREPA, LEGIS and IMPLE. They are the simple mean of the variables that characterize the individual phases of the budget process. The Slovak Republic shows somewhat better results in the summarized INDEX and the differences are more evident when we look at the individual sub - indexes. The Slovak Republic shows better grades in both preparatory and implementation phase, while the Czech Republic is more centralised in the Parliamentary approval stage. The results from years 2000-2003 are similar to the Gleich's study of the years 1994 – 1998.

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