The Czech Fiscal Council

Report on Compliance with the Rules of Budgetary Responsibility for the Year 2018

September 2019
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Introduction

The Czech Fiscal Council (hereinafter referred to as “CFC“) in line with Act No. 23/2017 Coll., on the rules of budgetary responsibility (hereinafter referred to as the “Act”), Section 21(2) evaluates compliance with numeric fiscal rules. The process involves the drawing up of a report on compliance with those rules and its presentation to the Chamber of Deputies of the Parliament of the Czech Republic. The Report on Compliance with the Rules of Budgetary Responsibility for the Year 2018 is the second Report on Compliance with Numeric Fiscal Rules issued by the CFC.

The CFC presented its first report to the Chamber of Deputies in December 2018. At that time, however, it was not yet possible to evaluate compliance with the rules specified in Section 10 and 12 of the Act (determination of total public institution sector expenditures and derivation of the expense framework of the government budget and state funds), as the Act had not yet been in force in 2016, when the Act on the State Budget for 2017 as well as the budgets of other relevant entities (extra-budgetary state funds, etc.) were being drafted. For the same reason, it was not possible to provide a comprehensive evaluation of the fiscal rule for self-governing units in the 2017 Report, as its part pertaining to the reduction of the debt of territorial self-governing units, pursuant to Section 17(2) of the Act, was not yet applicable.

The 2018 Report does contain an evaluation of compliance with all the rules for budgetary responsibility defined in the Act, as the preparation of state budget and the budgets of state funds for 2018 was already governed by that Act.

The Report is divided into four parts. The first part features a characterisation of the development of the financial management of the public institutions sector to date,[1] part two features information about an evaluation of compliance with the rule for the indebtedness of public-sector institutions, part three describes the determination of total public institution sector expenditures and derivation of the expense framework of the government budget and state funds, and part four is dedicated to the issue of adherence to the rule of budgetary responsibility of territorial self-governing units.

[1] The term “public institution sector” has been introduced by the Act and it defines the same range of entities as the sector of government institutions in the ESA 2010 national account system.

1. Financial Management of the Public Institution Sector

The economy of the Czech Republic has been reporting growth steadily since 2014 and GDP in 2010 prices increased by 15.9% between the beginning of 2014 and the end of 2018. The country's positive economic developments have also had an impact on key indicators of the financial management of the public institution sector. The structural balance amounted to 0.4% of GDP in 2018, and public institution debt expressed in proportion to GDP dropped from 34.7% to 32.6%.[2]

The macroeconomic forecast of the Ministry of Finance of the Czech Republic (hereinafter referred to as MF CR) from July 2019 assumes that favourable economic development will carry on in the 2019 to 2022 period, albeit with declining dynamism of year-on-year GDP growth (from 2.4% in 2019 to 2.1% in 2022)[3]. The convergence programme of the Czech Republic from April 2019 shows an expansive character of fiscal policy in 2019 and 2020 and a neutral character in 2021 and 2022. This will, according to the MF CR, lead to a gradual reduction of the positive structural balance of the finance of the public institution sector, from 0.4% of GDP in 2018 to –0.5% of GDP in 2022. The public institution sector debt will continue to decline, from 32.6% of GDP in 2018 to 29.7% of GDP in 2022. These values are very favourable in comparison to the EU, where the average debt of the public institution sector at the end of 2018 amounted to 80% of GDP.[4]

From the short-term point of view, the situation of the public institution sector in the Czech Republic can be seen as very good, as the total financial balance is a surplus, at a time of a positive output gap, and the debt relative to GDP keeps dropping. Somewhat of a problem is that the positive development of past years was due, in part, to the low investment activity of the public institution sector,[5] although its level in 2018 did post an improvement to 4.1% of GDP.[6]

Another factor that had a positive impact on the balance of public institution sector finances is the autonomous increase in the tax quota caused by a change of GDP pension structure. The share of employee compensation in GDP rose from 39.6% in 2015 to 43% in 2018. Given that income from work is burdened by higher effective taxation than profit, public budgets are gaining additional income.[7] The measures adopted in order to prevent tax evasion also played a certain role in the increase of tax revenue.

According to the government's plans, fiscal policy should have an expansive character in 2019 and 2020,[8] which will result in the structural balance dropping to negative values. Given that a positive output gap is expected to be maintained in those years, and also due to the very tight situation on the employment market, this conclusion cannot be called optimal from the macro-economic point of view.

2. Rule on the Level of Indebtedness (the Debt Rule)

The debt rule is defined by the Act in Sections 13 to 16. The subject of monitoring is the amount of public institution sector debt after the deduction of the financial provision in the financing of state debt, expressed in proportion to GDP. The limit values, the exceeding of which triggers certain measures, set out in the Act, are 55% and 60%.

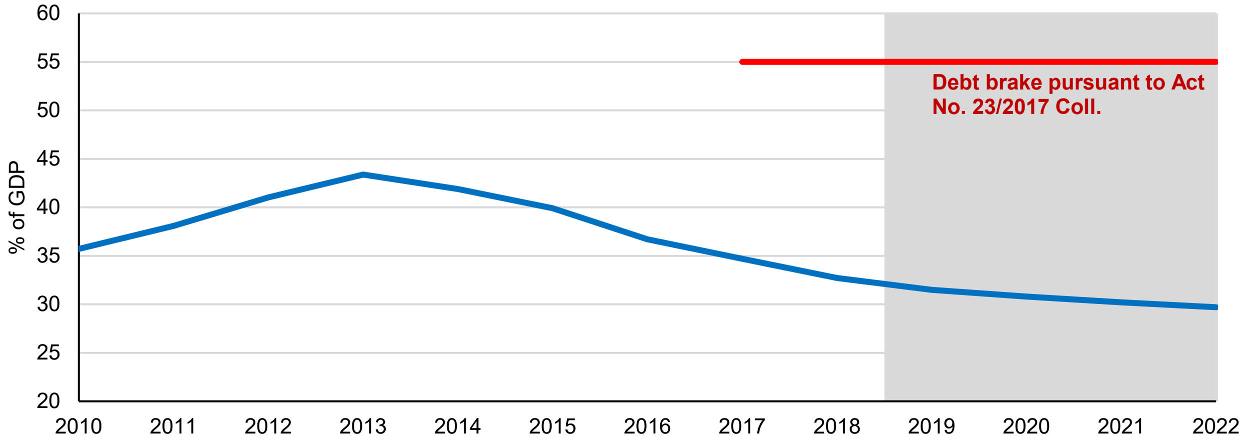
Based on the data provided by the Czech Statistical Office and the MF CR, the value of the indicator for 2018 was announced by a communication of the Czech Fiscal Council of 18 April 2019 at 32.7% of GDP.

Given that the nominal GDP value was increased later, in the course of a review of national accounts, the amount of public institution debt reduced by the financial provision in the financing of state debt dropped to 32.6% of GDP.[9] This update, however, does not in any way change the fact that neither of the above-mentioned limit values defined by the Act were exceeded. Chart 1 shows the development of the indicator between 2010 and 2022; data for 2019−2022 has been taken over from the MF CR forecast. The limit value of 55% was not exceeded

[2] MF CR (2019): Macroeconomic prediction for the Czech Republic - July 2019.
[3] Current assumption of the MF CR based on the materials for a meeting for the Committee for Budgetary Prognoses published 27 August 2019.
[4] EUROSTAT (2019).
[5] Creation of gross fixed capital in the public institution sector amounted on average to a mere 3.3% of GDP in 2016 and 2017, whereas the average for the 2006−2015 period was 4.8% of GDP.
[6] MF CR (2019): Convergence programme of the Czech Republic - April 2019.
[7] Taxes and insurance premiums collected, relative to GDP, went from 33.8% in 2015 to 35.8% in 2018. The calculations are based on Eurostat data.
[8] MF CR (2019): Convergence programme of the Czech Republic - April 2019.
[9] MF CR (2019): Macroeconomic forecast for the Czech Republic - July 2019.

a single time between 2010 and 2018, and provided the economy develops as expected, it cannot be expected to be exceeded before the end of 2022, either.

Chart 1 Debt of the public institutions sector in the Czech Republic minus the financial provision in the financing of state debt between and 2010 and 2022



Source: MF CR: Proposal of the state closing account of the Czech Republic for 2014, part E. Report on the management of state debt; MFCR: Convergence programme of the Czech Republic (2017–2019), CNB: Government financial statistics; CFC calculations.
Note.: for 2019–2022, an MF CR forecast.

<u>Conclusion</u>: The Czech Fiscal Council states hat in 2018, the limit values of the indicator of the public institution sector debt, defined in Section 14 and Section 16 of Act No. 23/2017 Coll., on the rules of budgetary responsibility, were not exceeded.

3. Rules for Determining Total Public Institution Sector Expenditures and Derivation of the Expense Framework of the Government Budget and State Funds

The drafting of the state budget for 2018 and the drafting of the budgets of other relevant entities in the public institution sector took place in 2017, i.e., after the Act had already entered into force – with the exception of Section 17 (3), the Act took effect on 1 January 2017. The MF CR set the following values for 2018: total expenditure of the public institution sector in the amount of CZK 2,132.6 bn. and the expense framework of the state budget and state funds (including the EU) in the value of CZK 1,394.0 bn.[10] In the course of the drafting of the state budget, an adjustment was made in line with Section 8 of Act No. 218/2000 Coll., on budgetary rules, in the expense framework of the state budget and state funds, to CZK 1,441 bn. Total approved expenses of the state budget and state funds amounted to CZK 1,400.6 bn. and were therefore nearly 3% lower than the approved framework. It can therefore be said that, in the approval of the expenditure level of the state budget and state funds, the process of determining the total expenditures of the public institution sector and the derivation of the expense framework of the state budget and state funds was followed.

The actual expenditures of the public institution sector and of the state budget and state funds diverged from the approved values. In the case of the former, the final value was CZK 2,163 bn., in the latter case CZK 1,445 bn. The main reason why actual drawing exceeded the approved values is the high dynamism of funds drawn, on account of unrealised expenditures. In 2018, the value of such funds drawn was higher than CZK 100 bn., which means a year-on-year drop in their value, from CZK 167.6 bn. as at 1 January 2018 to CZK 131.1 bn. a year later.[11] One of the reasons for this development was the implementation of a number of delayed projects financed from EU funds, which, among other factors, was manifest in the higher than expected level of investment activity.

[10] MF CR (2017): Budgetary strategy of the public institution sector of the Czech Republic for 2018 to 2020.
[11] MF CR (2019): Draft State closing account for 2018.

Table 1: Development of the key indicators of the expense rule and values actually achieved in 2018 (figures in CZK bn.)

	Budgetary strategy	Draft state budget	Approved budget	Reality
Public institution sector data	2,133			2,163
Expense framework of SB and SF, including the EU	1,394	1,441		
State budget (SB)			1,364	1,401
State funds (SF)			112	122
Transfers from state budget to state funds			76	78
Total state budget and state funds			1,401	1,445
GDP at current prices	5,103*	5,311*		5,329

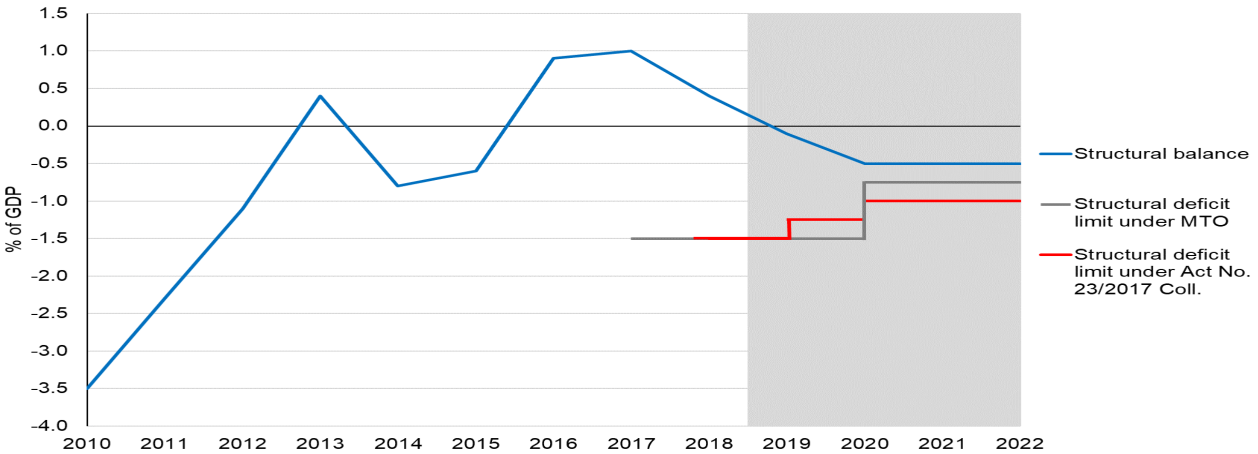
* Expectation presented in the given document

Source: MF CR (2017): Budgetary strategy of the public institution sector of the Czech Republic for 2018 to 2020, data from State Treasury Monitor, MF CR (2019): Treasury performance for January – December 2018, CSO (2019): The 2018 Statistical Yearbook, Draft State closing account for 2018, own calculations

Furthermore, the Czech Fiscal Council evaluates whether the balance of the public institution sector was complied with in line with the purpose of the rule, which is to limit the value of structural deficits. In 2018, the structural balance of the public institution sector amounted to 0.4% of GDP, which means that the figures were not even close to the limit value, which was set at –1.5% of GDP for 2018. In the two subsequent years, the limit will be tightened by 0.25 p.p. each year and from 2020 it will hold constant at –1% of GDP. At the same time, the medium-term budgetary objective for the Czech Republic is being tightened, from –1.5% of GDP to –0.75% of GDP, which is a level stricter than the value defined by the Act. Therefore, if the structural balance of the public institution sector reaches the expected - 0.5% of GDP in 2020, there will only be space of 0.25% of GDP for a potential fiscal expansion.

Chart 2 captures the development of the structural balance of public institution sector finances between 2010−2022; figures for 2019−2022 constitute a forecast of the MF CR. It is evident from the chart that until 2013, structural surplus was achieved with the exception of two years, and the limit of –1% of GDP was not exceeded even in 2014 and 2015, when structural deficits were reached.

Chart 2 Structural balance of the finance of the Czech public institution sector between 2010 and 2022



Source: MF CR (2019): Macroeconomic forecast for the Czech Republic - April 2019, MF CR (2019): Convergence programme of the Czech Republic - April 2019, CSO (2019); CFC calculations.

Note.: Years 2020-2022 – outlook (structural balance) according to the MF CR

Conclusion: The Czech Fiscal Council states that in approving the amount of state budget and state fund expenditures for 2018, the process of determination of total expenditures of the public institution sector and the derivation of the expense framework of the state budget and state funds was followed. The actual public institution sector finance in 2018 ended up with a structural surplus in the amount of 0.4% of GDP, not exceeding the limit value applicable for 2018 (–1.5% of GDP).

4. Financial Management of Territorial Self-governing Units

According to the Constitution of the Czech Republic, territorial self-governing units are municipalities and regions. The Act defines a special budgetary responsibility rule for their financial management in Section 17. In accordance with that rule, the debt criterion is monitored, and if that criterion is exceeded, also the rate of its reduction is monitored. Furthermore, territorial self-governing units establish many other organisations (mostly in the form of entities partially subsidised from public budgets), the finances of which have an impact on the overall results of the public institution sector. This chapter first presents the overall financial results of the sector of local government institutions, followed by an evaluation of the frequency and seriousness of violations of the fiscal rule.

4.1. Development of the financial management of the subsector of local government institutions between 2012−2018

Since 2013, the finances of local government institutions[12] have reported a positive balance. In 2018, the total income of the subsector amounted to CZK 640.2 bn., having grown by CZK 59 bn. in comparison to the previous year. The income of the subsector of local government institutions amounted to 28.9% of the total income of the government institution sector. Expenditures amounted to 28.7% of the total expenses of the government institution sector. The surplus of the subsector of local government institutions in 2018 was down year on year by CZK 22.8 bn. to CZK 19.1 bn. The balance of local government institutions in 2018 amounted to 0.4% of GDP, accounting for 40.1% of the total balance of government institutions.[13] The figures are shown in Table 2.

The positive results of territorial self-governing unit finance are due, above all, to higher tax income stemming both from a change in the GDP pension structure (increase in the share of employee compensation in GDP) and the position in the economic cycle (positive output gap). Also, the new budgetary designation of taxes (BDT), applicable as at 1 January 2017, contributed to the increase in income. Another factor that had an impact on the development of the financial results, but this time in the direction of a lower surplus, was the return of investment activities roughly to the level at which they stood before their decline in 2016 (see Chart 3).[14]

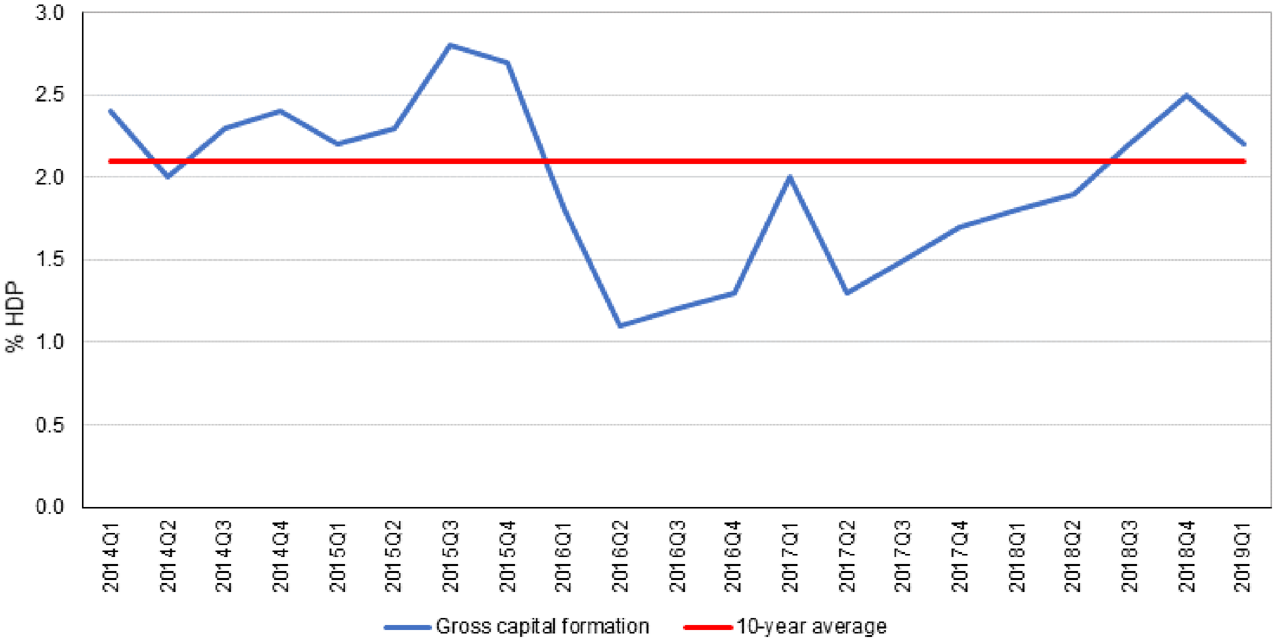
Table 2 Financial management of the subsector of local government institutions in the Czech Republic between 2014 and 2018

	2014		2015		2016		2017		2018	
	CZK bn.	% GDP	CZK bn.	% GDP	CZK bn.	% GDP	CZK bn.	% GDP	CZK bn.	% GDP
Income	505.7	11.7	544.2	11.8	535.4	11.2	581.2	11.5	640.2	12.1
Expenditures	498.0	11.5	518.2	11.3	485.7	10.2	539.3	10.7	621.1	11.7
Balance	7.7	0.2	26.0	0.5	49.7	1.0	41.9	0.8	19.1	0.4

Source: Eurostat (July 2019)

[12] The subsector of local government institutions is a part of the government institution sector in the ESA2010 methodology. It includes local public administration authorities and organisations directly managed by them, i.e., all organisations that have local competences and are financed from local budgets.
[13] Eurostat (July 2019).
[14] The creation of gross fixed capital of the subsector of local government institutions was up from 1.6% of GDP in 2017 to 2.1% of GDP in 2018, having approached the 2006–2015 average (2.2% of GDP).

Chart 3 Investments by the subsector of local government institutions in the Czech Republic between 2009 and 2018



Source: Eurostat (July 2019), own calculations

The continuing decline in the indebtedness of local government institutions corresponds to the surplus of their finances, which is evident from Table 3. The debt of the subsector of local government institutions in 2018 amounted to CZK 84 bn., which accounted for less than 5% of total public institution sector debt.

Table 3 Debt of the subsector of local government institutions in the Czech Republic in 2014 to 2018

	2014	2015	2016	2017	2018
CZK bn.	116	111	89	85	84
% of total public institution sector debt	6.4	6.0	5.0	4.9	4.8

Source: Eurostat (July 2019), own calculations.

<u>Conclusion</u>: The finances of territorial self-governing units (and organisations subordinated to them) does not involve any significant risks for the overall financial results of the public institution sector. On the contrary, they have been contributing to their stabilisation since 2013. Also, the level of indebtedness of territorial self-governing units is very low and, as a whole, it does not represent a major risk factor in terms of the growth of the indebtedness of the public institution sector. A positive fact is the increased investment activity of territorial self-governing units 2018, which approached the 2006–2015 average.

4.2. Rule of budgetary responsibility of territorial self-governing units and compliance therewith in 2018

The Act (Section 17) sets the following rule for territorial self-governing units:

a) A territorial self-governing unit (hereinafter referred to as “TSGU”) manages its finance in the interest of maintaining sound and sustainable public finance, such that the level of its debt[15] not exceed, as at the balance-sheet date, 60% of the average of its annual income[16] in the last four budgetary years (hereinafter referred to as the “Debt Rule”).
b) Should the debt of a territorial self-governing unit as at the balance-sheet date exceed 60% of the average of its annual income in the last four budgetary years, the territorial self-governing unit is obliged to reduce it in the next calendar year by at least 5% of the difference between the amount of its debt and 60% of the average of its income in the last four budgetary years (hereinafter referred to as the “Debt Reduction Rule”).

On the basis of the financial data and accounting records presented by municipalities, the MF CR monitors the finances of territorial self-governing units. In 2018, 6,265 territorial self-governing units of the Czech Republic were included in the monitoring, i.e., 6,252 municipalities,[17] including the City of Prague, and 13 regions.

In the first half of 2019, the MF CR performed its first evaluation of compliance with the rule as at 31 December 2018. Three of the total of 456 municipalities whose debt as at 31 December 2017 was higher than 60% of the average of their income in the last four years failed to comply with the obligation to reduce their debt in 2018 by at least 5% of the difference between the amount of their debt and 60% of the average of their income in the last four budgetary years: the municipalities of Felbabka (Central-Bohemian Region), Starosedlský Hrádek (Central-Bohemian Region), and Prameny (Karlovy Vary Region). In April 2019, the Ministry of Finance initiated administrative proceedings with those municipalities, aimed at stopping the transfer of their tax share in line with Act No. 243/ Coll., on the budgetary designation of taxes. In these proceedings, the Ministry gave the municipalities concerned 30 days to reduce their debt in the way determined by the law, which the municipalities did, and consequently the administrative proceedings concluded. This means that the Ministry was not forced to stop the transfer of a share in taxes to any municipality.

Indebtedness level in relation to the debt indicator

The indicator of the budgetary responsibility rule (i.e., the proportion of debt to the income average over the last four years) was above 60% in the case of 517 municipalities of the total of 6,252 (i.e., 8.27% of all municipalities). 590,418 inhabitants live in those municipalities, i.e., just under 5.6% of the Czech population (last year, it was 4.9% of Czech population).[18] Figures are also available in Chart 4.

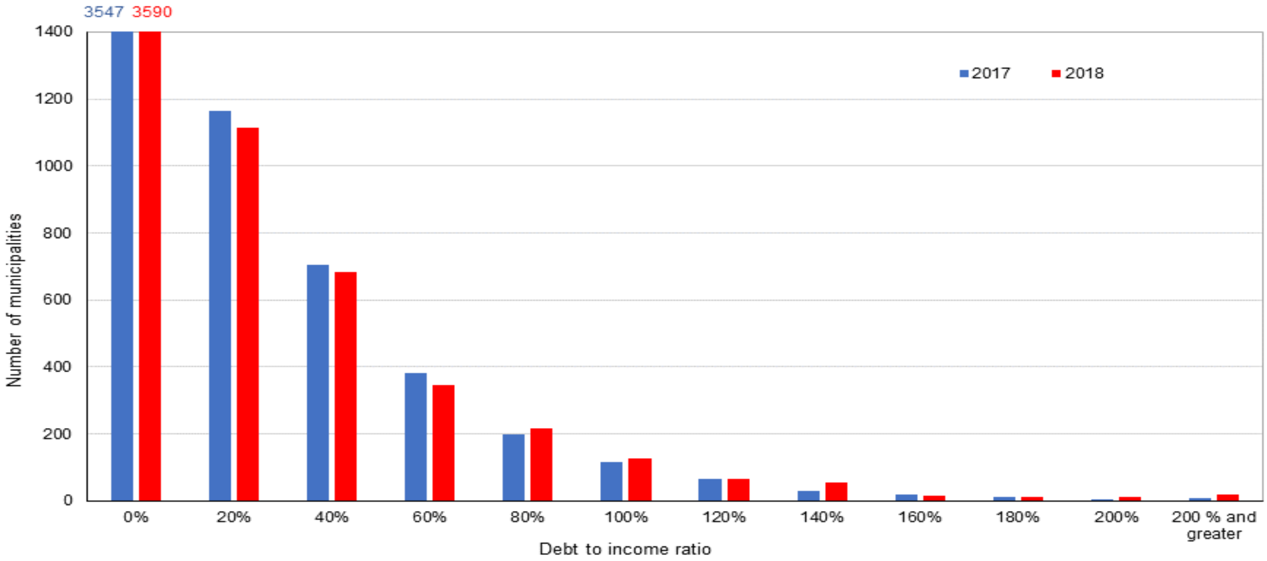
[15] For the purpose of the Act, the debt of a territorial self-governing unit is the value of outstanding payables on bonds in issue, credit, loans, and returnable financial assistance received, and provision of performance on the basis of guarantees and bills of exchange issued.

[16] For the purpose of the Act, income of a territorial self-governing unit means the sum of all monies received in its budget during a budgetary year, consolidated in line with another legal regulation.

[17] Two municipalities have not been included in the monitoring because of their failure to submit their financial reports to the Central State Accounting Information System (CSAIS): Přehvozdí (Central-Bohemian Region) and Bystřička (Zlín Region).

[18] Only 109,558 inhabitants live in those municipalities where this value of the indicator of the budgetary responsibility rule exceeds 100% (143, i.e., 2.3% of municipalities), which is only 1.03% of the country’s population (last year, it was 66,939 inhabitants, i.e., 0.63% of the population of the Czech Republic).

Chart 4 Numbers of municipalities at intervals according to the percentage level of the budgetary responsibility rule indicator, comparison of 2017 and 2018



Source: MF CR (2017, 2018): Information on the monitoring of the financial management of territorial self-governing units for the year 2017, Information on the monitoring of the financial management of territorial self-governing units for the year 2018.

The total amount of municipal debt in 2018 amounted to CZK 62.5 bn., i.e., CZK 0.6 bn. less than in 2017. The total sum of municipal debt in excess of the limit of 60% of average income amounted to CZK 3.6 bn., remaining unchanged compared to 2017. The average level of municipal indebtedness was 15.7% (in 2017 14.96%). 3,590 municipalities were entirely free of debt, i.e., 57.4% of all municipalities.[19] In 2017, 43 fewer municipalities did not have any debt.[20] On the contrary, the number of municipalities whose budgetary responsibility rule indicator was over 200% nearly doubled (an increase from 8 to 17 municipalities).

Table 4 The number of municipalities exceeding the 60% value of the debt criterion of the budgetary responsibility rule

Number of inhabitants in municipality	Number of municipalities		Number of municipalities exceeding the 60% value of the debt criterion		%	
	2017	2018	2017	2018	2017	2018
1–100	448	447	14	18	3.13	4.03
101–200	998	987	65	71	6.51	7.19
201–500	1,993	1,990	182	193	9.13	9.70
501–1000	1,372	1,377	113	124	8.24	9.01
1001–2000	748	753	57	71	7.62	9.43
2001 and more	695	698	25	40	3.60	5.73
Total	6,254	6,252	456	517	7.29	8.27

Source: MF CR (2017, 2018): Information on the monitoring of the financial management of territorial self-governing units for the year 2017, Information on the monitoring of the financial management of territorial self-governing units for the year 2018

[19] MF CR (2019): Information on the monitoring of the financial management of territorial self-governing units for the year 2018.
[20] MF CR (2018): Information on the monitoring of the financial management of territorial self-governing units for the year 2017.

Table 4 shows that the debt criterion of the budgetary responsibility rule is most often exceeded by smaller municipalities with 201–500 inhabitants, followed by municipalities with 1,001–2,000 inhabitants.

In addition to the budgetary responsibility rule set by the Act, the MF CR monitors another two indicators with respect to municipalities, for which it sets the recommended value: the indicator of the ratio of loans and advances to total assets and the total liquidity indicator. The MF CR considers those two indicators to be important, because unlike the budgetary responsibility rule, they involve information about the assets and overall liabilities of municipalities and regions. In spite of the fact that those indicators are not directly related to the Act, the CFC decided to take them into account as well, given that they complete the illustration of the context of the finances of municipalities and regions.

As for the indicator of the ratio of loans and advances to total assets, which expresses the share of assets covered by third-party finances, the recommended level is 25%. That limit has been crossed by a total of 106 TSGUs, of which 98 were municipalities (1.57%) and 8 were regions (i.e., 61.54%). The year-on-year increase is by 5 municipalities. 68 of the municipalities that do not comply with this requirement are municipalities that also exceed the debt criterion under the budgetary responsibility rule (i.e., 1.08% of all municipalities), and they are the home of 0.32% of the inhabitants of the Czech Republic. The municipalities of Turovice (686%) and Prameny (204%) report the highest values of that indicator.

As for the total liquidity indicator, which expresses the share of current assets to the volume of short-term receivables and indicates to what extent a municipality is able to fulfil its short-term obligations, the MF CR recommends that the values be kept in the ⟨0;1⟩ interval. That interval is not complied with by a total of 125 (i.e., 2%) of municipalities, which is a year-on-year increase of 18 municipalities.

In 2018, 10 municipalities (i.e., 0.16% of all municipalities) were included in the category of TSGUs that reported an excess of the limit values of all three indicators monitored at the same time, and hence, the MF CR classified them as TSGUs with a high level of financial risk. The year-on-year increase is by 4 municipalities. The total number of inhabitants living in those municipalities is 6,103, which is 0.057% of the country's total population (last year, it was 1,495 inhabitants, which is less than one-ten-thousandth of the country's population). Unlike in 2017, when no region had more than one such municipality, the situation in 2018 is different. There are 4 municipalities exceeding the limit values of all three indicators monitored in the Central-Bohemian Region, 2 in the Ústí nad Labem Region, and all other regions have no more than one such municipality. In spite of that, the problem of municipal financial management is not systemic. Rather, these are individual failures of a very low number of entities. The main cause of the excess of the monitored indicators by those municipalities was the implementation of investment projects financed primarily from returnable resources (loans), or the municipalities have not yet performed financial settlement of subsidies that they have been provided (short-term advances on transfers). Many of the municipalities concerned have only low immediately available financial reserves, and hence, their financial management may suffer from the following risks:

a) Insufficient funds for the management and repair of fixed tangible assets obtained;
b) Insufficient funds for addressing suddenly arising need of expenditures;
c) Failure to comply with the conditions of a subsidy that has been provided (promised) (including ensuring so-called sustainability of a project for the required period).

Aside from the municipalities that exceed the limit values of all three of the above-mentioned indicators, also the municipalities of Prameny and Turovice are facing serious financial problems. They do not exceed the limit values of all three monitored indicators at the same time, but they report the highest values of all municipalities in the country in terms of the indicator the ratio of loans and advances to total assets.

The municipality of Prameny is encumbered with long-term payables in the amount of CZK 52.2 mil., with the average annual income of the municipality being CZK 9 mil. Prameny has got itself into a serious situation due to an unsuccessful investment in a project of a mineral water bottling plant.

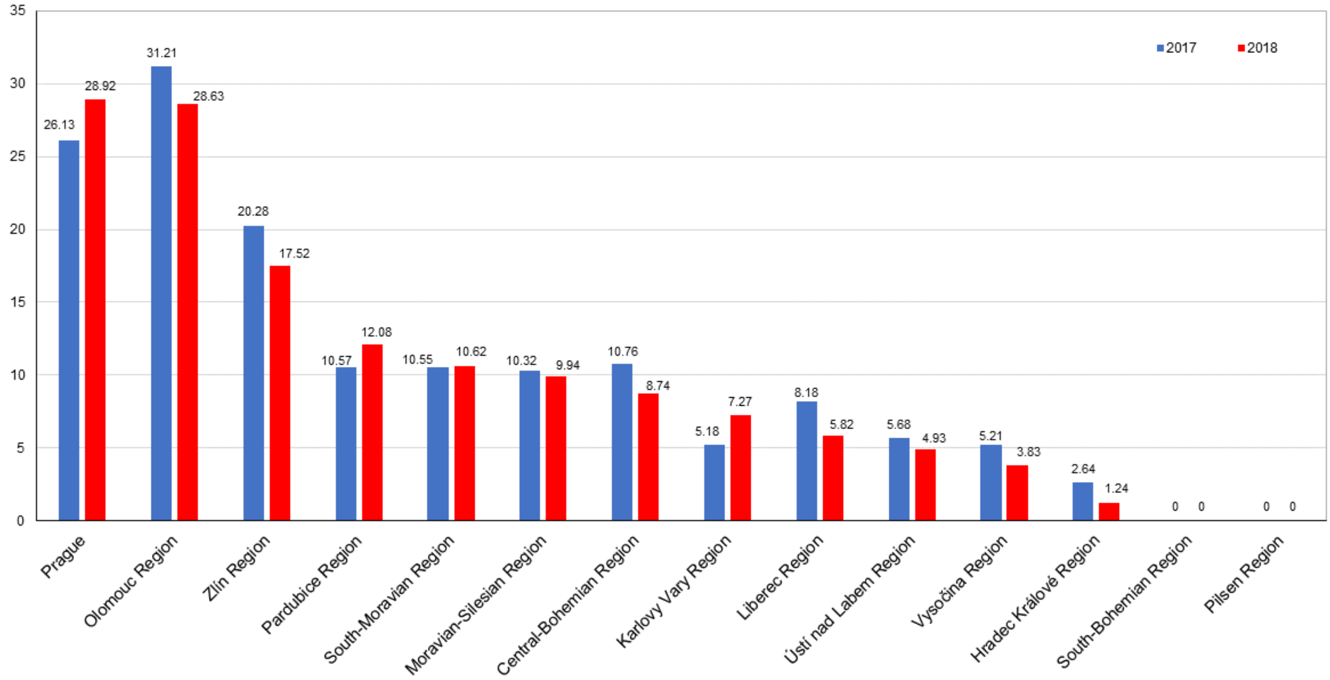
The municipality of Turovice is encumbered with long-term payables in the amount of CZK 76 mil., with the average annual income of the municipality being CZK 2.7 mil. The municipality has become indebted primarily due to a problematic construction of a seniors' home commenced ten years ago.

On the level of regions, the debt criterion of the budgetary responsibility rule is fulfilled with a reserve. The highest values of the ratio of debt to average income in the last 4 years has been reported by the City of Prague[21] and

[21] Prague is granted the status and powers of a municipality as well as those of a Region – see Act No. 131/2000 Coll., on the City of Prague.

the Olomouc Region. The South-Bohemian and Pilsen Region had absolutely no debt in 2018.[22] Compared to 2017, most regions reported a drop in the ratio of debt to average income over the last four years. An increase was noted by Prague (by 2.8 percentage points), Karlovy Vary Region (by 2.09 percentage points), Pardubice Region (by 1.51 percentage points), and South-Moravian Region (by 0.07 percentage points). The figures are shown in Chart 5.

Chart 5 Regions by the ratio of debt to average income in the last four years; in %, comparison of 2017 and 2018



Source: MF CR (2018): Information about the monitoring of territorial self-governing units in 2017, MF CR (2019): Information about the monitoring of territorial self-governing units in 2018.

<u>Conclusion</u>: As at 31 December 2018, the debt criterion defined in Section 17 (1) of the Act was exceeded by a total of 517 municipalities and no regions. In 2019, administrative proceedings were initiated with three municipalities that failed to comply with their obligation to reduce their debt in 2018 by the statutorily defined minimum level. All of them subsequently reduced their debt, which means that it was not necessary to proceed to stopping the transfer of their share in tax proceeds.

[22] See MF CR (2019): Information on the monitoring of territorial self-governing units for the year 2018.

Summary

This was the first year in which all rules for compliance with budgetary responsibility could be evaluated fully.

The Czech Fiscal Council sates that in 2018:

- **The rule for the indebtedness of the public institution sector (Section 14 and Section 16 of the Act) has been complied with;**
- **The procedure for the determination of total expenditures of the public institution sector and derivation of the expenditure framework of the state budget and state funds was complied with;**
- **The structural balance of government institution sector finance in 2018 did not exceed the limit (–1.5% of GDP) arising from the procedure for deriving the expenditure framework of the state budget and state funds;**
- **The limit of 60% of the amount of debt of a territorial self-governing unit (Section 17 (a) of the Act) was exceeded by a total of 517 municipalities;**
- **The obligation to reduce their debt by the set minimum level in 2018 was not fulfilled by a total of 3 municipalities, which, however, remedied the situation by the deadline set for them;**
- **The Ministry of Finance did not need to proceed to stopping the transfer of a share in tax proceeds to any territorial self-governing unit.**

Furthermore, the Czech Fiscal Council states that the financial balance of the public institution sector has been significantly positive in recent years, both expressed as current and cleansed of the impact of the economic cycle. The financial balance is far from reaching the limit value of structural deficit arising from the procedure for determining total expenditure of the public institution sector and for deriving the expenditure framework for the state budget and state funds. For the medium-term outlook period, i.e., for 2019–2022, it can be, however, expected that a shift will be made from a surplus to a deficit, which, in connection with the tightening of the MTO value, will result in a significant reduction of room for an active fiscal policy in the future.

In the case of territorial self-governing units, the Czech Fiscal Council warns that there is as of yet no systemic mechanism that would make it possible to address the situation of the most seriously indebted municipalities which have been in a hopeless situation for an extended period. The existing preventative measures defined in the Act do not address pre-existing insolvency. In the municipalities concerned, the level of services provided to their inhabitants has been seriously reduced. Given the above, the Czech Fiscal Council is of the opinion that such a mechanism should be created.