

Budget System Reform in Transition Economies: The Case of the Former Yugoslav Republics

by

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1. Introduction

The 1990s witnessed the unprecedented restructuring of a large number of formerly interconnected centrally planned economies into market-based systems. These reforms were fundamental, affecting all sectors of the economy and all segments of the population. An important component of this structural reform was the restructuring of the country's budget system to function in a more market-oriented economy.

It is apparent that the breadth and pace of these reforms have varied greatly, from those countries, such as the Czech Republic, Hungary, and Poland, that more readily adopted Western-oriented public institutions, to others, such as some of the former Soviet Union republics, that have been slower to reform their government institutions. The republics of the former Socialist Federal Republic of Yugoslavia (SFRY) represent an interesting case study in this transformation process. They emerged from the 1989 collapse of the SFRY with common institutions that they adapted to more market-oriented institutions with varying degrees of success throughout the 1990s.

Since the early 1990s, the Fiscal Affairs Department of the IMF has been providing technical assistance to these republics. As part of its regular process of evaluating its technical assistance, this paper summarises the internal review of technical assistance materials and, as such, represents a stocktaking exercise of what was needed, what was accomplished, and what remains to be done in this important area of reform. The study documents and evaluates the process of budget system reform during this transition period, analyses the various critical elements to successful transition, and – based on this – suggests an agenda for future reforms.

2. The heritage of the SFRY budget system

Prior to 1989/90, the SFRY budget system reflected the broader system of socialist self-management that determined the discharge of responsibilities for various government functions and the provision of public services in a highly socialised state. In the SFRY, this evolved into a very sophisticated system, with many features running counter to current practices in market-based economies. By the 1980s, however, the system was already under considerable strain due to a severe and prolonged fiscal crisis.

2.1. The budget system was very decentralised and lacked cohesion

There were three levels of government: **federal**, consisting of the military complex, the central bank, foreign affairs, and the social accounting service (SDK); **republic** (state), consisting of central policy formulation organisations and small ministries supervising and co-ordinating the policies in different sectors; and **local**, which supervised some local functions and services. To this government superstructure must be added a large number of extrabudgetary funds,¹ each of which received some share of earmarked taxes to carry out well-defined areas in the provision of public services (schools, hospitals, social welfare, and so on). The local institutions (*zavods*), which actually carried out government policy in delivering services to the population, were established as independent legal entities financed from one (or potentially more) of these extrabudgetary funds (EBFs). The EBFs were supervised by a governing board (with representatives from the public, the *zavods*, and the state ministry or local government representatives) and reported directly to the state parliament or the local government council, which approved their operations. *Zavods* also had their own supervisory boards with local representation, and they reported to the relevant EBFs. Even with the substantial move to a market system, the *zavods* still continue to occupy a problematic position.²

2.2. The state budget was limited and non-transparent

There was no real centralised budget. The EBFs and local government and state administrative operations were funded by a multitude of compulsory deductions at source (adjusted by geographical area). Although the state government effectively determined the tax rates for a major part of the aggregate tax base, it had no effective control over at least a third of the total revenues collected.

The budget in the SFRY consisted of a limited number of very aggregate budget lines (or “positions”) which provided only very broad level information to parliamentarians who reviewed and approved it every year.³ This level of aggregation provided very little opportunity to discuss, on the one hand, the input costs (and, therefore, an open examination of their efficiency and the possibility of alternative use) and, on the other hand, the policy objectives and programmes for each ministry (and, therefore, the basis to assess performance). In reality, the budget was a means of setting limits for budget users, within which they had a relative free hand in execution (of course, initially the limits were often so constraining that even this relative freedom was insignificant).

2.3. Budgets were prepared in a bottom-up manner, based on “norms”

The typical process of preparing estimates in the ministry of finance (MOF) consisted of sending a circular to the spending agencies requesting

their proposals for the following year's budget very late in the current year, after the present year's fiscal estimates had been revised. The discussions with agencies, therefore, were cut short, although the very tight controls on fund allocation during the year meant that there were almost daily discussions of agency spending requirements. The important aspect of this process was that there was little long-term focus, and, although the MOF might well have a good idea of a target spending limit (usually the expected level of revenue), it did not make proposals to the government in this regard as part of a planning process, nor did it communicate any target to other relevant agencies. The result was that the detailed examination of the budget, and the determination of the global level of resources available, took place virtually simultaneously – and very late in the budget preparation process.

Rather than the budget circular offering top-down guidance to discourage overbidding by budget institutions and to reinforce the government's intentions to maintain a tight fiscal stance, the bottom-up approach that was adopted put the MOF in the position of having to make deep cuts to the bids, often on an arbitrary basis. At the same time, a problem was posed for budget formulation by the fact that a large section of the budget was guided by legislated, or well-established, formulae or norms. Although such practices may have appeared to simplify the process, or even indicate accuracy or fairness in the allocation of resources, in practice they acted to reduce considerably the degree of flexibility available to the budget decision makers. Such formula approaches to budget preparation may also have tended to encourage spending agencies to overstate client numbers (*e.g.* pupil or patient numbers) in order to secure more resources. Unfortunately, many of these norms were established in a much different, more stable, economic environment. By the late 1980s the economic and political situation in the SFRY was under considerable strain, and hence these norms became unrealistic.

2.4. Budgets lacked a medium-term perspective

Although the successor of the state planning agency – the ministry of economy (MOE) – (and, in some cases, also the National Bank and other institutions) carried out some macroeconomic forecasting, it was not at all clear that it was an established part of the process of budget formulation. Typically, monthly forecasts of revenue flows and trade balances, for example, provided by the MOE were used within a budget year to support some very short-term resource allocation decisions. These data were usually supplied to the MOF along with regular data (daily, in the case of revenue) from the payments bureau (SDK), whose role is described below.

A major impediment to the MOF advising the cabinet on broad strategy was that the budgets were, at best, prepared for only one year. As the management of the current budget year progressed, there was no means by

which comprehensive estimates for the following year(s) could be built up until this information was requested from the agencies, usually around October. If the cabinet decided to become involved earlier in the budget formulation process, this would have been extremely difficult, given the lack of forward estimates.

2.5. The decentralised system was given cohesiveness through the SDK system

In this highly decentralised system, the SDK was the essential “glue” to keep the system together, to enforce fiscal policy, to provide the central bank with monetary oversight, and to provide the information on which to base financial decisions.

The *Sluba društvenog knjigovodstva* (SDK)⁴ or Social Accounting Service was a rather unique institution, created in 1963 by hiving off payments operations from the National Bank of Yugoslavia. The SDK grew to exert widespread functions in the fields of payments execution, tax collection, auditing and control of enterprises and government agencies, and the provision of statistical data. The SDK operated independently from government and financed its activity out of fees charged for its services, with a nation-wide network of regional offices and branch offices accessible even to remote areas of the country. It was a large employer of skilled staff (with better pay conditions than the ordinary public service), employing not only large numbers of economists, accountants and auditors, but also lawyers and electronic engineers who performed various functions.

The importance of the SDK within the SFRY went well beyond the servicing of government operations and affected all sectors of the economy, especially the financial sector, as shown in the wide range of functions it had accumulated by the 1980s, detailed in Annex A.

2.6. The MOF had limited functions and capacity

The role of the state level MOF in this decentralised system was extremely limited. Tax collection was largely in the hands of the SDK, which automatically deducted from enterprise accounts and distributed according to the ownership of funds established by law. The state did make some transfers to local governments, as well as to support federal level operations, but again these were limited. Even with respect to its own level ministries, in budget preparation the budget department was largely a consolidator of others' budgets, large sections of which in any case were determined by other laws. In terms of executing those budgets, the state MOF's role was limited to authorising monthly transfers to the ministries' accounts; the execution of this authorised spending was accounted for, reported, and even controlled to a

certain extent through the SDK system, which also provided the information for the government's annual accounts. Of course, in times of cash shortage, the MOF could decrease the flow of funding to match available resources, which often led to the buildup of arrears over which the MOF had little control and even less knowledge. The SDK, on the other hand, was uniquely placed to know these arrears, which it periodically cleared through elaborate multilateral "compensation" deals.

3. The reform challenge posed at independence

3.1. Immediate changes on independence

Apart from Serbia, which still had federal structures after the former SFRY broke up, the newly independent states were immediately faced with the need to create new functions that were previously federal functions, such as defense, foreign affairs, and customs. In addition, each new state inherited that part of the SDK operations which was physically within its territory, as well as the state branch of the Federal Central Bank. Given the conditions under which independence occurred, all of the new states were faced with particularly difficult financial conditions, with their share of federal assets denied them until much later.

Faced with these challenges, compounded in some cases by war, the new states had to take immediate steps to avoid chaos. The SDK was restructured to a state level operation and initially continued to perform most of its original functions. The state branch of the Federal Central Bank became the central bank of the new state. The role of the state MOF became more important as it took over federal MOF functions, including fiscal policy and debt. Among the early policy initiatives was the reorganisation of taxes, which introduced a more rational and manageable income tax to replace the multiple deductions, each earmarked for specific public services funded through EBFs. This led to the abolition of most of these EBFs soon after independence, with revenue instead being channeled through the state budget. In the climate immediately after independence, therefore, there was little choice but to hold on to those essential institutions which functioned, in particular the SDK which was renamed the "payments bureau" (PB) but otherwise remained essentially unchanged. It has been argued that this move delayed fundamental reforms, in the financial sector and the management of public finances, although it is questionable whether adequate and appropriate capacity was available in the MOFs and the central banks (and even the commercial banks) to take over these functions immediately after independence.

The increased responsibility placed on the MOF raised its profile within government. However, it would take a number of years before it revised the legal budget framework, acquired the relevant institutional structure, and developed

an appropriate internal capacity, essential elements to ensure sound financial management by other ministries. The immediate aftermath of independence was, to say the least, difficult for all the republics, and in some of them disastrous, as war broke out. Their economies contracted sharply, partly due to hostilities, partly due to the loss of internal markets as well as exports and tourism, and the uncertainties surrounding the division of assets. All of which led to significant declines in government revenues, hyperinflation, and loss of faith in the currency. As a result, the MOFs were faced with constant crisis management, and not surprisingly it would take some time before more deep-rooted reforms could be undertaken. In addition, independence did not bring about immediate change in political leadership; in many cases it simply became nationalistic, which meant that old habits and attitudes dominated government operations.

The fiscal crises of the early 1990s led the MOFs to introduce cash rationing as a main budgetary instrument, especially as they realised that the revenue targets set in the approved budget would not be met. In the absence of financial management reforms to improve oversight of ministry operations, and particularly for those countries engaged in war, it is not surprising therefore that significant arrears built up during this period. Key among the unpaid creditors were public enterprises, pensioners, public workers (salaries), and recipients of social welfare payments. Concurrently taxes were also not being paid by public enterprises. In the countries affected by war, in addition, substantial promissory notes were issued, to be paid after the war. Given these problems, the gap between budget and actual outturns progressively widened. This fiscal crunch led many spending units to understate (or even not report) revenues that they collected, in order to make ends meet. Unfortunately, the lack of ability to pay also had a “knock-on” effect on the banking system, creating a banking crisis, which was compounded by the lack of internal control within the banks due to the still dominant position of the PBs, in which secretive and old attitudes remained strong.

3.2. The challenge of budget system reform

Perhaps the biggest challenge to reform created by the SFRY heritage was the issue of what to do with the SDK system that survived independence under the recast “payment bureaus” (PBs). In this regard, reforming the budget system posed something of a dilemma. On the one hand, it was increasingly recognised that to develop the financial sector and the budget system on market-based lines would require dismantling the SDK system. On the other hand, it was also recognised that the SDK system was so central to the functioning of the financial sector and to government operations that these institutions would have to be restructured and their capacities developed before the dismantling of the PBs could safely take place. This resulted in an initial period where an attempt was made to develop viable capabilities in other institutions, not the

least in the MOF, though these were often handicapped by the continued existence of the unreformed PB system. Box 1 describes the various functions of the PBs and the reforms needed.

3.2.1. Limitations of the SDK system for budget management

The development of MOF treasury and budget management functions were those most obviously held back by the existence of the PBs. Using the PB's giro accounts management system, the MOF transferred funds from its main budget account to direct spending unit accounts of the main budget users' accounts, which in turn distributed these funds to the indirect spending units, or its subordinate agencies that also maintained giro accounts in the PB system. There were obvious problems, however, with the fiscal information available to the MOF. The PB maintained information of the balances and movements in the giro accounts of all the government agencies, as a counterpart to deposits with banks. The PB reported back this information separately to each spending unit. The MOF received information from the PB about the movements in the main budget giro account, but not, in general, about the transactions on giro accounts of the spending agencies (except its own as a spending agency). Information on the general budget giro account was the basis for the final accounts of government. Government expenditure was recorded, as a result, on the basis of transfers from the general budget account to the budget institutions' accounts, and not on the basis of real expenditure by each spending unit. Consequently, the MOF had only limited information on the outstanding balances of spending agencies, that is, on the government's available cash resources.

3.2.2. Limited capacity in the ministry of finance

At the same time, the PB removed the incentive to develop MOF capacity in budget management. From the government's viewpoint, its control over tax collection, which in any case was easier to enforce in the SDK system, meant that the MOF's capacity in tax administration was extremely limited. At the same time, in executing government payments, and in accounting for and reporting on these transactions, the PB removed the need to develop treasury functions.⁵ The system described was a decidedly decentralised decision-making process, with important resource allocation powers resting within the planning agencies or in the main ministries rather than the MOFs. In effect, the MOF acted merely as a distributor of funds, trying to balance incoming receipts with outlays, but often with real decisions made elsewhere. Information on budget execution resided firmly with the PB, and only some of that information was accessible to the MOF. The secrecy of the PBs also created difficulties for the MOFs. The MOF had no special status to the PB; it was largely treated as equivalent to other ministries that held their accounts in its giro system. Given this status, it was perhaps not surprising to find at the time of independence

Box 1. **Social Accounting Service (SDK) functions and their restructuring**

Payments clearing

- Each legal entity required an SDK giro account usually matched by deposits in a commercial bank.
- Banks, including the national bank, also had a giro account with the SDK.
- SDK's monopoly on all domestic payments meant it was in charge of all clearing, including bank clearing.

Reform: A real-time gross settlement (RTGS) under the central bank; and a small-scale clearing house, usually by a restructured successor to the SDK; banks in charge of executing payment requests from clients.

Cash distribution

- Legal entities, including banks, had limit on cash holdings, with excess deposited in the SDK giro account.
- SDK acted as intermediary between the central bank and the rest of the economy in distributing cash.

Reform: Commercial banks took over this function, maintaining system of secure depositories.

Tax collection

- Enterprises presented their tax payment orders to the SDK, specific to each tax.
- SDK credited transfers to the general budget giro account.
- Checked the accuracy of the assessment, and in charge of procedures for sanctioning tax default.

Reform: Creation of new tax administration authority to assess and audit tax liabilities, with taxes collected through the banking system.

Treasury operations

- Executed government payment orders.
- Accounted for and reported on all government inflows and outflows.

Reform: Creation of a treasury system in the MOF.

Control functions

- All legal entities, including government entities, made regular financial reports to the SDK.
- Reports used for general audit function.
- SDK could start bankruptcy proceedings for all entities facing payment difficulties.

Reform: Creation of external audit body reporting to parliament, and development of internal audit in budget institutions.

Box 1. **Social Accounting Service (SDK) functions and their restructuring** (cont.)

Information functions

- SDK produced large number of statistical reports.
- Major source for official statistical yearbook.

Reform: Creation of a modern statistical agency.

that the republic MOFs were not too well-staffed both in terms of numbers and quality and existed under the shadow of a more powerful federal MOF. With independence, the republic MOFs had to assume some functions previously undertaken at a federal level and also had to develop the capacity to take over other functions residing in the PB or other government institutions. It was evident that initially they were rather unprepared for this role.

4. The reform strategy in public expenditure management: Phase one

4.1. Balancing short-run crisis management with capacity building

The first phase of PEM reforms can be depicted as having advanced on two main tracks. First and foremost, reforms were aimed to **support crisis management**, often under difficult post-independence conditions of macroeconomic, social, and political instability. This focused on improving the system of fiscal reporting to provide fiscal managers with more information on which to act. Four main elements were discernable: increasing coverage of budget institutions under direct MOF control; developing better reporting through the PB system; improving budget classifications; and improving the coding of transactions. Second, with the break-up of the PB system there was the need for **capacity building in the MOF** as it acquired former PB functions. In particular, this effort focused on centralising accounting functions in a new treasury department and, based on this, rationalising cash management and improving other government financial management functions. Both tracks, to a large extent, concentrated on budget execution rather than budget formulation, largely delaying the latter for the next phase of reform. This was perhaps in recognition that, in the earlier days, any budget that was able to be approved politically tended to be unrealistic and not fully executable.

4.2. Short-run crisis management

4.2.1. Centralisation of budget controls

Among the first reforms undertaken by the newly independent republics was the concentration of taxation at the state and local government levels. In

this way, the states and local governments took over the role of transferring funds to their subordinate *zavods*. The majority of the EBFs were removed, except for the very largest – typically, the pension and health funds – as well as a few smaller ones that were directly financing operations to the economy or to households. While this increased the potential for controlling total general government spending, it also placed great strains on the MOFs, which suddenly found themselves with a substantial increase in responsibilities but with limited staff increases and inadequate skills.

This phase, which took place at different times in different republics, was usually accompanied by a system of cash rationing as a response to the highly uncertain times typically faced during the first years of independence. These were often years of rampant inflation and economic and social instability for many of the republics. The effects of war, the virtual halving of the GDP, and the uncertain revenue flows presented major problems. Added to this was the serious corruption and fraud brought about by the effects of war. Only after this initial period of disruption was reform possible. All such factors led to the introduction of strict controls on scarce cash resources and a consequent rise in MOF powers over other government institutions. At the same time, the weaknesses within the MOF were exposed.

Typically, one of the first moves to improve control was the elimination of central ministry giro accounts, and to make all payments (including transfers made to subordinate units) directly from the main budget account, under MOF control.⁶ This, in turn, necessitated creating ledger accounts within the main budget account. However, in order to handle these ledger accounts, it was necessary to develop accounting functions in the MOF. Moreover, it was recognised that to use the information from the accounts, and to make forward projections of cash use to mitigate the disruptions of cash rationing, would require analytical and management skills in short supply in most MOFs. To make the system work would also require stricter controls over the banking arrangements of government institutions. Accordingly, financial regulations governing the opening of bank accounts by budget institutions usually needed to be strengthened, explicitly stating that only the minister of finance had the right to open accounts on behalf of budget institutions.

4.2.2. Increasing coverage by reporting directly on transactions formerly captured by budget user accounts

A first step in delineating the institutional limits of the budget was for the MOF to make a survey of all direct (DSUs) and indirect users (ISUs) of the budget funds. In turn, by examining their functions, the MOF began to effectively reconsider the scope and coverage of budgetary operations. Progressively, it was recognised that fiscal reporting should be extended to include all of the institutions internationally defined as “general government”.⁷

However, it was recognised that organisations of a purely commercial nature, such as co-operatives, enterprises and banks (including the central banks) even if they were exclusively owned by government or any of its public authorities, were to be excluded – largely following international standards. Also to be excluded were organisations established by individuals and interest groups independently of government, such as clubs and associations, nonprofit organisations, and nongovernmental organisations, as well as political parties. All financial transactions (receipts and payments) were progressively included under general government, including budgetary transactions, off-budget transactions, and extrabudgetary transactions. A typically thorny issue revolved around the “own revenue” or retained revenue accounts of budget institutions, some of which supported commercial types of activity, where these institutions typically fought a rear-guard action against having these revenues included in their total available budget resources.

4.2.3. Developing improved reporting from the Payments Bureaus

While it was recognised that achieving complete coverage of general government would be the longer-term aim, in the short run the most that could practically be achieved was to obtain better reporting and control over the central government institutions, namely those covered by the DSU giro accounts. Initially, the MOF relied heavily on reports from the PB on the cash flows and balances in the main budget account. These were relatively timely and adequately tracked the release of budget authorisation once budgetary coding had been introduced in payment orders. However, these reports were of limited use since they did not include the ISU accounts (ISUs provided most of the actual delivery of public services) and hence did not track actual expenditure. On the revenue side, the SDK system had always provided to the MOF detailed reports of tax collections by each tax and place of collection, usually available within three days. Indeed the system of revenue reporting in the SFRY was efficient and timely. In almost all republics, it was recommended that existing reports be enhanced or supplemented/replaced by other reports. In some republics, owing to lack of co-operation of the PB, this improved reporting never became adequately operational.

The only country to fully implement coding of payment orders was FYR Macedonia, having the initial co-operation provided by the PB. Slovenia and Croatia implemented coding for DSUs only, once spending of these units had been centralised through the main budget account. Croatia went one step further with respect to the salaries of education, social welfare and judiciary ISUs, by using the PB to collect payslip calculations from these units and processing their payroll centrally, a major achievement considering that over a thousand units were involved.

4.2.4. Addressing the problem of arrears

The system of expenditure control focused on cash releases. The weaknesses of this system became increasingly evident in the initial post-independence period where most republics faced adverse macroeconomic conditions, lower available financing levels than projected, unrealistic budgeted levels of spending, and pressure from contingent liabilities falling due. The unpredictability of cash transfers to the ministries, and often below their authorised budgetary appropriations, resulted in a continuous process of rebudgeting. This was manifested in increasing reallocations between spending categories within budget institutions, negating the usefulness of the initial budget spending plans, and disrupting the orderly provision of government services. The system was also prone to the generation of arrears – although by very strict application of these cash controls on a daily basis, the MOF often prevented this problem from becoming significant. Arrears existing at the end of the year were usually rolled over into the next fiscal year, without an adequate separate budget provision for this purpose. The result was to make the next year's budget estimates even more unrealistic, so the problem of arrears was not resolved but merely recycled. The extent of the arrears problem was only revealed once the MOF had improved fiscal reporting.

By focusing on cash controls, the existing system had the inherent weakness of not being able to control for past commitments coming due. To exercise real control over spending, it was recognised that this must be applied at the commitment stage, early on in the spending process, as this would ultimately determine the future demand for cash expenditures. The approach is described in Box 2. However, improved control over commitments did not prove easy. When setting up a commitment control system, it is necessary to ensure that comprehensive procedures are put in place and that a robust system of enforcement is established. In brief, such a system is designed to ensure that the MOF is informed of potential obligations (including guarantees) of the government, and also of the signing of any agreement that will establish a future liability. In situations of severe fiscal constraint, as initially encountered in the former SFRY republics, it was recommended that the MOF give approval for every commitment above a certain level. Thus, an important prerequisite for this system of control was that the MOF had the power to cut planned commitments. Experience showed that the MOF seldom had the power to impose such controls, especially on the power ministries such as defence and interior. From a practical viewpoint, there were also capacity constraints within the MOF to be overcome. Even when commitment registering was possible in the MOF, effective commitment control would have to await a higher degree of computerisation and reform in the accounting system – the second stage of reforms (see below). In this second stage, there would be complementary reforms in budget formulation that aimed to construct more realistic budgets

and hence ease the pressures that created arrears. Fortunately, this was supported by increased macroeconomic stability attained by the time the second phase had been reached.

Box 2. **The approach to resolving the arrears problem**

Generally, an arrears reduction programme needed to be addressed on two fronts by: i) identifying and verifying the present stock of arrears; and ii) putting in place controls to prevent their re-occurrence.

The first aspect (establishing an inventory of arrears) entails:

- a very clear specification of the date at which the stock will be inventoried;
- a clear specification of which internal records of spending agencies should be used to estimate this stock;
- an agreement on how outstanding bills are to be valued;
- specification of all supporting documentation required for verification of their legitimacy;
- a deadline for completing this inventory.

A team in the MOF would be required for this work. It was recognised that this approach of asking the ministries to report their outstanding bills had inherent dangers, since the MOF had no separate check on the veracity of these estimates. Similarly, it is likely that the ministry would have to obtain this information by requests to its subordinate local units and ISUs, and may also experience difficulty in checking the accuracy of their accounts. Thus, there is a strong case for having the final inventory of arrears audited by an independent auditor.

The second aspect (enforcement) requires:

- that the MOF make it mandatory for the budget institutions to record purchase orders, invoices received, invoices due for payment, and invoices verified and sent for payment for all purchases;
- that the budget institutions report on the amount of invoices due for payment categorised by an agreed breakdown of the delay in payment; (This would make the definition of arrears at least consistent across all budget institutions and would give some opportunity for the MOF to check these totals against records kept in the budget institutions.)
- that penalties for non-compliance be enforced.

The MOF's role was viewed strictly to ensure that obligations entered into were within the budget, that the resulting cash flow was sustainable, and that documentation was complete.

4.3. Capacity building in the ministry of finance

4.3.1. Creating a stronger central accounting capability in the MOF

In some republics, such as Serbia and Bosnia, much of the accounting operations of DSUs were handled, at least for some ministries, by a government-wide state agency, the joint services administration (JSA). In these cases, bringing the accounting part of the JSA closer to the core operations of the MOF was one immediate measure to develop accounting in the MOF.⁸ In other republics, it would be necessary to create a new centralised accounting division (CAD), sometimes recruited from the PB, as well as some of the accounting staff from DSUs themselves (since they also performed some accounting operations). With this centralisation came some immediate benefits: first, improved control and supervision over accounting standards and procedures; second, a more focused development of accounting capacity, aimed at raising the standards and professional status of public accountants; third, timely and detailed reporting on actual expenditures and arrears, reported according to budget and accounting classification. In this way, the MOF would acquire the information to more adequately control budget execution and its overall cash resources. In retrospect, in the initial phase of reform these improvements often failed to materialise.

4.3.2. Strengthening financial management in government

The establishment of greater accounting capacity was an essential first stage in the development of an integrated financial management system for the government. With information more readily available in a timely and accurate form, governments could move away from their extremely short-term crisis mode of operations to a system where budget execution and cash management decisions could be made ahead of time, more proactively, and with less disruption to government operations. At the same time as strengthening the centre, it was also seen necessary to ensure the retention of an adequate financial management function inside each DSU, since ultimately they were responsible for the planning of their budgets as well as the utilisation of budget funds appropriated to them in the budget. In the typically cash-constrained early days of reform, this objective often fell by the wayside.

4.3.3. Improving government cash management

The establishment of ledger-based accounting for DSUs in the MOF, as opposed to the previous practice of giro account PB-based accounting, was an essential change in approach that enabled the much needed reform of introducing a treasury single account (TSA). This move would be based on the elimination of DSU accounts, with payments, including transfers to ISUs, being made directly from the main budget account, thus moving the control of

these accounts from the budget department to the CAD. In the first stage of reform, the bank/giro accounts of ISUs were usually left untouched. Due to their large numbers, they posed a severe problem for consolidation in a TSA.

One cannot underestimate the effort involved in establishing a TSA. The SFRY system of government banking arrangements was based on a proliferation of bank accounts all managed through the SDK. As an example, in FY2000 it was found that there were 14 082 legal entities of general government in the residual FRY,⁹ of which 12 922 were situated in Serbia and the rest in Montenegro.¹⁰ These legal entities had between them 94 943 giro accounts (86 918 belonging to legal entities in Serbia), of which 64 792 were revenue collection accounts (58 269 belonging to legal entities in Serbia). In addition, there were 93 legal entities (73 in Serbia, the rest in Montenegro) classified as unused funds, whose functions were indeterminate. These undetermined funds and other giro accounts had between them 9 742 giro accounts (7 937 for Serbia). Among these giro accounts were court and other deposits (some 9 215, of which 7 477 were in Serbia) which may have been funds held in escrow-pending court decisions.

This number of giro accounts, and associated banking arrangements, was not dissimilar to the situation in other ex-SFRY republics which inherited the same system.¹¹ Such proliferation of giro accounts, many with sight deposits in banks other than the central bank, presented a very complex problem for efficient cash management – just how complex was indicated by the excessive level of idle cash balances usually found in the banking system which were supported by these giro accounts.

4.3.4. Modifying the system of budget execution

With the accounting function centralised in the MOF, the new central accounts division could also establish centralised computerised operations, such as payroll, to ensure better control and accounting of this important item of spending. Since salaries usually were already disbursed through the banking system, such systems could be established relatively quickly. The aim of the new arrangements was to give the MOF better control over budget execution and, at the same time, to enable it to develop modern systems for all stages of expenditure management.

The new accounting arrangements implied that budget execution flows would also change as the MOF developed its treasury function. A usual first step was to require financial management units in DSUs to channel all payment requests through the CAD, which would code and record them by budget position and by accounts code, conduct pre-audit checks, and generate payment orders on the main budget account. These new arrangements provided the MOF with the opportunity for both a more direct and simplified

control over cash utilisation, and a more detailed and timely reporting system for budget execution. With all payment orders being made either directly to suppliers or to ISUs, the MOF could establish a system of payment order coding which could be the basis of a more sophisticated daily report from the PB system. Coding of each payment order would identify the budget position number, the institutional code of the ISU if it was the beneficiary, and the accounting code.

At this preliminary stage of the treasury system development, the CAD handled all payments made by DSUs, including individual payments to the accounts of ISUs. Financial management units in DSUs would send their payment requests directly to the CAD, which would check if they were within the available budget appropriation, as well as the periodic cash limits set by the treasury. Where a payment request was for a transfer to ISUs, the DSU would submit one payment request with an attached list of ISUs to receive transfers, indicating the amount for each. The CAD would then process these into individual electronic payment orders. Varying in coverage and timing, most republics in their reform process have tried to adopt some variant of this system of budget execution.

It was also recognised that the new system could include commitment recording. For example, the DSUs could submit commitment forms to the CAD's front-end operations, which would check and approve them if they were within budgetary and cash limits, after the budget department had given its approval, if this was required. Such a system was successfully introduced in Slovenia, which by then had constructed a computerised information system that could handle the extra work implied. FYR Macedonia is also introducing this system on a pilot basis. Information on these commitments was thus available, alongside accounting information, to all relevant departments in the MOF, particularly for budget and cash management purposes. As indicated, initially this was only judged feasible for large contracts. With this commitment recording in place, the process of establishing more reliable cash-flow projections, at least on the expenditure side, could be achieved, and early warning given to DSUs if the revenue situation did not meet expectations. Most other republics, however, decided to delay such a reform until their level of computerisation had been more fully developed.

4.3.5. Creating a supporting legal and institutional framework

Building capacity in the MOF, as outlined above, was typically facilitated by its institutional reorganisation. One of the most fundamental changes was to create a new treasury department, usually by redeploying sections responsible for budget execution from the budget department, but also generally requiring the recruitment of new skills. The CAD typically formed the core function in the treasury. Another change was to build up a macro

fiscal analysis and policy capability within the ministry, to replace the old-style central planning methodology typically located in the former state planning agency which mostly disappeared after independence. To empower the MOF in assuming its new role as the government financial manager also required giving it the required legal authority. This was generally done through a new budget system law that redefined the MOF's responsibilities much more comprehensively in the area of budget procedures, treasury operations, and the control and supervision of public resources. Such laws were modeled on other OECD countries, although in this initial phase of reform with the existing administrative capacity they were often not capable of being implemented fully, or else were amended regularly.

5. The reform strategy in public expenditure management: Phase two

The first phase of PEM reforms tended to focus on budget execution issues and putting in place a basic legal and institutional framework that would allow better control over government resources at the same time as giving the MOF some flexibility to make in-year adjustments if required by macroeconomic developments. The second phase of reforms, although taking the development of treasury operations a little further, can be seen as placing greater emphasis on budget preparation and management issues and tackling the fundamental weaknesses in the former SFRY budget system which were identified in Section 2 above.

5.1. Improving budget preparation and management

A reorientation in techniques of budget preparation and management is visibly under way in the former SFRY republics. In most of the republics the first steps have been taken to move away from the compliance-dominated traditional input-based system to one that stresses greater operational efficiency, greater examination of cost alternatives, the use of market mechanisms and cost recovery, and, above all, a focus on productivity and performance. In some cases this is at a very rudimentary stage, but once initiated it is expected that the pace of these reforms will increase. In most OECD countries, the budget office is not merely an assembler and consolidator of budgets prepared by others, but is more deeply involved in policy aspects of budget formulation and in the work of policy analysis and co-ordination. In the former SFRY republics, it was recognised as necessary to reorient budget preparation activities in this way towards policy and operational analysis, rather than merely remaining focused on the calculation of the cost of operations. In order to fulfill this role, the budget departments would be required to develop the capacity and authority to collect specific, detailed, and accurate information, both financial and qualitative, about government programmes and policies, and to compile and present the information to decision makers in the government and the legislature. This meant overcoming the dearth

of skills in analysis, planning, and monitoring to assist in defining the budget framework, to provide sound financial policy advice to the government, and to track the budget's performance during the year. The experience in the republics is that it is taking considerable time to build up this expertise.

One of the most important reforms for budget preparation has been the introduction of a programme classification to the budget. In principle, a programme is a collection of government activities and projects that share a common set of objectives. Conceptually, it is distinct from either an administrative or a broad functional classification based on policy. It represents a more specific operational and management orientation than a functional classification, and a more strategic policy orientation than an administrative classification. With a move to OECD budget standards, the focus was required to be progressively shifted from inputs and costs to the outputs to be achieved from budget programmes, thus enabling performance objectives or targets to be set. Such an approach highlights the underlying purpose for which public expenditure is being incurred (e.g. raising educational standards in schools) rather than the inputs used toward that purpose (e.g. per pupil expenditure on education). It is an important element in improving transparency and accountability in the budget, by enabling government to present to the legislature and the electorate the objectives and goals of its programmes and the measurable results it seeks to achieve from them. It also allows the possibility to improve overall effectiveness of expenditure, and forms the basis of an approach focusing on outputs and objectives used to force personal responsibility on programme managers in spending units for meeting output targets, while at the same time opening up the possibility of greater flexibility in deploying resources. For those countries aiming for early EU accession, such as Slovenia, an important impetus for them to review the effectiveness of government operations was the need to conform to Maastricht deficit limits and to find room for financing required EU budget contributions. Other republics may not have perceived the same urgency as Slovenia in developing their budget management system, although that attitude is now changing, especially in view of their likely eventual accession to the EU.

5.2. Providing a macroeconomic and medium-term perspective

The unsettled macroeconomic conditions encountered after independence made most republics quickly appreciate the need to develop a macroeconomic framework for fiscal policy and to set the overall annual fiscal targets for the budget to guide the ministries and lower-level governments in the preparation of their budgets.

Initially, the work of macroeconomic and fiscal analysis was severely handicapped by the very limited reporting information available. This improved with the development of the treasury system and the introduction of more meaningful budget classifications. The next stage of reform was to provide a

medium-term budget framework, consistent with the medium-term prospective developments in the economy, which is standard practice in most OECD countries. An important aspect of this exercise is to act as a consistency check on competing views of the evolution of the public finances relative to macroeconomic developments, and on this basis establish targets that can be translated into a ceiling for aggregate spending. These projections also enhance the transparency of the budget process, by forcing discussion on budget priorities and promoting a consensus on medium-term fiscal objectives. While a full medium-term budget framework (MTBF) requires forecasting a large number of different types of expenditures, often there are a few key variables (“cost drivers”) which are useful to subject different assumptions and provide a sensitivity analysis on overall aggregate expenditure ceilings.

5.3. Making the budget process more transparent

One of the fundamental principles underlying the recent process of public expenditure reforms around the world has been the promotion of greater transparency and accountability at all levels of government. This involves not only the government’s interaction with the legislature and with the public, but also the internal processes and procedures for assembling fiscal information and its review. Apart from introducing an MTBF, efforts to make the budget coverage more comprehensive – to include formerly retained revenue into budget totals; to scale down the number and size of extrabudgetary funds; to phase out such operations as tax concessions, tax offsets, concessional lending through state banks, directed social spending through state-owned enterprises; and so on – all increased the transparency of a formerly opaque budget system. Such reforms are being increasingly implemented in the former SFRY republics. The more reformed of the economies, which ceased to rely on multilateral financing and thus required market financing, have begun to appreciate that transparency in government operations was also an essential aspect of sustaining confidence in government and, through this, access to financial markets at more favourable terms. Accordingly, the more reformed countries have been interested in participating in the IMF initiative on fiscal reporting on standards and codes (ROSC). Slovenia was the first to complete a fiscal ROSC in 2001, and Croatia is likely to follow.

5.4. Developing accounting and information systems

The work in developing a treasury system that would not only replace the PB accounting and information functions but also improve upon them continued in the next phase of reform. With the closing of the PBs, there was an immediate incentive for MOFs to press ahead with improved government accounting systems, increased computerisation, and the establishment of government-wide financial management information systems.

There have been two distinct approaches to improving government accounting. The first has been to capture all stages of the spending process in the accounts. Using the PB-based accounting system, the MOF could only recognise in its records an institution's appropriation (in very aggregate form), and the PB recorded the funds released to them from the main budget account and the final cash debit from a spending unit's account – the final stages of spending, which often could only be fully reconciled with the appropriation at year's end. This system, which had the drawback of not allowing fast disclosure or monitoring of arrears, raised an interest in monitoring prior stages of spending, and, in particular, the commitment stage. By following all stages of the expenditure process in the accounts – appropriation, authorisation, commitment, obligation, obligation liquidated, and cash payment – it is possible to identify the sources and extent of the arrears problem and to get a better indication of the total resources used by the government and its future cash requirements. A second major reform, usually introduced partially in the republics, is to move the basis of accounting from cash toward accruals.

Parallel to, and in support of, the reform of the accounting system, there has been an increase in computerisation. To track the evolution of the budget with more complex classification systems and in its different stages of spending was not possible without enhanced computerisation. In addition, improved and more detailed budgetary classification systems based on a programme approach, so that costs can be allocated to individual activities to be compared with the outputs of these activities, had obvious management relevance. Similarly, moving to an accrual-based accounting system was often promoted by the existence of accounting software packages derived from commercial accounting which are generally accrual-based. Tailoring different reports to meet different management needs through a computerised accounting system has been a general public expenditure management reform attempted in the last few years by nearly all former SFRY countries. This has met with greater success in some republics; for others a considerable amount of work remains before such systems can be considered fully operational.

Simultaneously, there was need for capacity building, not just within government but within the economy as a whole, to develop the accounting function and establish accounting standards. Various elements are discernable: qualifications of accountants, particularly those occupying senior positions, to be prescribed by law; a professional certification process for public sector accountants; standardising accounting procedures; and establishing training programmes. These issues have now begun to be addressed in most of the republics.

5.5. Deepening financial management in government

The closing of the PB system removed a number of important controls in the budget process. As described previously, the PB did not merely process transactions but checked the veracity of these transactions and performed the role of external auditor. Accordingly, as part of the PB restructuring, it was important to replace these financial controls. This necessitated creating an independent supreme audit institution, again on OECD lines, as well as strengthening internal audit in government agencies. Moreover, as the republics develop a more modern devolved type of budget management model, where agencies will have wide responsibilities in resource allocation, it is essential to ensure that they operate within an effective internal financial management framework. There remains much to be done in this area.

6. Progress in reform

The progress attained in moving from these short-run reforms to more sustainable medium-term reforms has differed between republics. Usually, this has been dictated by the speed at which political and economic stability could be restored. The two republics which moved quickly ahead were essentially outside the war zone. These were Slovenia, which made rapid progress in the second half of the 1990s, and FYR Macedonia, whose problems were protracted by internal ethnic divisions and the political dispute with Greece, yet in recent years still made notable progress. In the last few years, but more noticeable after the change in government in 2000, Croatia has also begun to progress on the medium-term reforms. Serbia has only recently started to plan its reform strategy to catch up, but starting from a position where it can learn from the successes and failures of the other republics. For the most part, reform in Bosnia has been externally driven, if not forced, leading to the question of the longer-term sustainability of some of its reform efforts. To a lesser extent, reforms in Montenegro have also been externally driven. While nearly all republics still suffer fiscal strains, the second phase of reforms is underway in all republics to some degree, although they all have different starting points. Even in those that are more advanced, there remain unresolved issues (such as the status of the indirect budget users, the *zavods*) and the coverage of general government in their fiscal reporting.

6.1. The reform strategy with regard to the Payment Bureaus

The PB, as it was structured, could not be conceived as a treasury-to-be, where government agencies would hold their accounts as a substitute for bank deposits. However, the PB system was recognised as containing the basic elements out of which such a treasury system could be established. Initially, it was regarded as prudent that the reform of the PB would not destroy this

potential – at least until a treasury system could be developed in the MOF and the banking system could be strengthened. It was recommended that any reform relative to the payments system should, therefore, exclude any idea that government agencies and spending units could perform their payments without the intermediation of the PB.

As indicated, initially basic government accounting, while admittedly limited, was largely carried out by the PB. This was the general short-run approach before a more satisfactory medium-term solution was found by developing a treasury system. Improvements were made to the coding of payment orders in some republics, in conformity with reformed budget classifications, to give more economically meaningful reports. As to the medium-term solution, one option considered (*e.g.* in FYR Macedonia) was to modify the PB system to act more as a treasury and eventually transfer this to the MOF. It was argued that all the record keeping and consolidation could be carried out much more efficiently by the PB itself, using its computer facilities. The segment of the activity allocated to the PB – payment execution, accounting, and consolidation – would not differ in principle from the core paying and receiving functions assigned to computerised treasury systems under the control of the MOF. These operations, therefore, needed to be clearly identified and separated from its other functions (even if the same computer network had to be used for ordinary payments and for government payments) after which it was argued this segment of its activity could be put under MOF supervision. Movements of funds among government spending units would belong in this system, while payments from government spending units to and from other legal persons would build the link between this system and the general payments system.

While this strategy is presently being pursued in Serbia, for some republics it was very difficult to get the PB management to relinquish this important component of their operations, nor were there incentives for them to downscale their operations or plan for the PB's ultimate partition and disappearance. The case of FYR Macedonia was, in retrospect, one of delaying tactics on the part of the PB, and eventual loss of patience by the minister of finance that eventually forced the issue of the closure of the PB and the reform of the payments system in 2001. This approach was also tried in Slovenia, but the development of the treasury functions had to wait until the broader reform of the PB was implemented in 2002. Slovenia had a five-year plan for the eventual transfer of all non-government legal entities accounts from the PB to banks, with a conservative prequalification of banks. Once this had happened, a core element of the old system was retained and restructured to perform paying and receiving operations of the general government sector. In Bosnia-Herzegovina, the PB system emerged much weakened from war. Not only was it physically damaged and depleted of human resources, but the PB was partitioned along ethnic lines and used accordingly for financing political objectives, rendering its

basic clearing functions suspect. Largely at the insistence of external donors, the payments bureaus in Bosnia were forcibly closed in December 2000. This “big-bang” approach to PB reform only caused temporary disruptions to public finances particularly on the revenue side, but the experience there gave encouragement to adopt a faster track approach to closing the payments bureaus in other republics, such as Serbia and Montenegro. In yet other republics a more cautious stage approach was adopted. In Croatia, the payments bureau was recast into a commercial operation called the Financial Agency (FINA) and given a clearing house function for the banks, but otherwise left very much intact with much the same functions as before. The situation in Croatia is however evolving, as the MOF is engaged in an extensive computerisation project that will allow it to rely less and less on the PB. All countries have taken their own reform path, but, at the same time, by end-2002, all had reformed their payments systems or were implementing such reform plans. Annex A summarises this reform effort.

6.2. Progress from first- to second-phase reforms

As summarised in Table 1, the majority of the countries of the former SFRY have undertaken and accomplished most of the reforms in phase one. In Serbia, however, which began the process with the greatest lag, this has yet to be accomplished. Even for those implementing second-phase reforms, some elements of phase one still seem not to have been fully attained – in Bosnia for example, the resolution of the arrears problem in both the Bosnia-Herzegovina Federation and the Republika Srpska has yet to be fully achieved. Moreover, many countries still have to successfully resolve the internal capacity problems in their MOFs, which has not allowed the complete fulfillment of accounting and financial management reforms. With these qualifications, it is evident that between 2000 and 2002, these countries have significantly shifted into the second-phase reforms described previously.

In this movement, Slovenia has been the first to lead the way. Budget preparation and in-year management have been considerably improved by extensive training and capacity building. Slovenia introduced a programme classification in 2000 on a pilot basis which was fully implemented in the 2001 budget; FYR Macedonia began introducing programme budgeting in pilot ministries in 2001; Montenegro’s new budget classification of 2001 has functions from the Government Finance Statistics (GFS) and a basic programme structure; and it is apparent that Croatia also is seriously considering piloting the programme approach. The latter’s new chart of accounts allows detailed specification of activities and projects that would facilitate identification of the programme structure;¹² however, this may hold the danger that the programme structure is only seen as a way of retabulating budgetary data and not for decision-making purposes.

Table 1. Progress in First-Phase Reforms
Assessment made as of December 2002

	FBIH	Srpska	Croatia	Serbia	Montenegro	FYR Macedonia	Slovenia
1. Clear delineation of institutional limits of the budget							
a. Complete inventory/classification of government units	No	No	Yes	Yes	Yes	Yes	Yes
b. Regulations on opening/closing bank accounts	Yes	Yes	Yes	Yes	Yes	Yes	Yes
c. Own revenues now included in regular budget	Partial	Partial	Yes	Partial	No	Yes	Yes
2. Improved reporting							
a. From the payments bureau	Partial	Partial	No	Yes	Yes	Partial	Yes
b. From treasury	Partial	Partial	Yes	No	Partial	Yes	Yes
c. Using internationally accepted classifications	Yes	Yes	Yes	Yes	Yes	Yes	Yes
3. Arrears problem addressed							
a. Full arrears situation known	No	No	Yes	No	No	Partial	Yes
b. Commitment monitoring	No	No	Partial	No	No	Partial	Yes
c. Adequate commitment control	No	No	No	No	No	No	Partial
4. Accounting function established in the MOF	Yes	Yes	Partial	No	No	Yes	Yes
5. Cash management improved							
a. Financial planning strengthened	Partial	Partial	Partial	Partial	Partial	Partial	Yes
b. TSA substantially established	Partial	Partial	Partial	Partial	Partial	Partial	Yes
6. Budget execution controlled by the MOF							
a. Moved from budget department to treasury	Yes	Yes	Yes	Partial	Yes	Yes	Yes
b. ISUs payment orders also processed	No	No	No	No	No	No	No
7. Budget system law revised along international lines	Yes	Yes	Yes	Yes	Yes	Yes	Yes
8. MOF reorganised							
a. Treasury department established and functioning	Yes	Yes	Yes	Partial	Partial	Yes	Yes
b. MOF strengthened in human resources	Partial	Partial	Partial	Partial	Partial	Partial	Yes

Source: Diamond and Last.

Most of the republics have moved to provide a **macroeconomic and medium-term perspective to their budgets**. For many, this evolved from the economic adjustment programmes they have had with the IMF, which stressed the need for local counterparts to develop macroeconomic forecasting, policy, and analysis capabilities. Some have progressed beyond this stage. Slovenia, with the assistance from an EU-funded Swedish twinning project, introduced in 2000 a two-stage top-down approach to budget formulation. Macroeconomic decisions on the economy's evolution determined the future deficit/surplus, with implied ceilings, for discussion with line ministries at a high level before final negotiations on the detailed budgets. This process was further refined in 2001 by the introduction of a two-year detailed budget, aimed mainly at avoiding temporary financing and at providing a more secure horizon for the government's investment programmes. The FYR Macedonia budget circular also is increasingly based on a top-down process, with ongoing work to develop a medium-term macroeconomic framework, with explicit medium-term government priorities that can provide expenditure ceilings. Croatia is also at the early stages of developing a medium-term approach to its budget with a view to meeting EU monitoring and reporting requirements, following closely in the footsteps of Slovenia.¹³

All republics have succeeded in **making the budget process more transparent**, through improved budget procedures, usually required by new legislation. Slovenia, with improved economic and programme classifications, has provided a better link between priorities and the budget, and consequently political discussion in parliament on policy issues is more informed (amendments are allowed on the sub-programme level). Also introduced were new supporting documents and reporting requirements (to support performance auditing) making for a much more transparent budget document. The new Public Finance Act, passed in 1999, had as one of its requirements a listing of all the institutions of general government (some 3 200 entities).¹⁴ The entities in Bosnia-Herzegovina have been pushed by external donors to improve transparency. Budget laws have been adopted by the entities that improve the transparency of the budget procedures, limit the borrowing by sub-national governments, and incorporate own revenues of ministries and budget institutions into the entity budgets. Unfortunately, owing to the highly decentralised government structure, fiscal reporting continues to be generally weak and fragmented. FYR Macedonia has continuously improved its organic budget law, as it also has taken major steps in better defining the role of government and redefining state functions and activities and, since 2001, has introduced legal changes to divest non-core activities to the private sector. Montenegro's new budget system law, passed in August 2001, similarly helped make budget procedures more transparent. Serbia has recently introduced significant legislation in 2002: an organic budget law, an accounting law, and a law on government administration, which together aim to

reform its budget system to catch up with the other republics. The budget law provides a comprehensive cycle for the preparation, adoption, execution, control, and accounting of the budget. It sets out a clear timetable for the adoption of the budget before the start of the financial year. Considerable effort has been made to improve the coverage of the budget to include own or retained revenues, by identifying and allocating these revenues alongside budgetary resources in the 2002 budget documents.

Transparency has also been served by other major reforms. For example, the audit function has generally been redefined and considerably strengthened. In 2000, auditors general were appointed for the Bosnian entities, and this was followed by audits of budget execution for 2001 in Republika Srpska, and external audits of military operations have also occurred in Bosnia-Herzegovina Federation. The Montenegrin Budget Law of 2001 specified not only a treasury department and its functions, but also a department of internal audit. FYR Macedonia has strengthened its internal audit with a new department being created in the MOF in 2000, as well as establishing the State Audit Office as the external auditor of the government. Unfortunately, both institutions have found it difficult to recruit staff. Slovenia recently strengthened its Court of Audit to meet EU standards. All republics have introduced new public procurement laws to meet international standards, and they are all addressing the need to strengthen and modernise internal control and audit. Transparency has also benefited from the move to a TSA, closing the accounts of spending units and subunits, recording payments between government entities, and ensuring prompt accounting records and more timely and meaningful fiscal reports. In 2001, Slovenia undertook and published a fiscal ROSC (reporting on standards and codes), and Croatia is considering following suit.

There has been a general recognition of the need to **develop accounting and information systems**. Slovenia has established centralised financial management and reporting standards to be applied by all general government units through its Law on Public Finance. Based on the Accounting Law, which came into effect in 2000, cash-based accounting was prescribed for all general government units, but with additional requirements for accrual accounting by around 1 500 general government institutions classified as indirect budget users. The Bosnia-Herzegovina Organic Budget Law in 1998 spelled out the role of the treasury, but only with the regulations regarding treasury operations in 2000 (amended in 2001) were the TSA and general treasury ledger established. This, in turn, required introducing regulations on budget accounting the same year that were supported in the subsequent year with financial regulations regarding the chart of accounts, financial reporting, and annual accounts. Generally, as these countries changed their budget classifications to international standards, so too were amendments made to the government chart of accounts (e.g. Croatia in 2002).

All countries have turned to computerised information systems as a means to fulfill their new accounting and reporting requirements. In Slovenia, budget execution and accounting are supported by a locally developed software package for all central government units provided by the MOF (MFERAC). In addition, in the last five years, considerable effort has been directed to computerising the budget preparation process. The budget department now has a fully operational government-wide budget submission system that allows subsequent modifications and provides the electronic budget documents data that are transmitted to parliament in the first week of October. The changes made in parliamentary deliberations are also recorded, and then the final appropriation data are transferred to the government's MFERAC information system. Most other countries have concentrated their efforts on budget execution, partly to cope with the closing of their payments bureaus. In FYR Macedonia – following the creation of a treasury department in the MOF in 2000 – with the reconstruction of the payments bureau, the control of expenditures passed to a treasury system. The system operated a domestically operated software application, an “interim system”, to allow the treasury to operate with a TSA in the National Bank. The system uses a relational database and includes complete budget control, payment request approval and a payment order generator, revenue recording, reconciliation with accounting, and the facility to export data to Excel. The software was expanded to allow communication between the treasury and the National Bank's real-time gross settlement (RTGS). It is planned to replace this with a more modern integrated accounting system in the near future. In Croatia, a financial management information system (FMIS) has been developed, based on the SAP software within the MOF, that allows the MOF to communicate with other central government DSUs, but not used by them. As previously indicated, the Bosnian entities have benefited from an externally financed computerisation project by the United States Agency for International Development (USAID), which provided Oracle Financial software to support the various treasuries. Similarly, Montenegro has benefited from a less extensive EU-funded FUMES but recently has moved to adopt an integrated FMIS, with SAP software, and Serbia is planning to follow the same route.

Generally, the republics of the former SFRY have not done so well in **deepening government financial management capacity**. Slovenia, which has been developing its treasury system for the longest period, is perhaps an exception. In 1996, it reorganised its treasury department into two departments, one for cash management and the other for public debt. This allowed specialisation and skill development: the former specialising in liquidity management and the money market use of funds in overnight deposits; the latter in establishing the capacity to issue bonds in the European market, as well as in developing the domestic market in longer-term government debt,

including development of a repossession facility with government securities. Some republics, however, have not introduced a full TSA. In Croatia, although budget institutions still maintain foreign exchange accounts, many of the payments are made directly to suppliers via the TSA. Other republics are in the process of recruiting and training their staffs in new skills required for an increasing range of treasury functions. For example, FYR Macedonia has introduced a central register of public servants and other employees in the public administration, on which basis it has new software for updating monthly and monitoring public employee expenditure. There are also plans to begin a treasury bill auction, to replace that of the National Bank and to take over debt management functions from it. However, taking on new functions such as this has demonstrated a potential constraint – most MOFs are generally weak in financial management skills, and this is even more true of the other government agencies.

Recognising this constraint has occasioned a new regional initiative. All republics of the former SFRY have major ongoing reform agendas, and all are keenly aware of the need to train/retain their staff to ensure that these reforms stay on course. However, local public service training has, on the whole, not kept pace with the changing environment, and the universities have also been slow to modernise their curricula. In 2001, the Center of Excellence in Finance (CEF) was created to meet these needs. Slovenia, whose reforms are probably the most advanced in the region, has made both financial and technical commitments to supporting the new center that was established in Ljubljana. The CEF has benefited from significant lecturer resource assistance from a wide range of bilateral and multilateral donors and institutions, including the IMF. The CEF is currently developing a PEM training programme for newly recruited public finance staff in both central and local governments, and expects that this programme will eventually be situated in local training institutions. A second area of focus is the development of a training and certification programme for public accountants to meet a critical shortage faced by the region.

7. The lessons learned

The first lesson learned is that some degree of economic and political stability was required before reform initiatives could really get under way. The significance of the specific republic's history and starting point significantly influenced the reform process. While some republics emerged to independence in a situation of war, some even in civil war, and others with significant internal tensions, the speed of reform was significantly affected by the speed with which peace was restored. Added to the conflict was the significant economic disruption which created further problems. Sometimes it is argued that disruption to the status quo is essential to foster change. At the same time, it

can be argued that too much disruption can overwhelm reformers, since they are too preoccupied with short-run issues and find it difficult to gain widespread support for changes that bring benefits in the longer term. The experience of the former SFRY republics seems to support the latter view.

The second lesson is that inadequate administrative capacity can constrain reform. The budget systems created, either in law or by change of policies, evidently suffered because of the inability to administer them. Experience shows that it takes time to develop adequate capacity in the MOF to be able to operate the new systems. In part, this was a reflection of the lack of initial power by the MOF *vis-à-vis* other ministries and the inherited SDK institutions, but was also in part a question of the human resource base that eventually had to be replenished with outside recruits or with a younger generation more open to market ideas.

Third, budget system reform was constrained by the pace of reforms in other parallel areas. In particular, the financial sectors of the republics needed to be restructured by reforming the PB clearing system and allowing the banking sector to develop under the control of the central bank. All such changes required capacity building and innovation in these parallel sectors before the budget system could itself be moved onto a more market-based footing. Even now, most republics exhibit basic weaknesses in areas complementary to budget system reform, such as banking, accounting systems, procurement, and auditing.

Fourth, and most notably, most republics lacked a strategic plan for reform. Much of the initial reform was prompted by outside advice and often by external conditionality, rather than by the result of an internalised reform plan, with the notable exception of Slovenia. Republics moved toward such a strategic plan at different speeds. Slovenia, which started from the best initial conditions, was perhaps the first to arrive at a reform strategy; Serbia, owing to prolonged hostilities, was perhaps the last.

If one is to interpret the reform experience of the former SFRY republics in terms of change-management methodology, then it is possible to identify other key components that were often missing. Successful institutional change is thought to involve at least the following elements: recognition of a sense of urgency to make a change; development of a powerful enough coalition to support the change; identification of a champion of change, who creates a common vision and communicates and “sells” it; empowering others and giving them resources to act; and building the reform process stepwise on early successes and progressively institutionalising the changes.

Applying the change-management paradigm, the first element (the sense of urgency) was common to all republics. However, in some republics which were more homogeneous, such as Slovenia, it was easier to form a coalition

for change. When this was coupled with a long-standing champion of change, as in Slovenia, the combination soon produced a strategic vision and a medium-term plan for reform that was implementable. Other republics had to await the appearance of a champion before reforms could be energised (e.g. FYR Macedonia after 1999 and Serbia after 2001). For some countries, such as Croatia, the reform agenda was never clearly defined, without which the strategic vision reforms have been piecemeal and have been slow. The initial lack of an agreed reform strategy and work plan also often meant that the technical assistance was delivered ineffectively and sometimes inappropriately, sometimes supporting the agenda of the donor country rather than that of the recipient (for example, initially in Bosnia).

Finally, the case of former SFRY countries clearly shows the influence of peer pressure and best practice within the region. The presence within the group of a model for others to follow, in this case mainly Slovenia, has helped shorten the reform timeframe. The success of reforms in Slovenia provided the others, who all shared the same institutions inherited from the SFRY, with working solutions as well as highlighted mistakes to avoid. In this context, the establishment of the CEF regional centre provided a unique and important forum in which to exchange and disseminate reform ideas and experiences.

Notes

1. For example, Slovenia, the second smallest republic, had over 600 of these.
2. Many *zavods* could be excluded from the definition of general government, sometimes straddling the grey area between public policy and enterprise functions, and between public policy and local interest groups. In this context, it is important to note that, even today, in these republics the notion of “nonprofit” is almost universally used interchangeably with the function of the *zavod*.
3. On independence, typically the budget formulation process still bore the imprint of the system inherited from the SFRY. In the Republic of Serbia, for example, in the 2001 budget, there were only 250 budget lines, divided among some 40 main titles, most of which represented ministries or major government institutions. Each ministry would have on average six or seven positions, of which two were salaries and material costs.
4. This is in Serbo Croatian; or *Sluba drubenega knjigovodstva* in Slovenian; and *Sluzhbata na Opshestvenoto Knigovodstvo* in Macedonian.
5. Since the word “treasury” refers to different concepts in different countries, it should be noted that in the former SFRY this was defined quite broadly in functional terms: to make payments in and out of the government account, to manage this through a consolidated government bank account, to account for and report on all these transactions in a common ledger, and to act as the financial planner and manager of the government. Of course, in all countries the institutional arrangements to perform these functions differ, and it is not surprising that the treasury systems that emerged during the 1990s reflected individual country characteristics.

6. Rationalisation of accounts was often hampered by certain power ministries and institutions, and where there were complications arising from the geographical distribution of their direct and indirect users (*e.g.* courts and the ministry of the interior).
7. General government in the Yugoslav context typically included: the federal and republic governments, their ministries and dependent agencies, funds and public authorities and institutions; all local and regional governments, parliaments, assemblies and councils, their dependent departments, local administrative units, funds and public authorities and institutions; and all independent public authorities and institutions, including those of constitutional, parliamentary, and legal nature, attached to central or local governments.
8. Albeit this was found to be difficult in Serbia initially because the JSA was under the President's Office.
9. By 2000 only Serbia and Montenegro remained within the Federal Republic of Yugoslavia, which was officially dissolved in 2002 with the creation of a looser association called Serbia and Montenegro.
10. It was recognised that the number of Montenegrin entities may be incomplete, given the independence of their payments bureau operations.
11. At the time of independence, it was found that many government institutions also had foreign exchange accounts. Accordingly, it was usually recommended that these foreign exchange deposits be converted as soon as possible into domestic currency and integrated into existing domestic giro accounts.
12. The 2002 budget was tabled at the level of activities/projects.
13. It should also be noted that recently both the Federation of Bosnia-Herzegovina (FBiH) and the Republic Srpska (RS) undertook a medium-term expenditure review.
14. In the process, many inconsistencies were resolved. This cleared the way for common treasury management rules to be prescribed for all in 2001/02.

ANNEX A

SDK Reform in the Move to a Market System

Functions of the SDK

To understand the key role of the SDK system is to understand why the reform of this system was a precondition for fundamental budget system reforms. As indicated above, the former SFRY's financial system revolved round social accounting service (SDK) functions.

Payments clearing

The *raison d'être* of the SDK centred on its payments functions. Once legally established, all organisations had to register with the SDK and open a single so-called "giro account" maintained at the SDK office where the legal entity was located. All payments had to go through these special accounts. When the giro account was opened, its holder designated one or more sight deposits (with special code numbers under the banking accounting plan) with a commercial bank of its choice. These were the accounts where the money would be held, and where in- and out-payments were made. The single giro accounts held with the SDK were mere duplicates of the matching deposits held with banks. Through the giro accounts, the SDK, instead of the banks, was the manager and record keeper of the matching bank deposits. The SDK giro accounts functioned as mirror images of the bank accounts, and the SDK itself did not perform any deposit-taking or lending operations. Legal entities could hold time bank deposits not linked to SDK accounts. However, debits and credits to these accounts would have as a counterpart a credit or debit to the sight deposit controlled by the SDK, as any other financial or non-financial transaction.

Each government agency or spending unit also had one (occasionally more than one) SDK giro account (typically a Number 603 account), which mirrored a deposit with a commercial bank rather than with the national bank – although main ministries and other first-level budget institutions (direct

spending units, DSUs) usually had their accounts in the national bank (designated Number 637). In addition, there were numerous transient giro accounts where tax receipts were credited before being transferred to a general “budget giro account” (account Number 630). The latter typically had a matching deposit with the national bank that was under the control of the MOF and was debited with budget payments (actually transfers to the giro accounts of the spending units). Thus, expenditure took place by electronic transfer, debiting the main budget account Number 630, and crediting the Number 637 accounts of main budget users, the DSUs. The latter distributed these funds to their subsidiary units, ISUs, to Number 603 accounts.

Banks also had a single giro account with the SDK, which mirrored their ordinary deposit account (or giro account) with the national bank, which in turn also had an SDK account. The SDK knew the balances held by banks in separate required reserve accounts with the NBM, as it could exceptionally draw on them. The SDK had a monopoly on payments – legal entities were obliged to carry all domestic payments through the SDK; this included all government agencies, banks, and even the national bank. It also included payments that were a counterpart to credits or other financial operations, as in the case of banks or the national bank. By contrast, foreign exchange payments (both abroad and domestic) were performed by the banking system without the intermediation of the SDK. As the SDK covered only legal entities, households interacted directly with banks, where they held their accounts. They could deposit cash, get reimbursements in cash, or issue payment orders which were executed directly by banks through the SDK system. Payments were executed through the SDK on the basis of payment orders, whereby money was transferred from the payer’s account to the payee’s account.

Using its extensive computer facilities and regional branch network, the SDK was able to execute almost all payment orders within 24 hours across the whole country, as legally prescribed. The system was highly efficient from this point of view, though highly inefficient if account is taken of the effort required to deliver payment orders to SDK offices and to retrieve information on payments inflows and final deposit balances from the SDK. The inability of banks and the national bank to directly credit or debit their clients on account of other financial operations, as well as to carry out payments among clients of the same institution, involved additional inefficiencies.

Bank clearing

For the net result of payment orders issued by the banks’ clients, plus orders issued by banks themselves, the SDK had to enter a net debit or credit in the bank’s own giro accounts (deposits with the national bank). As a result, the SDK performed the functions that clearing houses and other netting

arrangements perform in other countries. New payment orders would not be processed if, according to the results of the last clearing, there was not a sufficient balance in the payer's account. As a result, no overdrafts could appear on the accounts of the bank's clients. By contrast, a cash deficiency could result on any settlement in some bank's giro account. Therefore payments may be considered final for clients, though not for banks. Usually from 10:00 a.m. onward, banks could know the position of their giro accounts after the provisional clearings, and could undertake measures to cover any deficiency of liquidity. Even if they did not do so, the SDK was entitled to automatically cover any deficiency with the required reserves of the banks held with the national bank, which was consequently the institution incurring the credit risk.

Cash distribution

Legal entities had a limit, assigned by the SDK or agreed with it, on the volume of their cash holdings. Any excess had to be deposited in the giro account (transfers through the post office were also available for this purpose). Legal entities in need also had to obtain cash from the SDK. This was only possible within limits, and only for certain declared purposes, subject to SDK scrutiny. Banks' cash needs (related to transactions with households) were subject to similar rules. As a result, the SDK was the only possible intermediary between the national bank and the rest of the economy concerning the distribution of coins and banknotes, necessitating that it maintain a nation-wide system of strong rooms. This implied that the SDK needed to maintain a correspondent account with the national bank, through which cash deliveries between the national bank and the SDK were registered. The cash delivery function implied that there had to be some permanent financial relation between the SDK and the national bank.

Tax collection functions

The collection of taxes was also made through the SDK. On tax collection dates, enterprises had to present to the SDK a payment order, together with a form specific for each tax. Tax proceeds were credited in some transient giro accounts in the SDK, according to the type of tax. These were subsequently debited, and the total revenue was credited to the general budget giro account Number 630, controlled by the MOF.

Since the most important taxes (sales, wages) were based on payments which must have been carried out through the SDK, it was in a position to immediately check the accuracy of the assessment. In case of failure in presenting the payment order when due, or of disagreement with the tax assessment, the SDK would stop the execution of any payment order of the defaulting entity, and would charge penalty interest rates on delayed tax payments. Eventually, the SDK was in charge of procedures for sanctioning tax

default. This was in the past a very expedient system of tax collection; however, with the introduction of new taxes, this became a large source of tax evasion. Enterprises, particularly in the case of the new private enterprises, turned to cash payments, avoiding SDK mediation partly or altogether, and so avoided the payment of taxes assessed or controlled through gross payments.

Control functions

Apart from the information stemming from payment orders, the SDK was obligated to receive different reports submitted by all legal entities, including government agencies, concerning their activity. Enterprises had to submit quarterly reports on taxes paid and other legal obligations, and half-yearly reports with income statements and a balance sheet. Other legal persons were obliged to submit yearly reports. This information was the basis for the general audit functions assigned to the SDK. These functions centred on the legality aspects rather than on performance criteria. A special role was typically assigned to the SDK in starting bankruptcy procedures of legal entities facing payment difficulties.

Information functions

In addition to providing each account holder with all the relevant payments information, the SDK produced a large number of reports, some yearly, some quarterly or monthly. For example, the monthly reports on budget revenues made to the MOF were critical for cash planning purposes. There were some annual and semi-annual reports on government expenditure which, however, were not based on information collected through the payments mechanism but on the reports submitted to the SDK by the spending agencies. Except in the case of government agencies, the SDK charged fees for these reports. The SDK was a major source of data for the official statistical yearbook.

Quite clearly, the SDK was a very powerful organ of the socialist state. The concentration of power to move funds, and the consequent information it possessed, were viewed suspiciously even before the collapse of the SFRY. Clearly, it carried out many of the control and supervisory functions of a central bank and hence stood in the way of the more modern conception of an independent and powerful central bank. Moreover, its monopoly on payments transactions was a barrier to allowing the commercial banking system to develop on market-based lines.

Reform of the SDK system

The progress in reforming the SDK system is summarised below.

Bosnia and Herzegovina – Federation of BiH (FBiH) and Republic Srpska (RS)

The closure of the three BiH payments bureaus¹ by 31st December 2000 was agreed by all parties at the Madrid conference following the Dayton accords, and follow-up pressure from the international community ensured that this decision was implemented on that date. While the closure of the PBs was abrupt, with immediate and wholesale movement to the banks for all customers, the implementation of new treasury systems to replace transaction processing previously managed by the PBs was considerably complicated by the number of levels of government involved – the State of Bosnia and Herzegovina (BiH), the Federation of Bosnia and Herzegovina (FBiH), the Republic of Srpska (RS), and the FBiH cantons, not to mention lower-level local governments and municipalities. On the revenue side in particular, the transition was difficult and problematic, as tax payment transactions through the banking system failed to identify both the taxpayer and the nature of the payment, making the accounting (and sharing of revenues) impossible. The government banking arrangements were further complicated by the unwillingness of the RS and the FBiH to use the “common” central bank for their main operating account. Instead they used commercial banks that were individually favoured by each government for political reasons (which resulted in two banks for the FBiH).

The changeover was assisted by external involvement in the process, in particular in the provision of computerised systems for the new treasury operations. USAID provided the bulk of this assistance, through the provision and customisation of the Oracle Financial software to support the various treasuries (locally known as the SUFI system) whose deployment started in 2001 but was only completed in 2002. USAID also provided last-minute support for the development of a special software application for revenue recording and sharing which was ready in January 2001. Both these systems went a long way towards replacing the functions previously performed by the PBs. These systems allowed the maintenance of treasury general ledgers, so that with the closing of the budget institutions’ bank accounts, new ledger accounts could be opened instead, thus allowing a TSA to be established in each entity (FBiH and RS). In the RS the treasury management and banking arrangements went further, with the establishment of branch treasury offices operating zero balanced transit accounts in commercial banks to look after regional revenue collection and to service the transactions of budget users based within their region. In contrast, the FBiH has only two branches (Sarajevo and Mostar) to cover, given that most service delivery operations are carried out in the cantons. To simplify the move, both entities limited the need for cash transactions for the launch of the new system.

The Bosnia State Treasury's conversion to a TSA was delayed to mid-2002, owing to delays in the software implementation and the special problems of putting in place arrangements for making payments to field locations (*e.g.* state border services).

In Republika Srpska, the successor to the SDK, the SPP, was closed and its activities passed to the APIF as an independent but publicly owned entity in charge of payments clearing. The Central Bank of BiH (Banja Luka Branch) took over the bank clearing, and the institutions transferred their accounts from the SPP to the commercial banks. The APIF took control of former payments bureau functions such as registration of legal entities and statistical returns, and maintained a residual IT capacity, which in theory allowed it to supply services to anyone but in practice mainly to government bodies. Tax administration received some staff from the SPP, with tax collection made through the banks, and other staff joined the treasury.

In retrospect, the "big-bang" approach to the payments bureau reform was not as disruptive as would have first been expected, largely due to significant levels of external technical assistance, but also because in the BiH the SDK system had already broken down. At the same time, there were losses of information (*e.g.* company statistics collection from end-of-year accounts had a two-year gap in their completion) and the lack of preparation in the treasury initially resulted in a significant loss of control over public finances, particularly in the FBiH.

Croatia

The Croatian payments bureau (called *Zavod za platni promet*, ZAP) was transformed into the Financial Agency on 1st January 2002, based on the Financial Agency and National Payments System Acts. Under these new arrangements, the responsibility for payments systems operations that were performed by ZAP were transferred to the Croatian National Bank, and the commercial banks were put in charge of processing and clearing their own payments. The National Bank had previously established an RTGS system in April 1999. The National Clearing System was established in 2002 as an independent operation managed by a branch of the Financial Agency. The Financial Agency also continued to provide agency services to the banking sector to handle payments operations, as many of the commercial banks had not made the required investment in systems and resources by the time the new law came into force. ZAP employees continued working as employees of the Financial Agency.

In Croatia, the migration of accounts from the ZAP to the banks was completed in one step, including the accounts of the DSU and ISUs. However all DSU and ISU accounts are to be reported to the Financial Agency, and the

banks are to provide regular balances on them. According to the Croatian National Bank Law, the accounts of the republic are managed through the National Bank, but the SU accounts are opened and managed through the commercial banks. The banks also receive and process payment orders for revenues and other budgetary receipts that must be filled in according to a 2000 Order of the MOF, and banks must have IT applications that assure compliance with this Order.

Banks that maintain the accounts of local government and municipal accounts are obliged to report daily on payments made and disbursements from those accounts. Information is sent to the Financial Agency on magnetic media in a form prescribed by the MOF Order. Since the Financial Agency also provides services to the banks in processing revenue payment orders, there was little change in the flow of information. For those banks not using this service, there were some initial problems in information that appear to have been resolved. On a contractual basis, the Financial Agency also performs tax sharing between central and local governments. In the treasury, the MOF has the capacity to process a significant part of the wage bill. Salary slips from ISUs in the education, social welfare, and judiciary branches are collected and processed by the Financial Agency and settled centrally from the various transfer budgets. Cash management is now a treasury function.

Serbia

Serbia only began a transformation of its payments bureau (called ZOP) beginning in October 2001, although it had taken a first step in the early 1990s by placing it under the supervision of the Federal Central Bank. The Law on Payments Transactions was adopted on January 2002, to take effect on 1st January 2003. This prescribed that all accounts of legal entities and physical persons would be moved to the banks and only denominated in dinars. The National Bank of Yugoslavia (NBY) will maintain clearing house settlement accounts and the giro accounts of the federal government and the Republic of Serbia. As in Slovenia, a part of the ZOP was employed as an agent for government payments transacting. And as in Croatia, the ZOP can provide agency services to the banking sector. The federal and state governments had until 31st December 2003 to establish a TSA. The payment system is based on an RTGS run by the NBY and a clearing house for small-scale transactions. To participate in the RTGS, a bank must be licensed by the NBY. The transition period for migration was very short, but it appears that, despite some minor disruptions in tax collections, the changeover on 1st January 2003 went rather smoothly, probably owing to lessons learned from the experience of Bosnia. It is envisaged that the NBY will maintain accounts for collection of public funds and allocate funds from such accounts up until December 2003.

Montenegro

The approach to payments bureau reform in Montenegro was to divest all non payments functions from the ZOP and reallocate them to successor institutions. The retained central processing and communications network was then taken over by the central bank, and the ZOP branch network was transferred to the commercial banks, still connected to the central processing hub. This meant that the payments service, its role as fiscal agent, and the giro and wide area network (WAN) services were integrated under the Central Bank of Montenegro (CBOM) management. In this way, Montenegro shied away from major changes, opting for modifications of present systems. There was no major investment in new IT systems (RTGS, a clearing house, or even commercial banking systems), providing a breathing space for the development of more modern and market-oriented systems. At this time, it is unclear if this deregulated giro system and WAN communications service for the banks are sustainable in the long term. Much will depend on the extent to which they are willing to subscribe to these services and how much they will opt for other solutions. At the moment, the inter-bank RTGS operating within the modified system appears to be functioning reasonably well.

FYR Macedonia

In the 1990s, the ZPP worked closely with the MOF to develop more effective reporting systems for government transactions, particularly on the expenditure side. This close collaboration began to wane, however, when it became evident that the government wished to reform the payments system in line with market economy practices. FYR Macedonia passed the ZPP Reconstruction Law in 2001, and in December 2001 it dismantled its payments bureau. The law provided for the accounts of budget users to be transferred to the treasury from the ZPP. An RTGS system managed by the National Bank of Macedonia (NBM) and the Agency for Inter-Bank Clearing System (KIBS) were the successor institutions to handle payments. A new revenue payment order was established, requiring the taxpayer to enter the correct tax code when making payment, and thereafter the Public Revenue Office (PRO) took over ZPP branch offices as local tax offices. A Skopje Treasury Office was formed (with staff and associated software transferred from the ZPP) to handle payment requests in the capital area. The other payments covered by a small treasury presence in the regional branch offices were taken over by the PRO. This was preceded by intense activity in 2001 in completing the alternative treasury system, based on the operation of a TSA. This was accomplished in two phases. The first phase, before the closure of the ZPP at end-2001, required the treasury to create software for the treasury general ledger (TGL) and the NBM to create a new payment system based on a clearinghouse for small-scale

transactions and the RTGS for large-scale transactions. The system required budget users to submit monthly spending plans to the treasury department, which approves and records them using specifically tailored software. The treasury then gives the budget user authority for its monthly expenditures. The budget users submit their requests centrally to the treasury, which electronically submits a payment order to the central bank, recording the transactions in a TGL. The central bank, via the new clearing RTGS, credits the accounts of the suppliers, giving online electronic reports of the inflows, outflows, and balance of the TSA to the treasury.

The second phase of the reform process under way involves budget units having increasing electronic access to the system, so that they can view their accounts and obtain online reports through a combination of prepared reports and download capability. At first, only the main budget units, the major DSUs, would be online to the treasury, and the ISUs would communicate electronically through their supervising ministries (DSUs). Beginning in 2003, the plan is to extend online connection to the smaller DSUs and larger ISUs, as well as to improve the methods for ISUs to directly communicate with their supervising DSU.

Slovenia

Work on the payments system reform started in the early 1990s, although institutional difficulties prevented the reform from being concluded at that time. However, in the mid-1990s, the Central Bank established the RTGS and small values clearing systems, imposed in-day reporting on the position of the banks at the payments bureau, and developed its own retail account management system for government users. During this period, the payments bureau shed some of its tasks, namely tax functions to the Tax Administration (along with 600-800 staff), banknote distribution to the Central Bank, and auditing to the Court of Audit. With this background, and with mounting pressure to implement a payments system reform, a renewed and concerted effort started in 1999, this time with MOF involvement as both referee and interested party. The Law on the Reform of the Payments System was drafted, with sections added to deal with the dismantling of the payments bureau, including the creation of two new entities, the Office of Public Payments (UJP), and the Office of Public Financial Records. The work on treasury reforms strongly influenced the drafting of the law, particularly with regards to the UJP, which was assigned the specific task of handling all general government transactions.

The Law on the Reform of the Payments System was adopted in March 2002 and implemented on 1st July 2002, determining the closure of the payments bureau at end-2002. Migration of business legal entities started in

batches from late 1999, under provisions in the old legislation. The gradual migration gave the banks time to adapt their operations to suit the needs of corporate clients, and the payments bureau time to downsize its operations and shed its staff gradually, with full union involvement and agreement. The 2003 budget received a windfall from the accumulated reserves of the payments bureau, part of which was earmarked for the development of a TGL system to be installed in the UJP, with the staff complement of around 250. By July 2002, 193 TSA accounts were established at the Central Bank (one central government and 192 local governments), and all accounts of central government, EBFs, and local governments, as well as those of the 1 500 third-level institutions (*zavods*), were established as sub-accounts of one of these TSAs. All general government budget users have therefore de facto become part of the TSA system and do not have their own bank accounts. All transactions (including own-source receipts and payments, and tax receipts) are processed through TSA sub-accounts maintained by the UJP. For the moment, ISUs continue to deposit their surpluses in the commercial banks independently, although the central treasury has begun to offer its own short-term deposit facilities aimed at attracting these surpluses.

Note

1. In the FBiH, there were two PBs: ZAP in the Croatian-dominated part, and ZPP in the rest. In the RS, the PB was known as the SPP. All three PBs had become heavily involved in financial transactions in support of the ethnic conflict, and were perceived to be highly politicised and factional after the Dayton accords.

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