Public financial management faces more and different challenges in transition economies than in most OECD economies, writes *Stephen MacLeod*.

Good practices are the key

The impact of poor public financial management (PFM) on the national economy frequently goes well beyond mere inefficiency and wastage of public funds. A government that cannot pay its bills undermines the legal basis of commerce; one that borrows more funds than it needs adversely impacts the money supply. Poor investment planning can hamper development and lead to financial problems in future years.

Good PFM is a key element in the ability of governments to fulfil their role efficiently, effectively and economically. Governments are the largest single entity participating in the national economy.

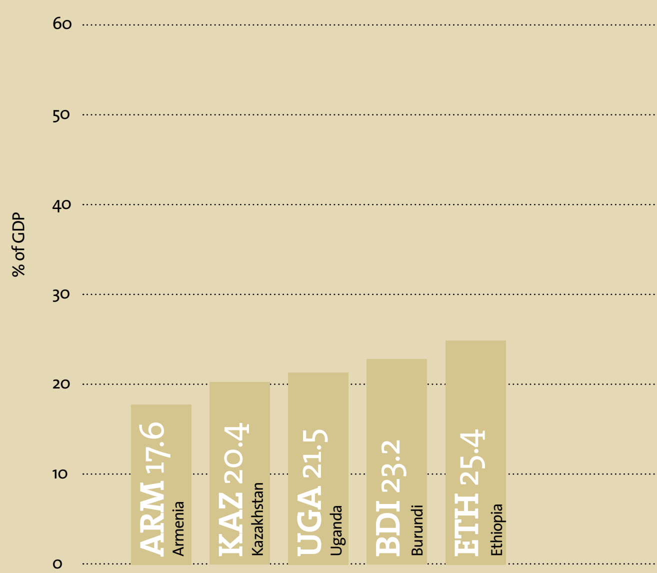
Unless the practices in transition economies move closer to the good practices in place in many OECD countries, it is highly likely that there will continue to be considerable inefficiency and wastage in the public sector of transition countries. The tension inherent in the need to balance limited resources against competing claims from line ministries ensures that the slightest weakness in the PFM system will be exploited and the integrity of the process consequently jeopardised.

A system that fails to control budget execution, enforce aggregate fiscal discipline or provide allocative efficiency will not result in budgetary outcomes that form a stable basis for the effective implementation of government programs and policies. A weak ministry of finance – whether as the result of institutional weakness or because it lacks the necessary technical competence to fulfil its analytical role – will undermine the integrity of otherwise sound budget execution and preparation processes.

When all the elements of the PFM system work together, when there is an authoritative ministry of finance, firm rules that are rigorously enforced, fiscal discipline endorsed from the highest level, and allocative efficiency in the distribution of resources, then the processes will deliver the predictable outcomes and stability necessary for the efficient and effective implementation of government programs. Without such a basis for government activity, most other public sector reforms are nugatory and the effect on the overall national economy detrimental.

Figure 1 shows that consolidated general government expenditure represents an average of 42.2 per cent of gross domestic product (GDP) among OECD member states and may be an even larger percentage in transition economies. The percentage in the

Figure 1: Government expenditure in selected countries



selected countries ranges from a low of 17.6 per cent in Armenia to a high of 63.4 per cent in Azerbaijan.

A government's financial activities are therefore very significant in terms of their impact on the other participants, both directly – through taxation and expenditures – and indirectly, through its demand for resources, which may influence interest and exchange rates. The task of matching expenditures to revenues is usually thought of in developed economies as being part of the budget preparation process conducted by ministries of finance.

Indeed, the main focus of budget reform in western countries in recent years has been in the area of budget preparation with most OECD countries moving away from the concept of a line-item budget to explore methods for more effective budgetary analysis, such as program budgeting, zero based budgeting and, more recently, resource budgeting.

Mechanisms designed to provide a better forecast of budgetary resource requirements, together with resource constraints, such as a medium-term fiscal framework and medium-term budget framework, are now widely used by industrialised countries; some 73 per cent of OECD countries prepared such frameworks by 2003.

All governments need to restrict their expenditures to the levels forecast in the budget and authorised by law. However, this is considerably more difficult than it might appear to the casual observer; indeed, in order to be carried out effectively, it requires complex systems and procedures to be put in place.

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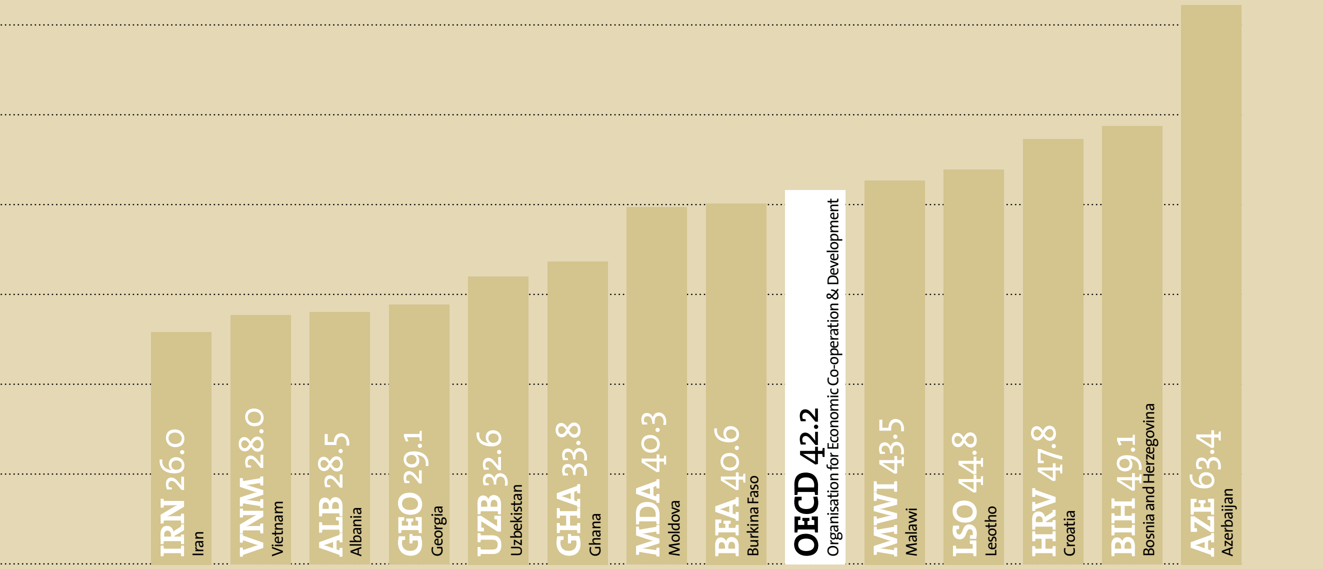
Western industrialised countries have developed laws and regulations governing PFM, internal and external audit of accounting systems and procedures and the accounting systems themselves, together with a hierarchy of internal management controls to assure management that the relevant procedures are being followed. These systems and procedures represent the accumulated experience and knowledge of, in many cases, a century or more of responsible government and professional civil servants.

AN HISTORICAL PERSPECTIVE

Weak PFM in transition economies is often a result



Sources IMF country data (2006); except OECD data (2005)
Notes Definition of general government may vary slightly between countries.
ISO 3166 3-letter country codes

Handling cash in the former Yugoslavia

While the majority of transition countries had inefficient systems for managing the government's cash, the former Yugoslav republics inherited one of the most sophisticated and efficient systems in the world. All financial transactions, for all legal persons and entities, were handled through payment bureaux. In the Socialist Federal Republic of Yugoslavia (SFRY), this organisation was known as the Social Accounting Bureau (SDK), but after the break-up of the SFRY into its constituent republics, it survived under many different names and continues in modified form in Slovenia and Croatia. Branch offices of the SDK were established in most towns. They were used by citizens to pay their taxes to the state, as well as to pay bills to various enterprises and businesses.

Cash was given over the counter to a cashier, together with a payment order detailing the name of the person making the payment, the beneficiary of the payment, the amount and various other details required for administrative and statistical purposes. All settlements were carried out electronically and the system would even permit businesses and enterprises to meet their own payables from the amounts being paid to them, so that they were credited with the net amount at the end of the day. During the period of hyperinflation suffered by the SFRY in the mid-1980s, the SDK would settle 10 or more times between 10am and 4pm.

Even today settlement is carried out several times per day. Although the SDK never regarded itself as a bank, since it did not offer the facility to open an account, or hold cash on a customer's behalf, it exhibited many of the hallmarks of a bank. It covered its costs by charging a small percentage fee for each transaction; indeed, the organisation was so financially successful that, often, when it had achieved its monthly revenue target before month's end, it would cease charging any fees. Any excess deposits still in its hands after the end of business each day were invested on the overnight money market. One of the first PFM reforms demanded by the IMF in the former SFRY republics has been the elimination of the payments bureaux.

of systems inherited from the centralised, or in some cases, colonial, mechanisms put in place by earlier regimes. Historically, responsibility for PFM in many command economies was divided between the ministry of planning or economy and the ministry of finance, with the former responsible for developing the national plan which provided strategic goals and production targets, while the latter assigned resources and handled the accounting.

The mechanisms usually associated with budget preparation in western economies were entirely absent, with treasury functions handled by the central bank. In the former Soviet Union all significant decisions were made centrally in Moscow and handed down to the constituent republics in the form of *diktat*. The USSR ministry of finance in Moscow, for example, would approve a staff ceiling of 2,617 for the ministry of finance of the Uzbekistan Soviet Socialist Republic. The ministries of finance of the subordinate republics were consequently largely devoid of any decision-making apparatus, in addition to lacking analytical capacity.

REVENUES AND EXPENDITURE

One of the first tasks of PFM is to take control of revenues and expenditures. This can be regarded essentially as a two-fold problem, covering budget execution or the allocation, recording and management of revenues and expenditures during the course of the fiscal year, and budget preparation, which encompasses the processes associated with the estimation of revenues and expenditures, and the allocation of resources to the various functions undertaken by government.

BUDGET EXECUTION

For effective management of public funds it is better to keep all one's eggs in the same basket. A major reform of PFM undertaken by the British Government in 1787 in which all revenues were carried to The Consolidated Fund (called by the IMF the Treasury Single Account or TSA) recognised that all monies raised by the government were fungible and allowed much greater flexibility in the application of those funds to government programs and priorities. It has since become the model used by ministries of finance worldwide.

However, the majority of transition countries operated on an entirely different principle, whereby each spending unit of each line ministry operated its own bank accounts. The ministry of finance transferred the monthly allocations for the spending unit into one of these accounts through the central bank, while others were used for the collection of revenues, both central and those accruing to the spending unit, and for various other purposes. This system worked effectively in a command economy; it did not translate well in the move to a market economy.

The majority of transition economies exhibit vestiges of this system: in 2005 there were some 45,000 government spending units in Uzbekistan; each would have operated multiple bank accounts, functioning largely outside of the supervision of the ministry of finance. The move towards a properly functioning TSA has often been relatively slow: although a nominal TSA exists, numerous bank accounts may still be in operation. Even the new member states of the European Union may have some relics of such a system: the Czech Republic still relies on separate subaccounts within the Czech National Bank to account for each individual tax or excise duty.

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BUDGET PREPARATION

The annual budgetary process is an allocative one, whereby finite resources are distributed among a myriad of competing priorities to achieve the government's desired outcome. It is often perceived as representing a somewhat arbitrary allocation of funds to spending ministries in a process that satisfies none of the players. Budgetary processes have been established to provide a more structured and predictable system that results in funding allocations in line with expectations. These processes are therefore of great significance, since they exert a very strong influence on the government's ability to develop and manage its annual budget effectively. Indeed, so crucial are these processes that considerable technical assistance in this area has been expended in transition economies by the international community over the past decade and a half. According to the World Bank, "... [the] institutional arrangements – the rules of the game, both formal and informal – influence the quality of the outcomes." There has been comparatively little research into the informal rules, although recently some studies have been undertaken.

Budgeting problems range from unrealistic budgeting, where expenditures exceed revenues for various reasons, to 'cashbox' budgeting, with the government meeting its commitments as cash becomes available, to 'deferred' budgeting, where certain elements are postponed until the following fiscal year. These high-level budget problems reflect a lack of aggregate fiscal discipline; in an attempt to instil this discipline, many countries have turned to medium-term planning.

Another difficulty facing ministries of finance is that often only the minister himself has an overall view of functions carried out by the ministry. There is no area to coordinate activities. Finance staff are often too junior to 'prune' estimates submitted by the subordinate spending units. For example, the central apparatus of the Ministry of Agriculture and Food (MAF) in Georgia consolidated the bids received from the numerous subordinate units for submission to the Ministry of Finance. This consisted of little more than the simple arithmetical process of adding up the 'wish lists' of projects and resources sent in by the various areas of the ministry. According to the Deputy Minister for Finance and Administration, the initial bids for the fiscal 2001 budget submitted to the Ministry of Finance by the MAF amounted to Georgian Lari (GEL) 80 million (approximately USD 40 million). This was cut to GEL 25 million by the Ministry of Finance. The MAF actually received less than GEL 17 million in funding from the Treasury, and was able to execute only about GEL12 million.

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The Just Transition Mechanism (JTM) is a key tool to ensure that the transition towards a climate-neutral economy happens in a fair way, leaving no one behind. It provides targeted support to help mobilise at least â‚¬65-75 billion over the period 2021-2027 in the most affected regions, to alleviate the socio-economic impact of the transition.Â The Platform also promotes actively the exchange of best practices among all stakeholders involved, including through regular physical and virtual gatherings. If you have an enquiry about the Just Transition Mechanism/Fund/Platform, please fill the contact form. Access the platform. Who will benefit? Support will be available to all Member States, focused on regions that are the most carbon-intensive or with the most people working in fossil fuels. international business communications lecture transition economies transition economies economies that are changing from central planning to free markets these.Â Key features of centrally planned economies: The economy is planned by the national planning office. They make key decisions on: Establishment/liquidation of a firm. Production. Allocation and distribution of products and materials. Decisions on pricing, investment, technology and foreign exchange. Key features of centrally planned economies. Appointment, promotion and dismissal of managers. Allocation and management of labour. Essentially the economy is run by a central planning system rather than a free market. Key features of socialist firms. Main aim is to meet production targets. Many transition economies experienced rising unemployment as newly privatised firms tried to become more efficient. Under communism, state owned industries tended to employ more people than was strictly needed, and as private entrepreneurs entered the market, labour costs were cut back in an attempt to improve efficiency.Â The transition economies also suffered from a lack of real capital, such as new technology, which is required to produce efficiently.Â Under communism, the state owned all the key productive assets, and there was little incentive to develop a sophisticated legal system that protected the rights of consumers, and regulated the activities of producers. The key obstacle in any economy is getting agreement on a decisive plan without politically compromising the plan to such an extend that it becomes ineffectual. 302 views. Sponsored by The Legacy Report.Â A transition economy is one that is changing from central planning to free markets. Since the collapse of communism in the late 1980s, countries of the former Soviet Union, and its satellite states, including Poland, Hungary, and Bulgaria, sought to embrace market capitalism and abandon central planning.Â We eat good, healthy food every day, and we have access to a botanical garden and excellent public library both within a 15-minute walk of our apartment. We can ride a reliable, cheap bus service or cycle around town. In transition economies regulator used to have a lack of human and financial resources and may has concentrated on other important areas, such as natural monopolies, political objectives, advertizing. In this case, anticompetitive agreements (especially vertical) may be sidelined by the regulator. 2. Key elements for the analysis of international antitrust experience. There are some good examples of cross-country antitrust analysis, but they usually interpreted first of all quantitative characteristics, without taking into account most of institutional differences.