

## REVIEW

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PRORAČUNSKI SUSTAV - ORNAMENT ILI SREDSTVO  
UPRAVLJANJA DRŽAVNIM FINANCIJAMA, Anto Bajo, 2006,  
Institute of Public Finance, Zagreb, 361 pp.

Review\*

*Proračunski sustav – ornament ili sredstvo upravljanja državnim financijama* (The Budgetary System: Ornament or Means to Manage Government Statistics) is a contribution to the study of a topic that is addressed relatively modestly in academic and professional literature. True enough, scholarly writing on the influence of fiscal institutions on fiscal results is extremely capacious – we might mention just familiar names in economics such as Poterba, von Hagen and Alesina, but their works deal above all with the influence of the parliamentary system, government (form of government coalition, position of finance minister inside the government and so on) and the electoral system on fiscal outcomes, i.e., the fiscal deficit and the public debt. Consideration of the technical and organisational features of the budgetary system has so far been neglected, and the work of Anto Bajo to a great extent fills in this gap.

It is the fourth, most extensive, chapter of the book, “The budgetary system as cause of fiscal problems in Croatia”, that is dedicated to the impact of the technical and organisational features. The author classifies the determinants of the budgetary system into five groups, giving for each one the desirable characteristics. In addition, Bajo also gives a detailed presentation of the development of and changes in these determinants that have occurred in Croatia since independence.

In the section “Preparation and planning of the budget” the author says that “the preparation and planning process from 1994 to 2004 in Croatia did not allow of a high quality control or successful allocation of resources to spending agencies or the execution of the budget in accordance with the amounts planned at the beginning of the year” (pp. 71-72). The author finds the causes of this in the poor scope of the budget, the unclearly defined spending agencies, the impossibility of consolidating the budget, the lack of any macroeconomic framework and the terse guidelines as to how to draw up the budget. It is interesting that up to 1998 only the central government budget was planned and that not until that year did the Parliament get any insight into the financial plans of the extra-

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budgetary funds, or spending agencies. The extra-budgetary agencies were a particularly serious problem because neither Government nor Parliament had sufficient oversight or control of them. This problem was partially solved in 2001, with the incorporation of the two major funds (the Croatian Institute for Retirement Insurance and the Croatian Employment Agency) into the central government budget. On p. 89 Bajo states that in 2002 planning in terms of programmes was formally adopted, yet the ministries did not make any reports concerning the success of implementation of the programmes, because the law still did not require it. The author does not come out decidedly about the point of the requirement for measuring success, because, clearly, in many programmes it is extremely difficult to measure.

In the section concerning the execution of the budget, the author gives a more detailed historical review of the execution of the budget, stating that the execution of the budget is based on three main technical characteristics. These are the allotment of resources to spending agencies pursuant to monthly and quarterly financial plans, the centralisation of receipts of revenue and payments from the budget via the single account of the treasury (JRR/SAT), and the bookkeeping records of receipts and payments that are carried out via the main ledgers of the government Treasury. Bajo alleges a great improvement in the centralisation of receipts and payments via the SAT from 2001 on, when the government Treasury was set up; this confirms earmarking of resources, meets demands for payments, and carries out financial control. The Finance Ministry managed by connecting up the government Treasury with area treasuries that are in given ministries to centralise the function of the execution of the budget. The scope of transactions via the SAT was essentially improved by the incorporation already mentioned of the two largest extra-budgetary funds in the national budget. The author gives a critical analysis (p. 117) of this solution, stating that these two funds could well have retained their status as long as they were required to carry out their financial operations via the SAT. He particularly analyses the role of the Financial Agency (FINA), an independent agency that conducts payments clearing operations for spending agencies, taking a commission on the transactions, and expresses the opinion that FINA should be transformed into a government institution.

In connection with “Government accounting, financial and fiscal reporting” Bajo states in detail the obligations that the funds, the spending agencies and local government units have in the area of financial reporting. Government accounting must have at its disposal not only information about monetary flows but also other information important for managing the budget, particularly information about claims and liabilities. Since 2001 budgetary transactions have been recorded according to a modified accrual system, with revenues being acknowledged only pursuant to the actual incoming of monetary resources, and expenditures on the basis of the occurrence of a business event (independently of whether it is paid or not). But as the author says on p. 146 “the new system of financial reporting did not affect the extra-budgetary funds” since the Finance Ministry had still not consolidated their financial reports.

In the chapter on “Cash and liquidity management” the author states, p. 160, that “the main objectives for managing cash and liquidity are control of government spending, efficient implementation of the budget and minimising borrowing costs”. However, until 2001 there was no cash and liquidity function in the Finance Ministry, in spite of the fact that

the SAT had existed since 1994. For the monetary resources of a lot of spending agencies were lodged in commercial banks (above all, those of the EBFs). Only in 2001 with appropriate operations was cash and liquidity management truly centralised and became the exclusive responsibility of the Finance Ministry's Treasury. True, public revenue (taxes and contributions) is still paid via FINA, which acts as a fiscal agent of the government, but payments do go into the SAT. In spite of the obvious improvement in managing and recording money flows, the Finance Ministry in an operational sense does still not totally carry out its function, and it is for example forced to borrow at commercial banks, in spite of cash surpluses held by local government units in commercial banks. That the area of managing cash and liquidity is still far from satisfactory is shown by the great rise in short-term borrowing that by issuing bonds the government has managed to shift into a long-term debt. What is particularly surprising here is the poor credit standing or credit-worthiness that the government has in commercial banks.

*Records and management of the public debt.* The unsatisfactory state of affairs in the area of cash and liquidity management, not surprisingly, translates into problems of public debt management. As Bajo points out, this area too was not transparent, and until 1997 there were no complete records of the public debt. From 1994 to 2000 the Finance Ministry did not draw up any reports concerning the state of public debt, and so the Parliament had not complete insight into it. Only since 2001 have the records improved essentially, and the Croatian National Bank took over the obligation to run all public debt records. In fact, the public debt rose very rapidly, from 27% of GDP in 1998 to 50% of GDP in 2005; the costs of debt servicing are thus rising, and repayments now make up about 5% of all expenditures of general government. Bajo states that one of the particular features of Croatia is that the proportion of foreign debt is greater than that of domestic borrowing, and domestic borrowing is almost all from the banking sector.

Also very interesting is the survey of the issues related to outstanding liabilities, with the proviso that most of it relates to the pensions and health insurance funds. In this area too there has been some gradual improvement and in 2000 the Finance Ministry set up a register of outstanding liabilities. Bajo says that "a key step in the improvement of the records of government liabilities occurred in 2001, when budgetary transactions started to be recorded according to the modified accrual system". In the region of guarantees given the situation has gradually normalised and, as Bajo says, since 1999 the Government has issued guarantees only on the basis of prior opinions from the Finance Ministry and a competent ministry, and in 2003 the government lay down criteria for the authorisation of guarantees.

After an exhaustive analysis of the Croatian case, Bajo moves to a comparative analysis ("The budgetary system as cause of fiscal problems in select countries"), covering four countries of Central Europe – as well as Croatia we have Slovenia, the Czech Republic and Hungary. In this chapter Bajo poses a simple and intelligible question: does a poor budgetary system i.e., poor budgetary planning and execution, poor accounting and cash and liquidity management, and poor public debt management, cause poor fiscal results, above all higher government spending, higher budgetary deficit and higher public borrowing? For each of these five components or complexes of the budgetary system Baj constructs a qualitative variable (an index) composed according to responses to a ques-

tionnaire filled out by fiscal experts from the countries in question. The author then uses regression analysis, in which the dependent variables are in order a given fiscal realisation, while the independent variables, apart from individual qualitative variables (the indices) include certain macroeconomic and financial variables (rate of growth of GDP, rate of unemployment, and government deposits in the central bank shown as percentages of total government deposits). The results show that the quality of budgetary system management, measured by indices for given components assessments pursuant to the values obtained from the completed questionnaires created by national experts does not have a statistically significant effect on trends in relevant fiscal indicators – the amount of government expenditures, the amount of the budgetary deficit and of the public debt. This negative result need not surprise. As can be seen from the graph of values of given indices for each country and according to years, the indices are constantly improving, the result of the general modernisation of the four states. The Croatian lag (visible from Graph 24) behind the three EU members observed is very small. Accordingly the budgetary deficit is the aggregate result of political and economic factors, and only to a lesser extent the result of the technical and organisational characteristics of the budgetary system. The quality of budgetary system management, it is true, can contribute to a smaller budgetary deficit, but in the best of cases this impact will be rather modest.

At the end the author gives a list of the concrete steps that the Croatian Finance Ministry ought to take for further improvement of the technical and organisational features of its budgetary system. As he so rightly states it is necessary “to develop an awareness of the nature and value of public money, the basic prerequisite for any high quality budgetary management”.

The book of Anto Bajo is an exceptionally valuable work and required reading not only for all Croatian experts from the area of public finances but for other experts as well who are interested comparative studies of transition countries. Like every worthwhile book, this one by Anto Bajo too starts up a number of new questions; it is very laudable that the author has stated some of these issues at the end of the book.

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