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# NEWSLETTER



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## A National Treasury in Croatia – a Reality or a Possibility?

The Ministry of Finance (MF) does not know the precise number of government kuna (Croatian currency) and foreign currency accounts kept in the commercial banks. Also unknown are the amounts in these accounts, and the conditions (interest rate) under which the government deposits its money here. The problem is that in the MF there is no management of cash, and there are no clearly defined authorities for managing the public debt. The Croatian National Bank (CNB) also has the problem of not covering in its monetary statistics the situation of the resources in kuna and foreign currency kept by local government units (LGU) in the banks. In addition, there is also the problem of the Payments Clearance Institute (PCI), the role of which in the system of government finances has not been defined.

The reason for this kind of situation is the fact that there is no national or government treasury system, payments are not made from a single treasury account (for all ministries, extra-budgetary funds and local units) and there is no clear regulation of payments clearance through the government accounts. We should recall that the project for the national treasury and payments from a single treasury account at the CNB started in 1994 has still not been put into practice.

The establishment of the national treasury and the single account of the treasury, and getting them to work, are becoming increasingly important when one considers that there are no clearly settled relations or responsibilities for the key "fiscal agents" (the MF, the CNB and the PCI) in the system of government finances. The most recent statutory approaches have created an additional confusion from the point of view of the organisation and functioning of the national treasury, and of payment from the single account of the treasury.

This paper discusses what has to be done so that the small Croatian government should have more control of the costs of the use of their funds.

### Introduction

In the last ten years the system of Croatian government finances has been faced with constant problems relating to the control and management of public expenditure and revenue. This is the result of the lack of a defined role for the key institutions that are linked (or not linked) with the government, i.e., the Ministry of Finance, by financial relationships. The inability to see into the real situation of the government's finances, the state of its deposits or the number of accounts kept in the commercial banks is a systematic hindrance to the government in the regular daily and monthly determination of real needs in the public sector, and the amount of the funds needed to finance expenditure. The numerous accounts of the government in the commercial banks lead to questions about the number of such accounts

and the amount of the funds kept in them. Apart from that, the banks make use of the deposits and funds of the government to carry on their own commercial activities. Every failure of any such bank must necessarily have the result of the government funds it made use of actually disappearing<sup>1</sup>. Of course, the costs of this disappearance will have to be borne once again by the taxpayer. The regulation of the finances of the government in such a way as at last to set up the national treasury system (the governmental financial and information management system) and getting the single account of the

<sup>1</sup> For example, in May 1999, bankruptcy proceedings were started in a certain number of banks that were for this reason excluded from monetary statistics. According to data from April 1999, deposits of the central government in these banks came to 193,5 million kuna (CNB Bulletin, 2001:76). As against this, the claims of these banks against the central government came to 17,8 million kuna (ibid:75). The government, that is, lost 175,5 million kuna through these bankruptcies.

treasury working would solve for the government many problems about making payments and the management of cash and the public debt. It is crucial that the government should finally start to regulate the relation between the Ministry of Finance (treasury department) with the CNB, the Payments Clearance Institute and the commercial banks within the system of government finances.

For this reason, in the sequel we shall draw attention to the basic problems that make it impossible to determine the amount of the funds that the state has at its disposal, the possibilities and preconditions for the establishment of the government or national treasury, and through the current organisational and functional solutions of the national treasury and single account of the treasury system to address the problems as well as the recommendations for the ultimate functioning of the treasury system.

### **I. The problem of the control of public revenue and expenditure**

For the banks, the government is “the mother of all clients”. And so in a centralised state like Croatia, transfers via the government accounts are both high and constantly maintained. However, unlike the other services that government institutions and companies arrive at via public tender invitations, the choice of bank in which to open an account is left to individual budgetary beneficiaries. The problem here is that not even in the MF (treasury department) are the criteria for choice of bank known, and there is no information about any uniformity in the conditions of individual banks. The MF should, at the same time as it ensures the functioning of the government treasury, pick the best offers for the provision of financial services such as opening government giro accounts. The necessity of such measures is shown by the many giro accounts that have been opened in the commercial banks.

That is there are 1,635 budgetary beneficiary accounts open in numerous commercial banks. Most of them have been opened in Zagrebacka (449), Privredna (201), Splitska (175), Rijeka (154) and Slavenska (131) banks. The accounts of other beneficiaries are split up among the other commercial banks in a range of from 65 to a single account in a bank. Although the accounts are in the banks, all the payments clearance related to these government accounts goes on via ZAP, Zavod za platni promet (the Payments Clearance Institute), which takes a fee for this service. To do with rate of interest, Zagrebacka banka, for instance, in 2000, paid an interest of 1% per year on giro accounts that it keeps in ZAP (and the accounts of the budgetary beneficiaries). To the hundreds of such accounts one has to add the accounts of local government units (the 544 communes and cities and the 21 counties) and the beneficiaries of their budgets, and the circa 7,700 transient accounts at the CNB for the collection of national and local taxes. The ministries and government agencies have about 60 accounts in the CNB, and the budgetary final beneficiaries have 474 of a total of 2,150 accounts (Mateljić: 2000). Apart from the great number of accounts, the state also has a problem with carrying on payments clearing.

From February 2001, the National Clearing System started working; the authorities for payments clearing were transferred to the banks. However, the problem appeared of

whether the banks would actually check to see whether taxes and contributions were paid. Hitherto, this had been done for the government by ZAP, which got a fee for the service. The banks, apparently, in their requests to have this obligation transferred to them, have the support of the CNB. And for this reason there is a banks-ZAP-CNB problem, that is, the question of which of these institutions should in the future (when the banks take over payments clearing) assume the role of ZAP, which has so far controlled the payment and collection of taxes and contributions for the government, i.e., for the Ministry of Finance.

Part of the answer is provided by the new CNB law, in which the relationship between the government and the CNB is laid down. Thus, according to the proposal, the CNB will run the accounts of the government in its liabilities (as it has done to date) and carry out payments clearing to do with these accounts. The CNB should work as fiscal agent for issuing securities. Apart from that, it will carry out payments from the account at the order of the government up to the amount of the funds deposited in the account. The amount of interest and fees will be jointly agreed on by the MF and the CNB according to market conditions. Of course, the CNB will charge a fee for carrying out payments clearance services. It is interesting that the CNB can authorise some other institution to carry out payments clearing with respect to the government accounts, all in accord with the conditions prescribed by the CNB, with the consent of the MF. However, one question is which that institution is to be (the banks, ZAP).

All this brings us to the key problem: how will the government organise the control of the collection of its revenues and the use of the expenditure of the Budget, the extra-budgetary funds and the local government units?

And this truly is the crucial problem for the government, that is for the main fiscal institution, the Finance Ministry, the answer to it lying in the functioning of the system of the treasury and the single account of the treasury opened at the CNB.

### **II. The treasury system – possibilities and preconditions**

The system of a treasury on an integrated centralised basis provides the central government with financial services such as payments, accounting, fiscal reporting and financial management. Most of the developed countries have a computerised system that unites all the functions for the MF and the other ministries, as well as the government agencies and their spending units. This system contains so called modules for the preparation of the budget, debt management, the extra-budgetary funds, local units and other functions. However, the construction of a government treasury system consists of four main components: 1) creation, within the MF, a treasury department that via its regional offices will collect revenue and make government payments; 2) consolidation of government financial resources in a “single treasury account” in the central bank; 3) the introduction of a better accounting regime for government operations through a “treasury general ledger” and 4) the development of financial management and the planning for the government sector.

It has to be known that the treasury system is a linked system of payments, accounting and a financial and

information management system, access to which is given to the Finance Minister, the treasury department, the ministries and the government agencies. All these may draw up payment orders, but only the treasury department can approve such orders for payment. Authority of this kind enables the treasury department to act preventively and to limit excessive government spending. Payment operations via the treasury and the accounting operations of the ministries, agencies and the treasury are the basis for the establishment of the standard financial and management information system of the government. This kind of centralised approach is possible only with a high level of computerisation, both in the MF and in the ministries, the extra-budgetary funds and the local government units.

### III. The existing system of the government treasury – the reality

Practice with government finances to date has shown weaknesses in the analysis of fiscal policy, lack of control of expenditure, weak or nonexistent cash management and inefficient supervisory and information systems for the fiscal operations of the government. This kind of situation contributes in a major way to the uncertainty in decision-making about the allocation of government resources. For this reason it is necessary to set up a treasury and a governmental financial information system.

The government treasury has not been allowed to function thanks to lack of professionalism and absence of long-term vision in the implementation of the reforms of the budget and budgetary process. One of the problems is the fear

of budgetary beneficiaries of the possible consequences that the establishment of a government treasury, and payment via the single account of the treasury, might have. It is known that budgetary beneficiaries can have their own sources of funds and make use of them without them being recorded in the single account of the treasury (Ott and Bajo, 2000). Bringing all the funds into the national treasury system would give such institutions no chance of using and disposing of such funds in a discretionary manner. Funds would be approved and used via the treasury system. All such, and many other, problems have led to the IMF and the World Bank deciding to get actively involved in the establishment of the functions of the national treasury in the RC as well.

Thus as long ago as 1996, Croatia was given a *Public Sector Adjustment Loan, PSAL*. This loan provided funds for the organisation of the treasury as an integral part of the MF. Problems with setting up the national treasury and the single account of the treasury in the CNB became additionally complicated in the following years. Thus the main problems were related to computerisation, to the ill-defined status of ZAP, and the lack of adequately professional people actually to implement the system. Of course, the whole government treasury system needed greater political support, which was signally lacking. Thus the whole process of the reform of the preparation, planning and execution and control of the national budget was drawn out.

In 2000, the question of the work of the treasury was once again mooted. American advisers to the MF about the establishment of the government treasury, according to the situation as found in the MF, laid down the basic principles for the reform of the budget.

#### **Principles for Budget reform in RC**

A modern integrated system of financial management has three main functional components that cover the budget, accounting and the treasury (including debt management) operations.

**Budgetary functions** comprise the policy objectives and decisions of the government, the requirements of ministries and other budgetary beneficiaries for financing, adjustments among the ministries in parliament. This includes the allocation of funds to the ministries, which ought to be adjusted with the plans of the work of the Ministers, and the anticipated amounts of cash through the functions of the treasury. Through the activity of the allocation of funds<sup>2</sup> one can assure regular supervision of the use of such funds. The allocation of funds covers all executive government agencies that obtain budgetary resources, including the extra-budgetary funds and the local government units.

The **functions of the treasury** cover cash management, public debt (foreign and domestic) management and forecasting and risk management. As part of cash management, the treasury manages government deposits as a consolidated account. The treasury supervises the collection of revenue, prepares cash flow forecast and advises on short-term financing requirements. As part of debt management, the treasury records issuance of government securities, register liabilities of the government, forecast debt levels and debt servicing requirements, and manages loan agreements. The treasury also works as financial adviser by monitoring market conditions (trends in interest rates and foreign currency exchange rates), projecting payment obligations and the needs to get into debt, and estimates the position of the government on the market.

The **function of accounting** includes the financial system of the recording of transactions, accounting rules, data, reporting, supervision and control. All transactions generated from the budget, and the function of the treasury, are covered by the accounting system. The accounting function has to be kept separate from the other two functions (USAID and the US Treasury, June 2000)

<sup>2</sup> The English word budgeting means the whole process of allocating resources, and the preparation of special documents, ie, laws, through which the allocation of resources takes on the nature of an obligation (Snyder, 1977: 99).

These principles have to be the framework for the organisation of the system of the national treasury, and this would greatly improve the system of the budget.

In June 2000, the government of the RC made a Decree about the internal organisation of the Ministry of Finance (Official Gazette 65/00), which defines the organisation of the treasury department. This decree states that the treasury consists of administrations for the execution of the national budget, for government accounting, and for managing cash and the public debt.

It is interesting that no administration for preparing and consolidating the budget(s) is included in the treasury, although the Instruction about the execution of the national budget from the single treasury account (OG 4/01) anticipates an active role for this administration in the treasury system. A classic administrative mistake in timing, one might say.

The government treasury is defined as an administrative organisation that is part of the MF and has responsibilities for carrying out matters relating to the execution of the national budget, government accounting, cash and public debt management. This kind of organisation has created a confusion in the organisation of the treasury, and determined a function for it that is essentially different from the previously proposed functional principles for the reform of the budget.

The actual definition of the treasury as administrative organisation in the MF has not been completely illuminated, and the roles of the administrations have not been precisely defined, nor have those of the departments that actually make up the treasury. The question arises about the role of the chief treasurer and what knowledge and skills this treasurer needs to have, as well as the highly placed administrators of the department of the budget of the MF included in the treasury.

The national treasury project was not completed in 2000, although most of the technical parts of the project were in their concluding phases. In the functional part, the basic solutions for most of the tasks have not been giving, and thus "via the national treasury it is not possible to plan the budget, execute the budget, manage monetary flows or monitor borrowing at the level of the country" (Linzbauer, 2000:255). This statement surely goes for 2001 as well. For this reason it is still not clear who in the MF, and how, manages cash and the public debt. Four revisions of the budget in the last six years have additionally confirmed the point that the existing organisation of the treasury does not facilitate any realistic budget planning.

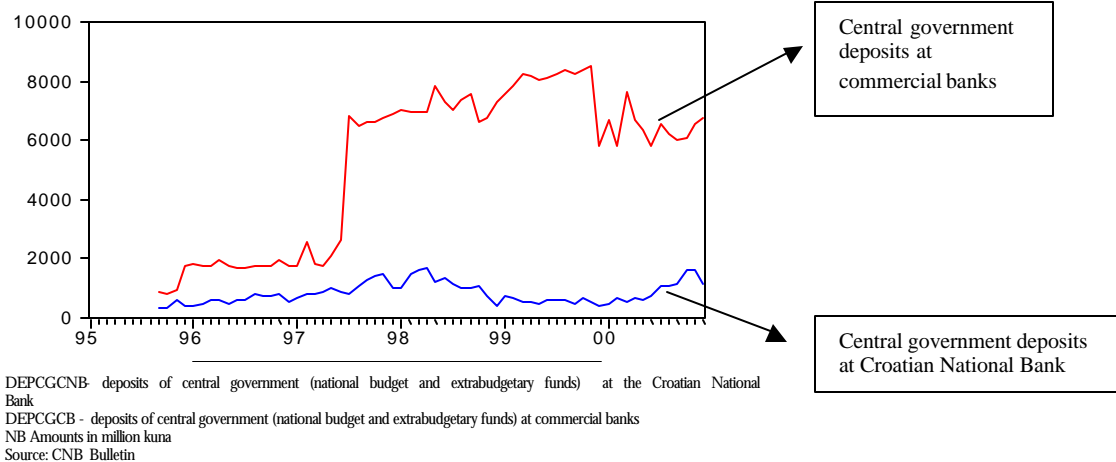
### The single account of the treasury

Apart from the organisation and functional organisation of the budget, there is also a great problem in the position of the single account of the treasury opened at the CNB. In the MF they have remarked well that "in the history of market developed economies it is a widespread practice to concentrate sources of cash or monetary resources in a single bank account, i.e., at a single account of the treasury in the central bank. In industrialised countries with a well-developed computer support and an effective payments clearance system run by the banks, the treasury system can operate from many accounts and management of the total monetary potential is not called into question" (Keser, 2000:92).

Problems to do with the single account of the treasury in the RC derive from:

- the ill-defined status of ZAP which actually functions as, and partially performs the functions of, the national treasury;
- the lack of any settled plan for placing all budgetary beneficiaries and their accounts within the purview of a single account opened at the CNB;
- the absence of any government financial information system to provide full information about the situation of cash in the accounts of the budgetary beneficiaries or information about the precise number of accounts of the government (or of the budgetary beneficiaries) kept in the commercial banks;
- there is no single administration for cash management in the MF within the treasury system; this administration should have an integral insight into the inflow and outflow of funds not only from the budget but also from the extra-budgetary funds.

However, it is actually the splitting up of the monetary resources of the government among many bank accounts instead of their being concentrated in a single account at the CNB that is the real problem with cash management in the RC. Thus the greater part of both kuna and foreign currency deposits of the state are kept in the commercial banks (Figure 1).



Government deposits with the commercial banks are four times greater than government deposits with the CNB. Thus from mid-1997, one can see a constant rise in government deposits at the commercial banks. Government

deposits at the CNB have on the whole remained at a low level, and at the end of 2000, a slight rise to a level of 1,1 billion kuna could be noted.

Table 1. Kuna and foreign currency deposits of the central government (national Budget and the extra-budgetary funds) with the commercial banks, in billion kuna.

The situation in December	1995	1996	1997	1998	1999	2000
Kuna deposits	1,8	1,6	2,4	3,0	3,3	3,0
Foreign currency deposits	0,2	0,1	4,4	4,2	2,5	3,7
Total	2,0	1,7	6,8	7,2	5,8	6,7

Source: CNB Bulletin no. 58

The total level of government deposits with the commercial banks increased from 1,7 billion kuna in 1996 to 7,2 billion kuna in 1998. In December 1999, central

government deposits in the commercial banks were 5,8 billion kuna, and in December 2000 these increased to 6,7 billion.

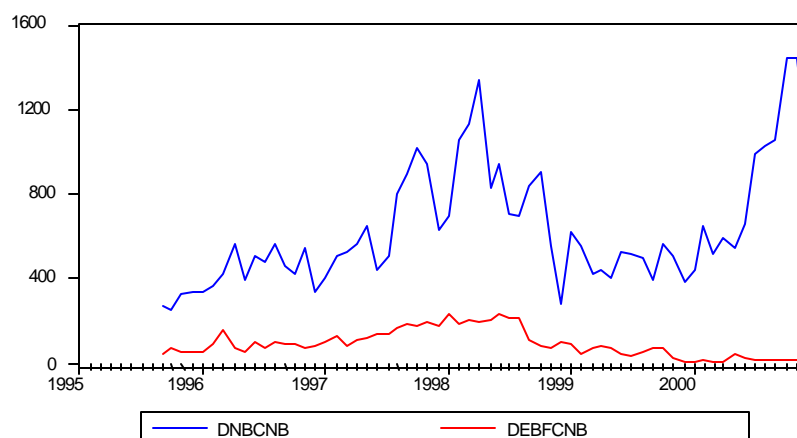
Table 2. Deposits of central government with the CNB in millions of kuna

The situation in December	1995	1996	1997	1998	1999	2000
Total deposits	395	558	1,033	435	397	1,157

Source: CNB Bulletin no 58

Most of the deposits of the government (the Budget and the extra-budgetary funds) at the CNB have been reduced since 1998, from 1,03 billion kuna to only 397 million in December 1999. In 2000, a rise in December can be seen, and government deposits were 1,1 billion kuna. One should bear

in mind that the deposits of the Budget were incused by the deposits of the extra-budgetary funds falling to a minimum in 2000, which is another proof of their very weak financial position (Figure 2).



DNBCNB - Deposits of the national Budget at the Croatian National Bank  
 DEBFCNB - Deposits of the extra-budgetary funds at the Croatian National Bank  
 NB – amounts in billion kuna  
 Source: CNB Bulletin

The fact is that it is not known precisely how many accounts the government has at the commercial banks. There is no clear criterion for transferring money to the commercial banks. It is even quite dubious under what conditions (and at what rate of interest) this money is kept, and what the purpose of the deposits that are kept in individual banks is. Apart from that, the official statistics of the CNB do not show the amount of the kuna or foreign currency deposits of LGUs in either commercial banks or in the CNB. All this creates great confusion about the real state of the cash of the government kept in the commercial banks.

In the reform of the system of the government's finances, the main question is the transfer of the deposits from the commercial banks to the single deposit account at the CNB. This measure, in current conditions of economic insolvency, would have profound consequences, because it would greatly reduce the loan potentials of commercial banks. However, this kind of measure would help the MF to manage its deposits much more easily and more thoroughly. The CNB would have, in addition, the direct ability to control the situation in such accounts and to measure or predict the monetary consequences that can be caused by changes in the situation of the government's deposits.

It is quite another question whether the MF will decide on having the banks, and which of them, carry out payments clearance on behalf of the government, and in which of the banks and on what conditions (at which rate of interest) the government might place its funds.

The problem becomes more complex when one knows that in the MF there is no apportionment of responsibility for the management of cash. The situation of cash in these accounts is also an unknown, as are the conditions in which such funds are deposited (short term or long term). It is even a problem to determine the exact amount of the monthly resources needed by the national Budget to overcome the unequal dynamics with which funds come into the budget and the financing of "extraordinary" expenditures that are done on the basis of the issue and auctioning of treasury bills.

For this reason it is necessary to decide on the establishment of a treasury system that will serve several levels of government, and under the direct control of the central government, i.e., the MF. Apart from that it is necessary clearly to delimit the concepts of central and regional government treasury. Thus in the Instruction about the execution of the national Budget from the single account of the treasury (OG 4/01), the regional treasury is awkwardly defined as *a functional and logical unit within the competent ministry*. The concept of regional treasury has not been worked out at all, nor are the local units informed about the whole project of the establishment of the national treasury.

New procedures for working out the precise dynamics and steps for closing the existing accounts of ministries and budgetary beneficiaries kept in the banks have to be brought into the central bank and the banks of budgetary beneficiaries.

However, in Croatia, ZAP still makes its contract with the MF about looking after all matters concerned with the collection of revenue and payment from the accounts of the national budget, as well as computer affairs. Thus according to Article 33 of the Budget Execution Law (OF 130/00), for its carrying out payments transactions to do with the accounts of the budget and the accounts of the budgetary beneficiaries, the MF pays ZAP a fee according to a contract that the Minister

makes with ZAP. However, officially, not even the amount of this fee is known.

For this reason, the establishment of the national treasury and payment from the single account of the treasury are connected with the "reform of payments clearance, and so also with the transfer of the account of the national Budget to the CNB with payments clearing according to this account" (Cota, 1998: 80). For reform of payments clearance in the country to be put through to the end, it is expected that the MF will take the initiative in the regulation of payments clearance on behalf of the government, and other legal regulations through which the timetable of the implementation of the reform of the budgetary system would be laid down.

#### IV. Conclusion

For the sake of overall control and management of public revenue and expenditure, a reform of the budgetary system has to be undertaken, and a government or national treasury set up before anything else. The decision makers in the executive, above all in the MF and the government, have to speed up the completion of the project of the national treasury. The amount of the funds that have "got stuck" in some of the many government accounts opened in the commercial banks certainly have to be determined, and some control of them undertaken. Determining the amount of these funds and transferring them to the single account of the treasury at the CNB can serve as a parallel process in the creation of a single administration for cash management within the MF. The work of this administration would be closely linked with the possible organisation of a Public Debt Management Council, in which there should be representatives of the CNB and the MF.

A precondition for the implementation of these proposals is the establishment of a national or government financial information system and the recording of all the transactions of the government in this system, and not, as hitherto, via ZAP and the many banks through which payments are made on behalf of the government. In addition, it is necessary to determine the final dates for the transfer of accounts and payments from individual bank accounts to the single account of the treasury at the CNB.

Also needing to be done is the definition of a clearer organisational structure of the treasury in the MF and making a clear-cut division of the responsibilities for the carrying out of given matters. This requires additional expert staffing, taking on new and more professionally qualified personnel in the MF, particularly to do with matters in the competence of the treasury.

Finally, much greater political support needs to be given to the reform of the budgetary system, with information being made available to public and parliament about the procedures undertaken in the reform, and the possible consequences and results of the implementation.

The new laws regulating the organisation of the national and regional treasuries, the amendments to the existing budget law, the passing of a new law about the public debt, and the making of a fiscal responsibility law should be the basis for the reform of the budgetary system that has the characteristics of an obligation as well as settled dates for its implementation.

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