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PRESS RELEASES

Government and government finance in Croatia - a clean start or a clean stop?

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On January 8, 2013, the Government published preliminary results of the *Clean Start project "A situation analysis of government bodies and state companies with a concept of improving management efficiency"*¹. Three consulting firms and a public scientific research institution were engaged in the project aimed at establishing the 'state of affairs' before January 1, 2013, and proposing framework measures to change the situation. The preliminary report results suggest that, in the short run, the Government should improve the asset and liability records of state and public enterprises, activate the public debt management and financial management in budgetary users and state-owned companies.

The *Clean Start* project is divided into four thematic areas. Clean Start A largely focuses on the analysis of liabilities in the health care, pension insurance and employment systems (the Croatian Health Insurance Institute, Ministry of Health, Ministry of Social Policy and Youth, Croatian Pension Insurance Agency and Croatian Employment Agency). The bulk of the analysis deals with the issue of assets, especially the amount and structure of liabilities within the health care system, with high off-balance sheet liabilities (which are specific, as in public companies). Clean Start B analyses the business operations of the Croatian Radio Television, Ministry of Science, Education and Sports, E-Croatia Directorate, Central State Office for State Property Management, Environmental Protection and Energy Efficiency Fund and Croatian Mine Action Centre. This includes the analysis of expenditures and investigation of saving potentials. Most of the findings are almost identical to the results of previously conducted commercial and state audits. Clean Start C covers a wide range of topics, from the visions, missions and goals, the organisation, number and structure of employees and budget execution to the economic policy assessment through the finance, economy and agriculture ministries. A similar analysis was made of public enterprises: Croatian Electric Utility Company (HEP), Croatian Water Management Company and Croatian Forest Management Company. Clean Start D focuses on the analysis of the Ministry of the Sea, Transport and Infrastructure, and, particularly, on 22 public companies, some of which have been subject to annual audits by the authors of the *Clean Start* project. Within this part, a credit analysis was made, including the calculation of (financial and non-financial) indicators. In the conclusions, some opportunities and constraints regarding investment in the transport sector were indicated.

The *Clean Start* analyses were not based on any previously agreed methodology. The methods used were freely chosen and included credit analyses, financial statement analyses, interviews and the use of results of analyses from primary and secondary scientific and professional publications.

¹ Government of the RC, 2013. *A situation analysis of government bodies and state companies with a concept of improving management efficiency. A presentation of the Clean Start project*, January 8, 2013.

Based on the current Clean Start analyses and previous studies of the Institute of Public Finance, below we give a summary of lessons learned, the main measures, findings and recommendations aimed at consolidation and improving the government finance management in Croatia.

The annual statements of competent ministries. The authors of the Clean Start project were unable to use the annual reports of competent ministries (with the exception of the Finance Ministry), as these reports are either prepared rarely or they are not published on the relevant ministries' websites. The annual statement of each ministry should contain an "inventory" of assets and liabilities, but also a list of employees and material costs, as well as an explanation of all activities carried out during the year in accordance with the ministry's mission, goals and development strategies. These reports should also cover the operations of public companies under the jurisdiction of each competent ministry. Thus, for example, the Annual Statement of the Ministry of Economy should contain not only a comparison between planned and achieved goals and activities, but also an analysis of the 17 companies in majority state ownership).

Laying emphasis on government assets and liabilities. Instead of dealing with revenues and expenditures, the Government and ministries should focus on assets and liabilities. The main challenge facing the government is the management of its assets and liabilities, especially the non-financial assets, as there are no consolidated lists of these assets nor are they properly evaluated. According to the information used in the analyses, it is more than evident that the public sector's financial reporting system has improved, and that the focus is not on the revenue and expenditure report (income statement) but on the balance sheets of extra-budgetary users and public companies. Each ministry should already have a consolidated balance sheet (of assets and liabilities) as a base for the preparation of a total government balance sheet. On the liabilities side, the most problematic are the amount and structure of liabilities of the companies and institution within the health care system (mainly hospitals).

Public debt management. How big is the public debt in Croatia? If we stick to the IMF's Public Sector Debt Statistics Guide², then Croatia's public debt includes not only the general government's budget liabilities but also those of majority state-owned companies. Apart from direct liabilities, the Ministry of Finance must also take account of contingent liabilities and arrears associated with the health care system. Almost all the analyses reveal the problem of huge direct and contingent liabilities of not only the budget but also of the public sector. This should be more than a clear signal for the Government to pay closer attention to improving the public debt management. The Government and the Ministry of Finance must broaden the scope of public debt, carry out regular credit and risk analyses and intensify the monitoring and management of the maturity risks of contingent liabilities, especially those arising from issued guarantees. Public debt management should be developed within the Ministry of Finance, and no other organisational frameworks can be considered before all functionalities in the public debt management system are put in place and the transparency of information on public debt is improved. The Government must not hesitate to carry out a complete audit of its public debt management.

Consolidation of the budget and financial reports of budgetary users and public companies. It is impossible to monitor the financial operations of ministries without an analysis of associated public companies that are the main seekers of extra liquidity and drivers of growth of government subsidies and guarantees. It is also necessary to consolidate the financial operations of the ministries with those of their budgetary users and companies under their jurisdiction. This includes, for example, the budget consolidation of the Ministry of Science, Education and Sports (with the revenues and expenditures, as well as assets and liabilities of all of its budgetary users), Ministry of the Sea, Transport and Infrastructure, Ministry of the Economy, Ministry of Agriculture, Ministry of Tourism and even the Ministry of the Interior. All these ministries participate in and influence the management of companies under their respective jurisdictions.

² IMF, 2011. *Public Sector Debt Statistics, Guide for Compilers and Users*. Washington: International Monetary Fund.

From financial transaction records to financial management. The financial management practice has not taken hold in Croatia's public sector. The financial operations of the budget and public companies are still focused on the recording of financial transactions, whereas the financial management and risk management are completely neglected. Reasons for the non-existence of financial management should be sought in an analysis of the professional qualifications of employees providing financial services at the relevant ministries, budgetary users and public companies. It was the Government that should have begun the Clean Start project by defining the professional qualifications of employees dealing with finance, accounting and financial management within the competent ministries and public sector companies. Such an analysis would probably show that there are not enough economists at the technical and operational levels of organisational units to secure conditions for financial management. Without such analyses the entire financial management process, in technical terms, will continue to be politicized.

Training in financial management. The Clean Start project analysis demonstrated even more vividly than before the need for additional training of the first level of management (deputy and assistant ministers) for financial management. This problem requires ongoing training of existing employees in the financial services of the government, budgetary and extrabudgetary users and public companies, as well as decision-makers. Short courses and briefings should be organised during the year for those government administration employees who very often cannot fully understand government finance and the principles of government functioning until the end of their terms of office.

Strategy and strategic management. In Croatia, there is no clear definition of structural reforms, nor have the implementation costs of previous (and current, i.e. proposed) structural reforms been determined. In new economic strategies, the plans should be associated with the sources and possibilities of financing and should be translated into concrete programs and budgets. Without this the reforms are doomed to failure. The competent ministries must clearly define their missions, visions and business goals, and the development and implementation of sectoral strategies must fall within the competence of expert bodies coordinated by heads of governments and competent ministries. One of the problems here may be a poor understanding of the entire strategy development process and programmes, and making them subject to the strategic budget planning at the Government level, as well as an inadequate transfer of recommendations to the competent ministries and budgetary users.

From a "clean start" to a "clean stop". It is unrealistic to expect that the Government will complete the clean start and carry out the necessary restructuring and consolidation of the public sector in only one term of office. However, the Government should abandon its current practice of merely recording the financial transactions and change its perception of the state budget and the financial plans of public companies as suspense accounts or just "payment/withdrawal accounts" and focus on the development of good financial management practices.