



Republic of Serbia

**Fiscal Council**

## **MAIN FINDINGS FROM FINAL STATEMENTS OF ACCOUNTS FOR 2002-2018 AND THE ASSESSMENT OF THE FINAL STATEMENT OF ACCOUNTS OF THE STATE BUDGET FOR 2018**

### **Summary and recommendations**

**Final statements of accounts are important elements in the budget process and it is good that the obligation to submit them to the Parliament has finally been complied with.** After three years of failure to publish and seventeen years of failure to adopt the final statements of accounts at the National Parliament, these important laws for the period 2002-2018 have now finally entered the Parliament procedure. This marks an important step towards the improvement of public finance management, as the final statement of accounts is the only document that shows final, detailed and comprehensive data on the execution of the State Budget and thus allows for its most reliable analysis. Execution of the State Budget is also monitored throughout the year and published in the reports of the Ministry of Finance, but these reports are not complete. Only the final statements of accounts provide precise data by category of revenue and expenditure and encompass beneficiaries which are not a part of the regular budget execution reports.

**Final statements of accounts shed new light on the value and structure of public expenditure in Serbia.** One of the most important conclusions is that budget beneficiaries' spending far exceeds the budget plan and current reports of the Ministry of Finance. Namely, the final statements of accounts show that there is a part of the budget bodies' expenditure that has not been encompassed by regular reports and that amounts to 570 m Euros per year. These are extra-budgetary revenues of educational and social institutions that they use to fund their current expenditures, primarily salaries and goods and services. When they are taken into account, it turns out, e.g. that the entire wage bill of the general government adds up to more than 10% of GDP (which was estimated to be lower). This is an important conclusion bearing in mind that the salaries in the public sector are an important anchor of budget and economic policies. In addition, final statements of accounts show that about 850 m Euros per year is spent differently than shown in the budget plan adopted by the Parliament. Even before, we knew (in general) that budget appropriations are changed during the year using budget reserves and other non-transparent sources. Still, only final statements of accounts allow us to see the value and structure of these changes. They are not entirely economically problematic (e.g. about a quarter of the sum pertains to an increase in capital expenditures), but this is still too high an amount to be allocated completely outside of the Parliamentary procedure and without the public scrutiny that the Budget Law has

been subjected to. Finally, final statements of accounts fail to show some important information, such as, to whom and why enormous penalties have been paid, which public enterprises paid a part of their profit into the budget and in which amount, which private enterprises used subsidies for foreign investors and other important information that will be discussed below.

**Final statements of accounts should include some important information that, insofar, is missing.** Final statement of accounts is an ideal space to answer some important questions regarding public finances which had not been clarified when the budget was prepared, or when current reports on execution were submitted. However, many budget categories - important both in terms of public policy and in terms of magnitude - have not been sufficiently clarified. We provide a review of the largest shortcomings in that regard below.

- *It is unclear on what grounds the government paid fines and penalties, despite the fact that the sums are large and growing.* In the final statements of accounts only the final sum is provided, there is no detailed account on the payments of penalties and fines, so it is unclear to whom the government has paid out these sums and in which individual amount. This is an issue because it represents a non-productive expenditure which keeps growing from year to year. In 2018, this sum reached 19 bn dinars and was about four times higher than in 2010, which certainly warrants a closer explanation. More importantly, a detailed insight into fines and penalties would help analyse and prevent their causes in the future. Even if there is justification for keeping these payments out of the budget plan (since there is a possibility that they would not be executed in full), there is no justification for excluding them from the execution, since they have already been executed and are therefore known.
- *Beneficiaries of subsidies for foreign investors are not known.* The information on what companies have been given these subsidies and in what amount is not present in the Law on Budget, with the explanation that the Budget includes the maximum planned amount that might not be paid out in full. However, once the payments have been made, there is no justification to keep the public in the dark as to how the budgeted funds have been allocated to beneficiaries.
- *Capital investments are not presented transparently enough.* For certain budget beneficiaries, such as, e.g. Public Investments Management Office and the Ministry of Finance, the final statement of accounts does not provide a sufficiently clear view of what concrete projects were invested in, only the total amount of investment. Consequently, it is impossible to ascertain how much exactly is being invested into some fields critical for sustainable economic growth and economic policy, such as education, which is partially financed from the budget of the Public Investments Management Office. In addition, it is impossible to conclude, from the final statements of accounts, for which exact projects the land expropriation was paid, which is funded from the budget of the Ministry of Finance (only from the reports of the National Audit Office can it be seen that in 2018, the majority of payments were for the Belgrade Waterfront project). This would be important to know, since expropriation costs hint at the scope and structure of future infrastructure works.
- *The sources of payments (non-tax revenue) that were quite significant for the budget in the period 2015-2018 have not been explained.* Namely, in the period from 2015 to 2018, non-tax revenue exceeded the planned amount by about 115 bn dinars. It is known that as much as 110 bn dinars were collected from state-owned enterprises and public agencies in this period (the plan was about 60 bn dinars); the Ministry of Finance did publish the details of the largest payments over the years, but not all payments. Unfortunately, the final statements of accounts do not reveal which enterprises and agencies made payments into the budget, or in which amount. A good practice example is the City of Niš, which shows this data in detail and

regularly in its final statement of accounts. Another example of unsatisfactory reporting in the final statement of accounts of the Republic of Serbia is *other irregular non-tax revenues* which were collected in an amount five times higher than planned in 2018 (20.8 bn were collected, compared to 4 bn that were planned) and there is no explanation in the final statement of accounts. Indirectly, from other sources, we conclude that approximately a half of this amount pertains to payments related to the issue of bonds; however, the final statement of accounts should present these explanations and for the entire amount, at that.

- *The tax expenditures are not estimated in the final statement of accounts.* Tax expenditures are foregone revenues of the government, which were not collected due to various tax exemptions or tax credits (e.g. VAT exemption for the purchase of the first apartment etc.) and can be treated as a form of subsidy to the economy or the population. Budget plans for 2010-2012 comprised assessments of the tax expenditures, which was a good practice example. In this period, this amount was about 20 bn dinars per year (it was higher in 2012 due to a new calculation methodology), therefore, it was a budget value that was reported. However, neither final statements of accounts in that period, nor later reported on the tax expenditures, despite the fact that this is an important information for economic policy and it should be assessed as precisely as possible and included in budgets and final statements of accounts.
- *Information on which companies required payments of activated guarantees and net lending from the budget should have been presented.* It should be clearly shown on behalf of which companies, and in which amount, were the loans repaid and who the recipients of budget lending were. Practically, in the entire observed period, these expenditures were large, but until 2014, they were mostly classified “below the line”. Since 2015, they have appeared “above the line” and have been included in the calculations of fiscal results; at least since that time, these payments should have been presented in more detail.
- Amendments to the Budget System Law prescribe the obligation for final statements of accounts, starting with the one for 2018, to comprise information on performance indicators execution for individual budget beneficiaries’ programs. The Fiscal Council warned that this was a counter-productive measure that would require enormous administrative capacities, while the international experience shows a lack of positive effects on budget allocation. Since the proposed final statement of accounts for 2018 does not comprise this information, we propose to have either this Draft Law amended with addition of information on the execution of performance indicators or that, even better, the Budget System Law be amended and this administratively challenging procedure revoked, as it would yield no positive effects on the budget system process.

**Final statements of accounts provide insight into revenues from extra-budgetary sources; it was shown that this item was systematically underestimated in budget plans.** For indirect beneficiaries, extra-budgetary revenues consist of revenues from the sale of goods and services (the so-called own revenue of indirect beneficiary) and transfers from other levels of government, in approximately 50:50 ratio. Even though they are included in the budget plan, in general, they are not monitored in the regular execution reports (same goes for expenditures funded from this revenue), so the final statements of accounts are the only documents that show in which amount this item was actually executed. In 2018, these revenues and the expenditures funded from them amounted to a total of 67 bn dinars, i.e. about 570 m Euros. On the other hand, the budget plan envisaged this to come in at 53 bn dinars and this underestimation is not surprising. It turned out that these revenues have been underestimated in the budget systematically, for many years, as the average discrepancy of the revenue collected from the plan in the period 2013-2018 amounts

to 23 bn dinars, meaning that, on average, the state level expenditures are higher by this amount, too. Also, based on the final statements of accounts we can see that the revenues from the sale of goods and services are forecast very close to the actual value, but that the transfers from other levels of government are underestimated, even though they are relatively easy to predict.

**Extra-budgetary revenues are used to fund mostly current expenditures, which is why expenditures for the wage bill are somewhat larger than previously thought.** Extra-budgetary revenues are used by indirect budget beneficiaries for funding expenditures of equal value. Hence, just as the execution of these revenues is not followed through regular reports of the Ministry of Finance, the execution of the expenditures, funded by these revenues, is not monitored either. With the final statements of accounts, it became clear that the current state expenditures are higher than shown in the execution reports by the Ministry of Finance and that in 2018, this amounted to about 67 bn dinars. This sum is mostly used to fund salaries (26 bn dinars in 2018), goods and services (33 bn dinars) and, to a lesser extent, for capital expenditures (6 bn dinars). As for the salaries for employees, an important information from the final statements of accounts is that, when these funds are considered, total expenditures for the wage bill of the general government employees exceed 10% of GDP. An acceptable level of this indicator is 9.5% of GDP, which is what the Government committed to in official documents and in the IMF arrangement, and now it is clear that the indicator is higher. Additionally, the wage bill would be even higher if the compensations earned by scientists and a part of employees working on contracts on temporary and intermittent tasks - who, in essence, are performing regular tasks, were to be included in the wage bill instead of being classified under expenditures for goods and services.

**Final statement of accounts shows that large amounts are used, throughout the year, differently than prescribed in the adopted Budget Law.** When the Parliament adopts a budget that is the plan for budget beneficiaries' expenditures for the upcoming year. It would be expected that the expenditures would diverge little from the plan and that the budget would be a true and binding roadmap of public expenditures. Still, in practice, there are major discrepancies between plans and executions. Thus in 2018, as much as 850 m Euros were spent differently than what was planned in the budget. The structure of these funds is as follows: 1) about 400 m Euros was reallocated and then spent out of the current budget reserve, 2) about 160 m Euros were spent on the grounds of legally permitted changes of appropriation of up to 10% within a single beneficiary - reallocating funds intended for one purpose, to another, 3) about 290 m Euros was spent from additional sources, among which the largest item is the one that covers additional loans for capital expenditures (170 m Euros). All in all, this is too large a sum to be spent differently than what was passed in the National Parliament with the adoption of the Budget Law, and it warrants a more detailed explanation.

**Expenditures funded from the current budget reserve are large, growing and mostly non-transparent.** Current budget reserve is an amount that the Government can reallocate between budget beneficiaries during the year, changing the expenditure compared to the budget plan, without the approval of the National Parliament. This mechanism is justified for the sake of unforeseen circumstances that require adjustments during the year. However, the scope and manner of budget reserve use show that, in our practice, these are not urgent matters, but a usual approach to budget management. First, the fact that the amount of funds spent from the current budget reserve increases every year is alarming. In 2010, it was possible to use only up to 1.5% of the forecast revenues in this manner. In the meantime, the limit was increased, and it now amounts to 4% of the forecast revenues, which, in 2018, is an enormous sum of 47 bn dinars or 400 m Euros. It can also be seen that in recent years some state expenditures have been budgeted too wide (transfers to

organisations of mandatory social insurance, interest rate payments, pensions) even when they are easy to forecast precisely - and the funds from these positions are then moved to the budget reserve during the year. In short, this makes space for the filling and the emptying of the budget reserve. The budget reserve beneficiaries repeat from year to year - Ministry of Defence has used about 20% of the funds from the budget reserve in the last three years; about 35% went to capital expenditures of the Public Investments Management Office and the Ministry of Construction, local governments get about 10% as support for liquidity and 10% is used to fund salaries. What is additionally problematic is that the purpose of the used funds is not always clear, and in 2018, a half of the funds used from the budget reserves had not been explained by any grounds of payment (it is known that the defence sector is the beneficiary, but also the General Secretariat of the Government, the Government Air Service, Ministry of Economy, Joint Operations Administration etc).

**In this document, the Fiscal Council issues recommendations on how the budget process can be improved in the domain of the issues presented in the final statement of accounts.** Commending the submission of the final statements of accounts for all the missing years, we provide our conclusions and the recommendations that we have derived from the information in them. The purpose is to improve the final statements of accounts, contributing to Serbian public finance. We will also be basing our future analyses on the published final statements of accounts, so that they will serve as lasting analytical basis and a source of information for public finance assessment. Proposals for improvement are directed at several areas that we analysed in more detail.

- *The limit for funds that can be included in the budget reserve needs to be lowered.* The sums allowed to be reallocated through the budget reserve need to be lowered from the current 4% of the forecast revenues, to 1.5% which was the limit first introduced (in 2010). Bearing in mind that these funds started funding major government economic policies, large funds and new programs should pass through a regular budget adoption procedure and get legitimacy through a parliamentary vote. At that, the practice in comparable countries is that the amounts allowed to be included in the current budget reserve are much smaller than is the case in Serbia now. With a limit of 1.5% of planned budget revenues, the reserve in 2018 would amount to about 18 bn dinars, which is quite sufficient for it to meet its purpose.
- *Reporting on the use of the current budget reserve, both in the final statement of accounts and throughout the year, needs to be improved.* During the year, the use of the current budget reserve is published in the Official Gazette, but not in a satisfactory manner. The biggest issue with this reporting is that explanations are often generic and non-informative, as well as the fact that some payments out of the budget reserve are not even published in the Gazette. We believe that reporting during the year should be improved by including the reports on the use of current budget reserve in the regular reports of the Ministry of Finance (at least quarterly). In addition, in the final statement of accounts, the nature of payments needs to be explained better, since only a third of the transactions have been explained in a satisfactory manner and, for two thirds, this explanation is either too general (and therefore inadequate) or is not offered at all.
- *Extra-budgetary revenues of indirect beneficiaries need to be planned more objectively.* It is both necessary and achievable in the short term to improve the extra-budgetary revenue planning to reflect the actual situation. This means that the practice of constant underestimation of the funds budget beneficiaries get via transfers from the local government needs to stop.

These amounts are determined in line with clearly defined parameters, so there is no reason for their imprecise planning.

- *Extra-budgetary revenue execution needs to be included in the reports throughout the year.* Even with a certain delay, the regular records on the execution of the budget need to be complemented by the part of expenditures funded from the extra-budgetary revenues of indirect budget beneficiaries. We would advise the Ministry of Finance to report on the expenditures funded from the extra-budgetary revenues, at least quarterly, as it cannot precisely consolidate all their direct and indirect beneficiaries, as part of the transactions are still executed outside of the consolidated treasury accounts. Even though this information would arrive with a certain delay compared to the regular monthly reports, we believe that this practice would force indirect budget beneficiaries to use the budget funds in a more rational manner.
- *Educational institutions need to be included in the budget execution system.* In the future, the entire scope for reporting on the State Budget execution needs to be presented. Since 2012, the scope of central level institutions whose revenues and expenditures are reported in the current budget execution reports began to expand, which is a good thing. In 2019, social institutions became a part of current reporting on the state budget. Now only the educational institutions need to be added into the single public expenditure execution system, which would make them equal to other beneficiaries of public funds that are part of the central level of government.
- *It's important to improve reporting on individual beneficiaries' breaches of plan.* Beneficiaries are obliged to explain all deviations in execution from the plan in a special section of the final statement of accounts. However, beneficiaries often report deviations not from the original amount approved by the budget, but from the so-called current appropriation. This position encompasses all changes in the planned expenditures that occur during the year, e.g. funds approved from the current budget reserve or additional loans drawn. This leads us to a paradox where budget beneficiaries explain the deviation from this new plan even when this deviation is minor, but, on the other hand, fail to explain the deviation from the original budget, even when the execution is by far higher than the originally budgeted amount. In addition, in some cases, no explanation is offered for the deviation from the plan, even when the deviation is huge. This, for example, goes for capital projects that together make up a half of the executed public investments of the Republic of Serbia in 2018 (e.g. entire Ministry of Construction, Office for IT and E-governance), so it is impossible to take a comprehensive look at the reasons that were crucial for the capital project investment dynamics; at that, the excess of capital expenditures compared to the original plan represents the highest deviation from the plan in 2018.