

CHAPTER IV. THE INSTITUTIONS OF THE BUDGET PROCESS

Introduction

4.1 The emerging budgetary problems in Belarus have increasingly focused Government's attention on crisis management. The consequence has been to create a wedge between the budget as approved and as implemented. Although the government has succeeded in keeping the fiscal deficit under control on a cash basis, the uncertainty that has been introduced for spending agencies, transfer recipients, public employees and contractors is having a large negative impact on the budget institutions. At the heart of the matter there appears to be developing an inconsistency between the capacity of the productive system to generate revenues and the expenditure plans of government. The government is conscious of the urgency to address such misalignment. The challenge will be how address these problems systematically, so as to build up the institutions that sustain the budget process.

4.2 The world has accumulated abundant experience in improving the management of public moneys over the last decades. These experiences show that budget reforms to improve the quality of expenditure management take a long time and are best initiated as soon as possible. This experience also sheds light on the different options for institutional budgetary arrangements as well as the sequencing of reforms. The experience of the transition economies in this regard has its own peculiarities. The role, scope, and size of the state has been significantly streamlined in these countries. The state has moved from being direct provider to regulator and overseer. New concepts, such as accountability and transparency have been introduced, and preliminary efforts have been made in some transition countries to create a tighter link between objectives, budgetary instruments and outcomes. The role of the Treasury has been strengthened. However, most of the transition countries operate to varying degrees with a mix of old and new institutions. Belarus is no exception.

4.3 This chapter reviews the existing budget processes and institutions in Belarus. The chapter begins with a presentation of the normative principles of public expenditure management. The rest of the chapter looks at each of these dimensions as now practiced in Belarus. Finally, the chapter closes with recommendations to accelerate improvements in the allocation and use of public moneys.

Public Expenditure Management Principles

4.4 Robust budget systems facilitate public expenditure management. Public expenditure management has three overarching and interrelated objectives, which are to ensure that: the

government operates within resources reasonably available; resources are allocated across competing national priorities in a clear, deliberative and consistent manner; and once allocated, resources finance only effective and efficiently managed activities. Government budget processes – as well as the budgets themselves – are essentially the tools for ensuring achievement of the objectives of public expenditure management.

4.5 *Fiscal Discipline.* As discussed in Chapter II, establishing and maintaining aggregate fiscal discipline helps maintain a solid macroeconomic environment and sets the basis for a sustained rise in incomes. Governments, like households, must “live within their means.” Thus, fiscal deficits are necessarily short-term and the accumulated public sector debt must be kept within reasonable and sustainable limits. In developed market economies, the financial markets impose fiscal discipline. In other environments, countries will have to depend more on administrative measures to exercise fiscal discipline. The budget process is the mechanism through which a country both adheres to aggregate fiscal policy targets, identifies spending priorities and specifies how it will achieve service objectives.

4.6 *Allocating Resources Among Competing Ends.* By definition, public budgets ration scarce resources across alternative competing uses. The process of establishing strategic priorities and formulating a budget reflecting those priorities is necessarily a political process, which has to be supported by a sound institutional underpinning. Such institutional underpinnings must include an effective process for managing the extent and form of departmental bids and for allocating shares of total funding across sectors, departments, and spending units. The objectives of strategic prioritization are to encourage an allocation of funds that both reflects well-defined government priorities and that channels funds to those programs providing the highest return on the use of public funds. Among the institutional features and enforcement mechanisms cited as supporting allocative efficiency are:

- an effective medium-term fiscal framework that clearly outlines a government’s policy priorities and facilitates a multi-year horizon for financial planning and implementing structural change;
- comprehensive budget coverage to ensure that tradeoffs between competing demands for funding can be fully considered and accurately assessed;
- consistent and transparent criteria for assessing the full costs and benefits associated with alternative uses of public funds (or at least one that explicitly identifies beneficiaries); and
- a process for establishing policy priorities and compatible allocations that incorporates demand information across a variety of stakeholders, but also provides an opportunity for top-down enforcement of sectoral or departmental spending limits (envelopes).

4.7 *Technical and Operational Efficiency.* How to achieve and improve technical efficiency in public expenditure continues to be debated. Still, modern approaches to public expenditure

management highlight an appropriate balance between managerial autonomy and accountability in the spending agencies. The following are key points of this approach:

- clear definition of measurable program outputs;
- flexibility or autonomy on the part of program managers, allowing for decentralized decision making to determine best inputs to produce expected outputs;
- predictability in the level of funding;
- strict reporting and monitoring of spending;
- high quality audits;
- merit-based recruitment;
- competitive procurement; and,
- involvement of the end-users.

Organization

4.8 The chapter is organized around the key phases of the budget cycle: preparation, approval, execution and audit and evaluation. Note, however, that the budget cycle phases overlap e.g. preparation of the budget for coming years is accomplished during execution of the current year. Thus, although for analytical purposes, it makes sense to discuss the phases separately, the various phases of the budget process are inter-related and progress has to be made across the board. Good preparation is needed for a successful implementation and a fair implementation of the budget enhances the credibility of the preparation process. It is important to have this in mind, because responsibility for the stages of the budget process lies with different agencies. A central authority is needed then to guide the overall process. The experience of countries with successful fiscal systems shows that a strong fiscal authority is needed. That authority is often the Ministry of Finance.

The Legal Framework and Accountability

4.9 The legal framework for, and extent of coverage of, public budgets define the degree to which it is possible to achieve effective public expenditure management. The effectiveness of the legal framework, however, will depend on appropriate enforcement. Hence, the single most important objective of an effective legal framework for public budgets is to provide for the accountability of individuals with authority for managing public finances. In order to accomplish this, the prevailing legal framework must set a clear and predictable set of roles and obligations for those involved in public budgeting – across all phases. Accountability can be encouraged internally and externally (Box 4.1). Internal accountability requires an appropriate balance of powers across branches of government as well as across and within government agencies. External accountability,

to those outside of the government structure, requires a high degree of transparency in all fiscal matters and explicitly outlined arrangements for independent audit.

4.10 The existing legal framework in Belarus is a combination of old and new practices. This incomplete legal framework wrests effectiveness from the public budgeting process and prevents full accountability and transparency. The legal framework has to move from being an instrument that records and tracks expenditure to being the main instrument that translates policy objectives into concrete outcomes on the ground.

Box 4.1: Public Budgeting and Accountability

In the aggregate national context, there are at least four dimensions on which to assess accountability: financial, administrative, public and political. Robust public budgeting systemically addresses the first three dimensions. Financial accountability is fully addressed through the process of annual audits conducted according to internationally accepted accounting standards. Audits also at least partially address the issue of administrative accountability – as do evaluation, the structure of civil service and administrative laws and controls.

An important instrument for accountability is transparency. Hence, public accountability – and efficient use of resources – is reinforced by ensuring access to information throughout budget cycles. Government policymakers and service providers need information on demand conditions (i.e. what services in what amounts the public wants) in order to best allocate resources. Similarly, the public – whether individuals, interest groups or private producers – need information on the shape, size and effectiveness of government finances and programs in order to make rational economic decisions.

4.11 The legal framework for budget management in Belarus includes provisions in the Constitution, the Budget System Law (BLS), the Annual Budget Law (ABL), the Law on Local Government (LGL), and other laws including those governing budget classification, the banking sector, government debt and taxation. These laws address most dimensions of budget process, but still they are incomplete, particularly in key areas of transparency, such as audit.

4.12 The government has recognized that there is a need to complete and streamline the legislative base for public budgeting and is presently considering formulation of a comprehensive budget code. In doing so, the government faces a trade-off between making short-run improvements in current practice versus composing a ‘best case’ comprehensive budget code. Since changes are always skill intensive – at both technical and legislative levels – and there is a limited pool of qualified staff available to address aggregate-level public budgeting issues, there is some concern that focusing reform efforts on preparation of a comprehensive budget code might preclude making much-needed changes immediately. Nevertheless many countries, including Russia and Ukraine, have successfully amended and updated their budget process through the development of a Budget Code.

4.13 In the interim between existing conditions and enactment of new comprehensive budget legislation, prevailing legislation on budget processes could productively be amended to: (i) require the Government to produce a public budget policy statement; (ii) reduce significantly the scope of off-budget activities and clarify the legal status of the republican level extra budgetary funds (Social Protection Fund) ; (iii) expand access to information on fiscal performance to parliament and the public at large; and, (iv) establish a legal basis for an independent external audit agency reporting directly to Parliament.

Budget Coverage

4.14 The extent of budget coverage – i.e. what is included in the budget versus what is handled through special funds or is ‘off budget’ – is important for several reasons. First, it determines the degree to which the budget can function as a tool for maintaining aggregate fiscal discipline. Second, comprehensive budget coverage facilitates resource management and tracking and allows for the tradeoffs between competing demands for funding to be assessed against consistent criteria. Third, comprehensiveness facilitates transparency and accountability. The scrutiny of oversight agencies and the general public reduces the risk of imprudent or undisciplined use of public funds. To extend budget comprehensiveness, however, requires removal of the financial incentives that encourage ministries, budget organizations and lower levels of government to utilize off-budget funds.

4.15 Chapter II has already identified the public expenditures not included in the budget. The Belarus government must decide either to drop expenditures not in the budget or incorporate them, even if only through the treasury. On the expenditure side, the power ministries should be brought into the budget and the corresponding resources managed through the treasury. Extrabudgetary funds should be kept at a minimum. Those financed with contributions, like the Pension Fund, may be outside the budget, but they should follow strict accounting and transparency rules, and over time resources (certainly, revenues) should be managed through the treasury.

4.16 The streamlining and potential elimination of Innovation Funds requires special attention. Today, they are part of the government’s effort to direct investment to critical sectors of the economy. It would be best to replace the mechanism of Innovation Funds by including the

investments they support into the system of capital grants, or for those allocated to commercial enterprises to strengthen the ability of the financial sector to respond to investment needs.

4.17 The rules and incentive structures governing fee for services and non-tax revenues derived from the entrepreneurial activities of ministries should be reviewed to remove perverse incentives that may complicate budget management and make difficult the implementation of hard-budget constraints. The experience of other transition countries show that spending units when facing a hard budget constraint seek alternative sources of income to keep the level of expenditures and postpone reform. This often leads to a distortion of fee-for services, as the link is lost between tariffs and costs and equity considerations are not taken into account. To prevent this from happening, it necessary to enforce clear rules for the calculation of the fee-for services and to include expected fee collection in the budget, without reducing other allocations proportionally (claw-back.)

4.18 The rules regarding non-tax revenues derived from entrepreneurial activity also provide perverse incentives. The present rule in Belarus is that the surplus generated by entrepreneurial activities of the ministry are to be deducted from the allocation to the respective ministry. Not surprisingly, according to the Ministry of Finance, these activities do not show a surplus, meaning that the present rules induce ministries to use all of the resources available. This leads to the allocation of public resources on non-priority expenditures. If spending agencies have the incentive to spend all of the non-tax revenues under their control, the marginal social benefit of the use of these resources may be lower than in other activities in the public sector.

4.19 As seen in Chapter II, quasi-fiscal expenditures continue to be present, especially with respect to the banking system, directed credit and controlled interest rates. These expenditures not only do not go through the budget, but rarely are they carefully accounted for. A first step to address the issue of quasi-fiscal activities is to assure that there is a full accounting of those activities that have an implicit impact on the budget so that the sum total of their effect is made clear. The second step, is to eliminate price distortions and to explicitly include in the budget support for targeted groups that may need assistance based on their low levels of income. Moreover, a broad effort is needed to examine the extent of the contingent liabilities in the Belarus economy and to streamline and tighten the rules that may directly or indirectly be extending public sector guarantees to activities carried out by spending agencies or enterprises outside the purview of the budget authorities. This issue may be particularly relevant in the case of energy debt of enterprises.

4.20 Lastly, on the revenue side, there should a policy of accounting for tax preferences. Tax preferences are in the end expenditure items and they should be properly accounted for. Also, there should be a strict policy of not issuing tax preferences, and if tax preferences are given, a proper costing should be made of the impact on the budget. Moreover, practices of targeted exemptions by decree or by fiat are best discontinued (See Box 4.2).

4.21 The government is aware of these problems and recognizes that improvements in the coverage of the budget are necessary to allow sound fiscal management. Already in 1998 the budget consolidated five targeted funds previously excluded from the budget. In addition, reporting requirements have been strengthened for two of the largest remaining off-budget funds (Social Protection Fund and Innovation Funds). In fact, since 1 January 2002, the Ministry of Finance keeps record of revenues and expenditures received from entrepreneurial activity by the establishments financed from the republican budget; Innovation Funds created by the Republican governing bodies and other state organizations; and the Social Protection Fund. While this information is collected by the Ministry of Finance it is not fully incorporated into budget planning and into the fiscal system more generally. While the government plans to extend coverage of the treasury system to include all Republican budget organizations and local budgets is a positive step, the “power ministries” (Defense and Internal Affairs) remain outside the treasury system, thus continuing to allow only a partial picture.

Budget Classification

4.22 The main shift to a Government Finance System (“GFS”) -based system occurred, according to the Ministry of Finance, in 1997. Thus, the budget analysis would generally be consistent with the GFS analysis. However there are issues that remain in the transition to this system. With respect to the economic classification, much work needs to be done to assure that capital expenditure is fully consistent with those expenditures only spent on actual investment. The current costs that accompany investment should not be considered as part of capital expenditure. The functional classification still uses a broad range of categories that are not fully in line with GFS categories. Finally, the Belarusian budget continues to treat privatization of assets as a source of revenue rather than as a financing item. Because privatization reflects a change in the assets and liabilities of the governments and is typically a “one-off receipt” international practice is to treat revenues from privatization as a financing item.

Box 4.2: International Experience with Covering Tax Expenditures and Contingent Liabilities

In addition to direct expenditures, comprehensive budget coverage also necessitates reporting on tax expenditures, quasi-fiscal activities, contingent liabilities and other fiscal risks.

Tax Expenditures

A growing number of countries now produce as part of budget documentation an explicit list of tax expenditures, i.e. legislation or regulations that entail a revenue loss due to the application of a rate reduction or tax exemption for a specific taxpayer or group of taxpayers. In *France*, the list of tax expenditures is classified

Budget Preparation

4.23 *Budget preparation* encompasses the formulation and eventual presentation of the budget by the chief executive to the consideration of the legislative branch. The process of budget preparation has to be framed within a precise timeline of critical decision points (the calendar) and clear directions issued by the executive/budget office (budget circular.) The preparation of the budget itself involves input from individual government agencies (i.e. line agencies) as well as key budget institutions (i.e. Ministry of Economy, budget office). Budget preparation concludes with executive acceptance of a budget as ready for submission for legislative action.

4.24 Two elements are key to effective executive budget preparation: forecasting, and the procedures for the allocation of resources among competing ends. First, reliable forecasting of revenues and expenditures is necessary. The revenue forecast is particularly crucial, as it sets the context for the expenditure allocation process by establishing the envelope within which expenditure

allocations must fit. Second, clarity and reliability in roles and procedures spelled out in budget circulars and calendars, has a critical effect on the quality of budget proposed by the chief executive to the legislative body. If budgets do not materialize as expected, or if they are subject to arbitrary revisions, spending agencies will have little incentive to cooperate in improving preparation and work on evaluation.

4.25 Budget preparation requires priority attention today in Belarus on account of:(i) emerging budgetary arrears, meaning that a disconnect has appeared between budget preparation/planning and execution, and (ii) the very limited extent to which effective results on the ground are taken into account in budget preparation.

4.26 *Budget Calendar & Budget Circular.* The budget calendar and budget circular should define the responsibilities of different actors in the budget process, specifying information to be included in budget requests, and establishing a timetable for producing an effective budget. The budget calendar deadlines must allow sufficient time for macroeconomic and revenue forecasting, priority setting by senior leadership in light of resource constraints, translation of policy priorities into indicative spending envelopes, preparation of budget submissions by spending units, review of these budget submissions, and consolidation of a final draft budget document. The budget circular plays an important role in setting out the parameters to be used in the various stages of the process covered by the calendar.

4.27 Public budgets in Belarus cover the calendar year. The deadline for the submission of a completed draft budget by the President to the Parliament is 1 October, and Parliament is expected to approve the budget before the end of the year. In recent years, budget circulars have been distributed to ministries and other organizations financed by the Republican budget toward the end of June, and budget proposals submitted by spending agencies by the mid-July. This timeline left a relatively short period of time for spending units to prepare their budget submissions.

4.28 Moreover, the existing timeline leaves roughly two months for review, negotiation, and reconciliation of budget submissions with finalized macroeconomic and aggregate fiscal constraints, final approval by the CoM and Presidential Administration and preparation of budget documents. Negotiations over final allocations incorporated into the draft budget extend well into August and possibly September. Despite the lingering macroeconomic revisions and negotiations, the process has been successful in meeting the 1 October deadline set by the Budget System Law (BSL) for submission of the draft budget by the President to the Parliament.

4.29 Notwithstanding the ability of the government to meet budget preparation deadlines, the budget calendar can still be fine-tuned to best serve the budget preparation process. Ideally, the initial resource framework should be ready by March, the indicative ceilings by April, and the

budget circular issued by May. This calendar would leave more time to spending agencies to present their proposals by June. Then, with a revised macro-framework, the final budget can be put together by August and be presented to Parliament in September. However, with a high and variable inflation, it is more difficult to generate macroeconomic forecasts early on and issue expenditure ceilings. Over the medium term, the effectiveness of the budget calendar can fruitfully be increased by taking a multi-year view of the budget and sectoral allocations.

4.30 With regard to the budget circular, in addition to the current practice of presenting key macroeconomic parameters, the MoF has expressed an interest in using the circular to provide ministries and other spending agencies with indicative figures for fiscal aggregates and sectoral spending envelopes. This would be a very welcome initiative. However, the initiative will only be effective if the ceilings are effectively enforced

4.31 Additionally, the budget circular should require that spending units provide a breakdown of spending according to standard GFS-type economic and functional classifications, as well as a breakdown of spending between funding needed for the continuation of existing activities and funding for new policies, where the latter includes both a change in level of existing services and delivery of new services. For effective cash-flow management, the MoF should also require spending units to provide an accurate monthly cash payment schedule, and notify them that significant deviations from the schedule submitted may incur penalties. Spending units should also be asked to identify sources of savings either through efficiency gains in existing service delivery or through termination of services where the social return on public funding is low relative to possible alternative programs. Finally, the circular should require that spending units begin the process of defining measurable performance indicators and outputs associated with individual spending programs, along with explanation of how those outputs relate to policy objectives. In a nutshell, the MoF and the MoE need to improve their information regarding spending needs and outcomes.

4.32 *Forecasting.* Reliable forecasts are needed to make informed policy prioritization and define expenditure ceilings for spending units in order to allow spending units to prepare reasonable spending plans (budget submissions). The basis of good forecasting is an accurate and consistent macroeconomic framework. Inconsistent macroeconomic scenarios increase the likelihood of budget revisions and deteriorate the credibility of the budget process. Such a framework should cover at least two to three years beyond the coming fiscal year, so as to provide policy makers with adequate information for strategic planning. Effective coordination and communication within government is vital to assure consistency of the macroeconomic and fiscal forecasts. Similarly, effective communication to the public regarding forecasts can play an important role, not only for promoting accountability, but to allow for fully informed decision making by economic agents.

4.33 In Belarus, there is already a tradition of macroeconomic forecasting, primarily with the Ministry of Economy and the agencies that provide essential inputs to economic policymaking. The

MoE produces the five-year Socio-Economic Development Plan (SEDP), which establishes priority macroeconomic and fiscal targets, including rates of real economic growth and annual inflation.

4.34 Revenue estimates for the budget are done within the MoF by the Revenue Department. Although the methodology is detailed, the reliability of the budget revenue forecasts has been less certain. This is an important source of risk for the budget execution today. Recently, revenues forecasts appear to have been overoptimistic and significant tax arrears exist at present. As of May they amounted to 208 billion rubels compared with 134 billion rubels at the beginning of January 2002.

4.35 The main problem with revenue forecasting in Belarus today seems to be an inconsistent macroeconomic framework, which has consistently generated inflation above government targets. In addition, in some cases the sectoral data used for forecasting GDP also appear to be based more on optimistic expectations on the part of individual line ministries striving to achieve policy targets rather than a more realistic assessment of production trends and demand. The MoF has to have the main responsibility for putting together the yearly macroeconomic scenario. Mid-term scenarios, out of indicative planning and the responsibility of MoE, have to be revised on a continuous basis to reflect the evolving environment and to avoid wide discrepancies between the plan and outcomes. These revised scenarios should be the basis of a more realistic mid-term macroeconomic forecasting in Belarus.

4.36 *Spending Unit Proposals.* All Ministries prepare budgets and all budgets are included in the national budget.¹ The only exception are some functions of the Ministry of Internal Affairs that are paid for by local governments. Spending agencies prepare separate recurrent and capital budgets.

4.37 Preparation of recurrent budgets combines two approaches: incrementalism and bottom up. The budget preparation approach is incrementalist because a budget envelope for the coming year is based on the expenditure of the current year, adjusted by parameters such as inflation (built into the budget at Ministry of Finance level), or any special programs that have been approved, and the impact of any Decrees issued by the President (see Box 4.3). At the same time, the budget preparation is bottom up because it is based on a set of agreed norms that are used to calculate expenditure. Reportedly, the norms have been derived from statistical evidence and reflect existing technologies in the production of government outputs. Based on this information, preliminary figures are prepared by the Ministries, who are expected to take into account the government's priorities as set out in the budget circular. Naturally, at this stage Ministries aim to maximize their

¹ Local budgets financed with revenue sharing are also prepared. These budgets are very important, since they account for a large percentage of the public sector budget. Local budget budgets tend to cover social expenditure-health, education, etc. Reportedly, during the process of preparation there is coordination between the local governments and the line ministries. However, local governments present their budgets directly to the MoF and defend them as well. Oblast budgets cover the budgets of the rayons.

own allocation. This dual approach produces two sets of budget expenditure estimates—one based on an updated estimate of the previous year’s allocation and another from the bottom up and based on norms. These two approaches are reconciled during consolidation.

Box 4.3: State Programs

State programs in Belarus are numerous and varied. As of 2002, the list included 108 presidential, state economic and social programs, and special programs plus 30 scientific and technical programs. Typically, sectors lobby for programs in order to get more funds and as a result, they do not typically reflect state priorities and availability of public resources. They also are not presented with clear objectives and expected outcomes, a rationale for public expenditure, an assessment of the amount and mix of resources needed to achieve the objectives, and quantitative or qualitative indicators for assessing the program outcomes. From time to time Ministry of Economy on the order from the Council of Ministers conducts an inventory of state programs. However, this procedure does not imply an evaluation of the existing programs and working out recommendations for extension, phasing-out or redesigning the programs: the major purpose is to compile the full list of such programs with their brief description. Although there seems to be an understanding by MoF and MoE that more and more programs are transformed into unfunded mandates, no attempt has been undertaken to estimate the costs associated with the implementation of all of the adopted programs in a sustainable way and to compare these costs with the availability of public resources. Among the largest programs are the following:

- ◆ Presidential Program “*Children of Belarus*”: BYR 739.84 bn during 2001-2005;
- ◆ National Program “*Mitigation of the Consequences of Chernobyl Nuclear Accident for 2001-2005 and up to 2010*”: BYR 2177.88 bn during 2001-2005 and BYR 2422.66 bn during 2006-2010;
- ◆ State Program “*Conservation and Use of Meliorated Land for 2001-2005*”: BYR 153.39 bn during 2001-2005, including BYR 89.4 bn from republican budget;
- ◆ State Program “*Roads of Belarus for 1997-2005*”: BYR 181180.1 bn in 1997 prices during 2001-2005
- ◆ *Housing Program* (as approved in the “Program of Socio-Economic Development of the Republic of Belarus for 2001-2005”)- commissioning of 2500-3000 thousand sq. meters of housing annually. 2001: BYR 110 bn of the NBB long-term credits and BYR 14 bn subsidies from the Republican to Local Budgets, BYR 93.7 bn from local targeted budgetary housing-investment funds; 2002: BYR 132 bn of the NBB credits and 17.4 bn subsidies from the Republican to Local Budgets and BYR 132.3 bn from local targeted budgetary housing-investment funds; 2003: BYR 140 bn of the NBB long-term credits, BYR 21.2 bn subsidies from the Republican to Local Budgets and BYR 187.3 bn from local targeted budgetary housing-investment funds

Such programs represent important government initiatives, but are not well integrated into the budgetary process. They appear to be separate from overall sectoral programs and the multitude of programs suggests that financing for all these programs remains uncertain. The creation of such programs also strains the budgetary process, by drawing resources away from other activities. Some activities, such as the housing program are financed directly from the central bank rather than being part of and financed through the budget. Finally, it seems clear that the financing of all such programs is not feasible within a sound fiscal framework.

4.38 Several shortcomings stand out today in the preparation of the public budget in Belarus. First, budgetary proposals and allocations do not seem to take account of the effective outcomes on the ground. That is, as discussed in Chapter III, allocations are not supported by a solid system of assessing public expenditures – nor even by a more narrowly defined system of traditional evaluation. Second, there is not a concept of improving efficiency embedded in the preparation of the budget², such as improving norms over time. Partly, this is due to the fact that the spending agencies would not get to keep either all or part of the gains from potential efficiency increases. Hence, there is little incentive for spending agencies to improve efficiency. Third, the practice of protected items, during execution and even preparation of the budget, provides an incentive for spending agencies to emphasize the use of protected items, and hence distorts the input mix in the production of desired outputs. This practice clearly has a very negative effect on efficiency. Fourth, there is not a consistent practice of phasing out programs or activities that have already accomplished their objectives. All of the above lead to bloated requests for financing and to low efficacy of public outcomes. The direction of reform should combine binding sector envelopes and greater flexibility and accountability for the sector agencies in the preparation of their budgets.³

4.39 *Consolidation.* Consolidation of initial submissions into an aggregate budget is accomplished through an opaque process of iterative negotiation or ‘reaching consensus’. The process amounts to one-to-one negotiation between the Ministries or the local governments and the MoF, based on arguments of previous spending patterns, bottom-up budget estimates based in norms, protected items, and new priorities.⁴ Once the Ministry of Finance concludes iterations with the various Ministries, the Council of Ministers discusses and agrees on the budget. The budget is then submitted to the President for his approval.

4.40 Recently, given the limited public resources, the MoF has taken initiatives to streamline expenditures, for instance, by eliminating some privileges. It is noteworthy that the initiative is taken by MoF, as this points out the limited incentives of the spending agencies to initiate expenditure reform. In these circumstances, the spending agencies tend to play a passive role, seeking above all to protect their allocations in terms of salaries and other priority expenditures, rather than focusing on improving performance and delivery. Since, it is spending agencies that have a more detailed knowledge of the expenditure programs, the

² The usual definition of the term ‘efficiency’ in Belarus is that of ‘spending in accordance with the budget law’. Improving efficiency does not mean a greater ‘value for money’.

³ The information requested from spending agencies should identify all their expenditure programs, regardless of the source of financing. Each program should identify the expected outcome. Information on changes of existing programs or the identification of new ones should be discussed as early as possible with MoF and before the budget is submitted.

⁴ Reportedly, there is continuous communication between the MoF and the spending ministries and agencies regarding budget needs. This continuous communication eases somewhat the strain placed by the short time available for consolidation, as pointed above. However, continuous communication does not substitute for a more structured consolidation process.

present approach of expenditure reform is not likely to lead to the best outcomes. Hence, if Belarus wants to undertake an ambitious program of streamlining expenditure and improving efficiency, a new institutional framework of cooperation between the MoF, the MoE and the spending agencies is necessary. Some successful experiments in this regard have already been undertaken in the health sector.

- 4.41 A key outcome of the modern consolidation process should leave all parties relatively satisfied. The Ministries of Finance and Economy should be certain that the proposed budget does not strain the macroeconomic situation of the country. There should also be certainty in the government that the proposed budget meets national priorities. Spending ministries and agencies need to be satisfied that the process of allocation is fair and that they have the resources to meet the priorities that have been assigned to them. Also, they should have enough operating autonomy to align resources assigned and objectives. The way to address these requirements is to implement a policy of budget ceilings and to enforce it, with greater autonomy for spending agencies. In the process, spending norms should be revised. (See Box 4.4 on best current practices.)
- 4.42 *Capital Budgeting:* A separate budget for major capital items exists. This budget is controlled centrally even though it is allocated over to individual ministries. The separate capital budget appears to be intended for major infrastructure projects. Upon examination, however, the capital budget does not seem to include all investment expenditures nor are all items included investments proper. Thus, some capital expenditures are often included within the individual ministry budgets and treated exactly the same as recurrent expenditures. Since the capital budget is subject to the rules of ‘protection’ applied by the Treasury and therefore spending included within this budget could be deferred, spending agencies may be trying to protect certain expenditures by moving them to the recurrent category.
- 4.43 On the other hand, the capital budget appears also to be used as a source of funding for special purpose activities that would not normally be regarded as ‘capital purposes’ although some of the expenditure could fall into the definition of capital. In other words, it was not being strictly used for capital investment purposes. Thus, there is no overall capital budget in the conventional accounting sense and no separate identification of capital expenditures within the budgets of individual Ministries. To improve capital budgeting in Belarus, it is necessary that the capital budget be developed to include all investment under implementation and that non-investment expenditures be taken out.
- 4.44 Also, it is essential that investment decisions be made within the context of a medium-term framework. That framework should include a stage of determining aggregate resources available for capital investments and a policy prioritization process to set the parameters for allocating funds across sectors in accordance with sectoral priorities and needs. The specific project proposals should be primarily the domain of sectoral specialists in spending units, with MoE and MoF officials providing the necessary

guidance regarding government priorities, budget constraints, informational requirements for proposals, critical analysis of submissions from spending units and oversight during implementation of approved projects.

Box 4.4: Policy Prioritization and Sectoral Allocations

Two critical aspects of budget preparation are establishing a government's commitment to well-defined and publicly stated fiscal policies and establishing a budget process that effectively allocates funding in accordance with policy priorities. The Fiscal Responsibility Act in *New Zealand* requires the government to produce a Budget Policy Statement (BPS) each year no later than three months prior to the beginning of the fiscal year. The practice has actually been to produce the BPS even earlier so that macroeconomic and fiscal forecasts presented in the document along with the statement of sectoral policy priorities serve as parameters for budget formulation by spending agencies.

The medium-term fiscal frameworks employed in *Australia, Denmark, Germany, New Zealand, Sweden, the United Kingdom* and other countries all provide examples of a budget process that sets down indicative baselines or expenditure ceilings for spending units or sectors before those spending agencies formulate their annual budget proposals. There are several important contributions this has for sectoral prioritization. First, the indicative baselines or ceilings are concrete indicators of the government's intention to fund particular sectoral activities. Second, the "top down" indicative allocations give spending agencies both greater certainty of funding levels and a clearer definition of budget constraints. This encourages spending units to carry out a more thorough internal prioritization of sectoral programs and pursue efficiency gains in existing programs in order to finance new or high priority programs. Spending units do not have to fear losing funding to a "claw back" by a finance ministry.

4.45 Over time, it is advisable to consider jointly both capital and recurrent budgets. After all, both recurrent and capital budgets seek to meet joint objectives within a given sector. The historical practice in many countries, however, has been to have separate capital and investment budgets. In some cases, the capital budget is entirely separate, produced and managed by a separate agency. In some countries, this reflects the impact of a high level of dependency on donor financing and the donors' preferences or preconditions for control or oversight. This is clearly not case of Belarus. In other cases, as in many transition economies, the institutional separation of capital and current budgets reflects the traditional organizational roles of distinct central ministries (i.e. the MoE and the MoF). Whatever the source of the bifurcation, the lack of integration can seriously undermine a government's effort to formulate and implement a cohesive set of policies incorporating an efficient level of capital investment and combination of current and capital spending.

4.46 Lastly, as seen from the data in Chapter III, the capital budget is treated as a residual item and subject to extreme compression, both in the initial formulation of the budget and in subsequent interim budget revisions. A consequence of the present institutional environment for capital budget could well be the emergence of a sizeable stock of incomplete projects. This has already happened in other transition economies and is beginning to emerge in Belarus.

4.47 *Medium-Term Expenditure Framework.* Best practice today in the budgeting of public resources takes a multi-year approach (See Box 4.5). Although the idea appears simple, proper implementation requires dealing with many of the basic concerns that are identified in this review. Otherwise, current problems are simply transferred to a multi-year framework. For instance, if it is now difficult to forecast next year's revenues, it will be that much more difficult to forecast them in the medium term. Likewise, in the absence of a truly comprehensive budget, actors may find ways to further elude budget control by developing even more complicated schemes over the medium term.

Box 4.5: Medium-Term Fiscal Frameworks

Many countries now use some variant of a medium-term framework for macroeconomic and fiscal forecasts to: promote aggregate fiscal discipline by explicitly accounting for outer year costs of both current and capital spending; focus the attention of political leadership on strategic decision-making for sectoral policy prioritization; strengthen planning and implementation of multi-year structural changes in fiscal policies; and encourage greater technical efficiency by increasing the predictability of funding for spending units. In all cases, the medium-term fiscal estimates are updated annually, that is, they are "rolling" estimates.

In *Australia*, forward estimates of budget baselines cover both the budget year and an additional three years. Cabinet and Department of Finance (DoF) consideration of annual budget proposals by the spending units (ministries) focuses on changes in the aggregate forward estimate of indicative allocations for that spending unit. The DoF carefully scrutinizes any policy proposals from spending units that imply an increased allocation, and spending units may be constrained to financing any new spending initiatives out of cost savings in existing programs.

In *Denmark*, annual budgeting begins with the application of macroeconomic forecasts to existing multi-year projections of spending. Medium-term baselines adjusted for changes in key parameters such as inflation and wages act as spending ceilings for individual ministries when preparing annual budget proposals. Again, this allows for the political decision-makers and the MoF to focus negotiations with individual spending units on how to accommodate fiscal pressures of new spending proposals, either by increasing the indicative allocations or by requiring offsetting reductions in spending elsewhere within the sector's budget allocation.

In *Germany*, preparation of the annual budget begins with submission of a multi-year financial plan to Parliament. The financial plan is the work of the Financial Planning Council with representation by all levels of government. The plan provides both an aggregate level of spending and a set of forty sectoral allocations. The sum of indicative allocations is held below the projection of total spending in order to provide for a general planning reserve accommodating the additional costs of new programs and unanticipated price increases for existing programs.

In the *United Kingdom*, determination of aggregate spending over the medium-term is subject to two constraints. First, there is the "golden rule" that the government will borrow only to finance investment spending and not current spending. The second rule is that the ratio of net public debt to GDP be held at a stable and "prudent" level to ensure that the level of borrowing and investment be fiscally sustainable. As in other cases, medium-term baselines are provided to spending agencies, incorporating updated macroeconomic forecasts, and periodic program reviews every few years are used to provide in-depth assessment of the quality of public spending programs. To encourage greater technical efficiency by spending units, including both incentives for seeking cost savings and avoidance of year-end "spend-ups", spending agencies are allowed to carry over unspent funds from one year to the next

Budget Approval

4.48 Budget approval practices vary greatly by country, but overall, the effectiveness of the approval process is dependent on: how the system is organized for the task; the quality of information available (i.e. in budget draft and relevant documentation); the level of staffing and support; clarity in defined role for the chief executive; and the extent and quality of communication between the chief executive (or his/her designate) and the legislative body.

4.49 In Belarus, the President submits a draft annual budget to the legislature. Parliamentary Committees consider each element, and may press for extra funds to be allocated to particular activities. However, in such situations, Parliament has to identify sources for the additional funding. Where Parliament proposes changes, the authority still remains with the President to decide whether to accept or reject Parliament's advice. Once approved by Parliament and the President, the budget becomes law and imposes obligations on each respective ministry.

4.50 The Parliament in Belarus plays a limited, but not totally passive role, in the budget approval process. The limited role of Parliament is due mainly to fact that the budget is discussed at high degree of aggregation. The information provided seems adequate, but since the budget is not comprehensive, Parliament does not get a complete picture of public expenditure. Moreover, the practice of revising the budget throughout the year (in response to fluctuating resource expectations and cash position) combined with the exercise of Presidential decree power, limit the influence and relevance of the formal budget approval process. Given the relatively limited actual power of Parliament to modify the draft budget, that leaves ample time for a legislative decision to be taken before the beginning of the fiscal year on 1 January. It would be advisable in Belarus to strengthen the role of Parliament during the approval and revision process. There has to be a limit to the capacity of the executive to change the budget.

Budget Execution

4.51 The challenge is to ensure that the budget is implemented as approved, and that changes during the year (to cut, increase, or shift resources within spending categories) are introduced following a clear-cut due process. Thus, line ministries need to be held accountable for achieving agreed-upon fiscal targets if the budget is to represent a meaningful constraint. More specifically, aggregate fiscal discipline requires that spending units not be permitted to exceed their budget allocations.

4.52 The cash management system must ensure that budget implementation leads to a distribution of actual spending in accordance with intersectoral policy priorities as specified in the detailed implementation budget. Also, cash management should support operational efficiency by providing an appropriate balance between autonomy for spending units, on the one hand, and their accountability to the MoF on the other. In situations of shortage of resources, commitment control and cash management acquire special relevance. In these circumstances, it is very likely that budgetary intentions are severely distorted during the implementation phase.

4.53 *A detailed budget.* Parliament approves the budget along very broad spending categories and thus the MoF and the executive in general retain considerable discretion in the final allocation of public funds. For execution, the Ministry of Finance breaks down the approved budget into detailed lines for each item of spending and for each part of the spending Ministry responsible---activities are allocated over the actual spending agencies of the Ministry, for example to a university or hospital. Within that, each line is broken down into quarters to reflect the level of spending expected to be incurred in that quarter. The arrangement for spending is that ministries cannot engage in spending above the limit allotted for the specific quarter.

4.54 *The mechanics of budgetary spending.* Upon allocation of the detailed budget (broken down by line, agencies and time), a ministry is able to commence issuing orders for services, works and equipment. For expenditures other than protected items (see below) and where the order/contract is for the supply of services, works and equipment, the Ministry is not able to commit spending of more than the quarter's allocation even though it may enter into a contract for the whole year. The quarterly allocations are those specified by the Ministry of Finance; there is no separate quarterly cash allocation made by the Treasury. The Treasury makes the actual payment through a centralized payment system and also makes decisions about which items will be paid and which held up. The Treasury carries out an ex ante payments check and as part of that process ensures that there is provision in the budget for the spending. The Treasury also attempts to control the ceiling of any contractual commitment to ensure that it can be funded within the budget.

4.55 *Advances in treasury management.* Treasury operations have been much improved in recent years. Systems of reporting and control are now in place that permit the MoF to track the use of funds, monitor arrears, and improve the flow of funds to spending agencies. The expanded coverage of spending units funded by the national budget appears to be contributing to more effective tracking of spending and reporting to the Ministry of Finance. Treasury coverage was expanded in 2002 to include five previously off-budget targeted funds. Further extension to other off-budget funds is envisioned, but it unclear at present whether the treasury system will also be expanded to incorporate local budgets.⁵

⁵ A comprehensive review of treasury activities was undertaken on 2001 by an IMF Mission.

4.56 *Book-keeping on expenditures and arrears.* There have been significant advances in public expenditure book-keeping in Belarus. Each Ministry maintains its own bookkeeping system on the basis of the agreed chart of accounts. It therefore lines up with both the Treasury and budgetary systems. The Ministry of Finance specifies the bookkeeping methodology. The bookkeeping system in some ministries is fully computerized and information is available on a daily basis. In other ministries the bookkeeping system may be partly manual and partly computerized.

4.57 The bookkeeping information is used to control expenditure and to keep the central ministry aware of the levels of spending by the different establishments for which the ministry is responsible such as universities that have their own individual budgets (albeit as part of the overall ministry budget). Thus, if such an establishment is not spending its budget, a ministry will get to know and will be able to seek explanations. The information contained in the ministry bookkeeping system is also used as a comparator with the Treasury information and from such comparisons the ministry is able to identify the extent of payment arrears, at the levels of ministerial agencies.⁶ Where bookkeeping systems are fully computerized, there is a computer link with the Treasury that allows a daily analysis to be made. Generally it appears that the same bookkeeping system is used to provide information about ministry off-budget activities and the same bookkeeping staff is used for this purpose. The only exception to this appears to be for the Social Security Fund.

4.58 *Commitment control can be improved.* Ministries keep records of commitments and the Treasury is informed of these but not the Ministry of Finance. However, the information provided to the Treasury may not be systematic and appears to amount to an indication, when contracts are entered into, of the whole amount of the contract for the year even though the current application to spend is for one quarter only. Poor commitment control and reporting may well be an additional reason for the emerging budget arrears. Clearly, Belarus needs to improve its system of commitment control.

4.59 *Cash-management under shortage of funds.* Belarus has not been able to take a full advantage of the advances made in treasury management. Optimistic revenue forecasts incorporated into the budget have contributed to cash shortages during budget implementation. Furthermore, strong political pressure to finance initiatives not included in the original budget have added to the imbalance of available resources versus expenditure demands. The result has been a critical cash shortage and budget sequestration in which the allocation of resources becomes a day-to-day management of available funds directed to priority spending categories. While spending units may have a formal appropriation for a given amount of funding and apportionments are made quarterly, spending units face a high degree of uncertainty as to whether they will actually receive their full funding, inclusive of unprotected items. The need to guarantee a modicum of fiscal discipline gives the Treasury control over the use of cash during budget execution, supplanting formally approved budget appropriations as the mechanism for allocating resources across priority programs. Thus, the

⁶ Where such arrears occur a Ministry is able to discuss with the Treasury what is held up and if necessary can appeal to the Council of Ministers to arbitrate.

Treasury takes a central role that derives from the fact that the present system in Belarus suffers from serious deficiencies.⁷

4.60 This situation has developed partly as a result of a budget preparation process that relies more on past trends than on emerging realities, unexpected expenditure mandates during implementation, and difficulties with tracking revenues month-to-month during the year. Hence, besides improvements in budget preparation and limiting executive discretion in altering the budget approved by parliament, as emphasized elsewhere, Belarus needs also to improve short-term revenue and expenditure forecasting. Forecasts should provide budget officials with a reasonably accurate projection of the revenue stream on a monthly or quarterly basis, noting seasonal patterns for key sources or government income. Similarly, for expenditures, the MoF requires a reasonably accurate global picture of cash needs on a month-to-month or quarterly basis. This would include a careful analysis of past trends regarding the seasonality of different types of expenditures, assessment of cash flow needs and, quite importantly, the provision of monthly cash payment schedules by spending units as part of their budget submissions. The MoF should establish appropriate incentives for spending units to keep their actual cash needs in line with projections, including negative sanctions for deviating widely from the schedule without suitable explanation of circumstances beyond their control. (See Box 4.6 on cash-management practices.)

4.61 *Protected items.* To manage the cash shortage, the government has defined certain items of expenditure as ‘protected’ such as salary and wage payments, food and what are defined as ‘essential’ items.⁸ ‘Protected’ for this purpose means that the expenditure is given priority for payment and is generally not held up if there is a cash shortage. Protected items are allocated to separate budget lines. Control over employee costs is particularly tight and ministries have to comply with pay norms that are laid down. Should a ministry wish to increase the number of employees it would need to seek the specific approval of the Ministry of Finance. Despite these measures, the concept of protected items introduces serious distortions in the structure, especially when the concept is also used as part of the budget preparation process. Moreover, as more items are moved to the protected category and budget funds grow scarcer, arrears may emerge even in protected items, such as wages. This appears to be already happening. Such practices remove the relevance of the concept of “protected item” and point out that this approach is at best a temporary tool. This is no real replacement for good budgeting.

⁷ In practice when spending starts, Ministries know that because of the cash difficulties of the Government ‘protected’ items will be paid but others could be held up. This means in effect that it may not be possible to provide full spending for the activities as envisaged in the budget. In particular, the Ministry of Finance said that equipment spending tended to occur in the last quarter because this provided a cushion if there were cash funding difficulties because equipment purchases were not ‘protected’ items.

⁸ See Chapter III, for a quantitative analysis of the protected items.

Box 4.6: Cash Management

Effective cash management is critical during budget execution to avoid costly short-term borrowing, prevent the build-up of arrears and avoid interruptions in the provision of basic goods and services. Generally, the system regulating planning, disbursement, use of cash by spending units, financial reporting and monitoring should support an appropriate balance of fiscal control and managerial flexibility. Incentives play an important role in promoting responsible cash management by spending units. Examples from various countries show how specific characteristics can contribute to these objectives.

Over the past decade, the *Philippines* has implemented a series of reforms to its system of cash management in order to improve the ongoing alignment of disbursements and revenue collections. Reinforcing interagency linkages and communication, both through information technology and committee oversight, between the Department of Budget and Management (DBM), Department of Finance (DoF), Bureau of the Treasury and Central Bank has been one important component of reforms. The Simplified Fund Release System (SFRS) implemented in 1995 seeks to standardize the release of funds across spending units, allow spending units greater flexibility within prescribed legal limits, reduce paperwork and other transactions costs, and strengthen monitoring instruments. The system also seeks to establish a formal process for coping with interim cash constraints, while protecting a degree of flexibility in resource allocation for spending units.

Sweden has also taken measures to strengthen incentives for sound cash management by spending units. Annual appropriations are divided into monthly apportionments and deposited according to schedule into each unit's interest bearing accounts. If balances are drawn down more slowly than scheduled, the spending unit retains the additional interest income accrued. Conversely, if spending exceeds the monthly apportionment, spending units must pay the interest costs to offset the government's cost of borrowing. Also, a carry-forward provision applies to both unspent balances and overspending. The provision allowing for the carry-forward of unspent funds into the subsequent financial year removes incentives for end-of-year "spend-ups", while also encouraging greater attention to efficiency gains, since spending units are entitled to retain any savings. Applying the carry-forward provision to excess spending encourages fiscal discipline to avoid commitment of the next year's appropriation.

Any features of cash management systems that contribute to overall fiscal discipline and a spending pattern in accordance resource availability and scheduled financial plans help to minimize the government's costs of borrowing, an important objective of cash management. Technology permitting, another measure used in some countries, including *New Zealand* is a nightly "electronic sweep" of government accounts into a single account so that interest income earned on the balance of funds held by government agencies accrues to a central account rather than to individual spending units.

4.62 *Revising the Budget During Implementation.* No matter how well prepared a budget might be, circumstances are almost certainly going to arise that necessitate interim revisions. Such circumstances include macroeconomic developments deviating from forecasts used to formulate the budget, unanticipated program costs, new policy proposals and the realization of contingent liabilities. And while the budget can and should incorporate some provisioning for these potential fiscal pressures, some revisions during the fiscal year are virtually inevitable. Therefore, it is

important that the legal framework and administrative procedures support a formal process for interim budget revisions. Otherwise, agents lose the incentive to do a good job in budget preparation, as they would have the option to still alter their allocations through the budget revision process. These incentives take precious time away from focus on proper implementation and performance assessment. At the close of the fiscal year, it similarly complicates accountability in the use of public resources.

4.63 Pressures for recent budget revisions have included unfavorable revenue outturns, increases in the cost of existing programs due to inflation and interim policy initiatives such as wage increases. According to MoF officials, there are no formal rules governing the process of budget revision.⁹ Recent experience actually suggests that revisions are more often made in a crisis-like environment, where political pressure to finance new policy initiatives even in the face of revenue shortages has forced significant compression of pre-existing budget appropriations. Moreover, due to the broad scope of protected spending categories enshrined in the ABL, a relatively narrow range of unprotected expenditures (e.g. capital investment, capital repairs and maintenance, and purchases of goods and services), have had to absorb more extreme reductions.¹⁰

4.64 General principles governing budget revisions include legal requirements that revisions above a certain amount or percentage require explicit approval by the legislative body. Conversely, the executive should have the authority to make relatively minor revisions including fiscally neutral transfers with program areas without prior approval from the legislature. In exceptional cases, when the revisions are significant and funds are needed urgently, the revision may need to be implemented prior to formal legislative approval. However, circumstances allowing for urgent action should be quite restrictive, and the executive should be required to submit a revised budget for legislative consideration and approval within a specified period of time. If budget revisions entail a significant shift of resources across sectors or programs, indicative of a change in policy priorities, then the rationale for such changes must be thoroughly explained to the legislature and to the public.

4.65 One option utilized by some countries is to establish a regular timing for periodic interim budget revisions. A mid-year budget baseline update is an effective way of accounting for the fiscal impacts of evolving macroeconomic conditions, unanticipated program costs, new policy developments and the realization of any contingent liabilities. It also reduces pressures for an excessive number of revisions over the course of the fiscal year. As part of a routine mid-year

⁹ But, there is an understood process in place for allowing variations. Budget variations are dealt with in the following manner. With the agreement of the Ministry of Finance, Ministries can shift spending between quarters. They can also agree changes to budget lines provided an increase in one line is offset by an equal reduction in another line. There is little or no possibility of a change, which would require an amendment to the budget law, that is, to any item specified in the budget law itself, which in effect is at the level of main budget heads.

¹⁰ The lack of predictability associated with the ad hoc application of Presidential authority throughout the budget year undermines fiscal discipline as well as effective program performance (i.e. discrepancy between Presidential budget submitted to Parliament and final for a given FY). It also affects the quality of the budget preparation process.

update, new round of macroeconomic forecasts should be conducted and necessary fiscal adjustments can be made accordingly.

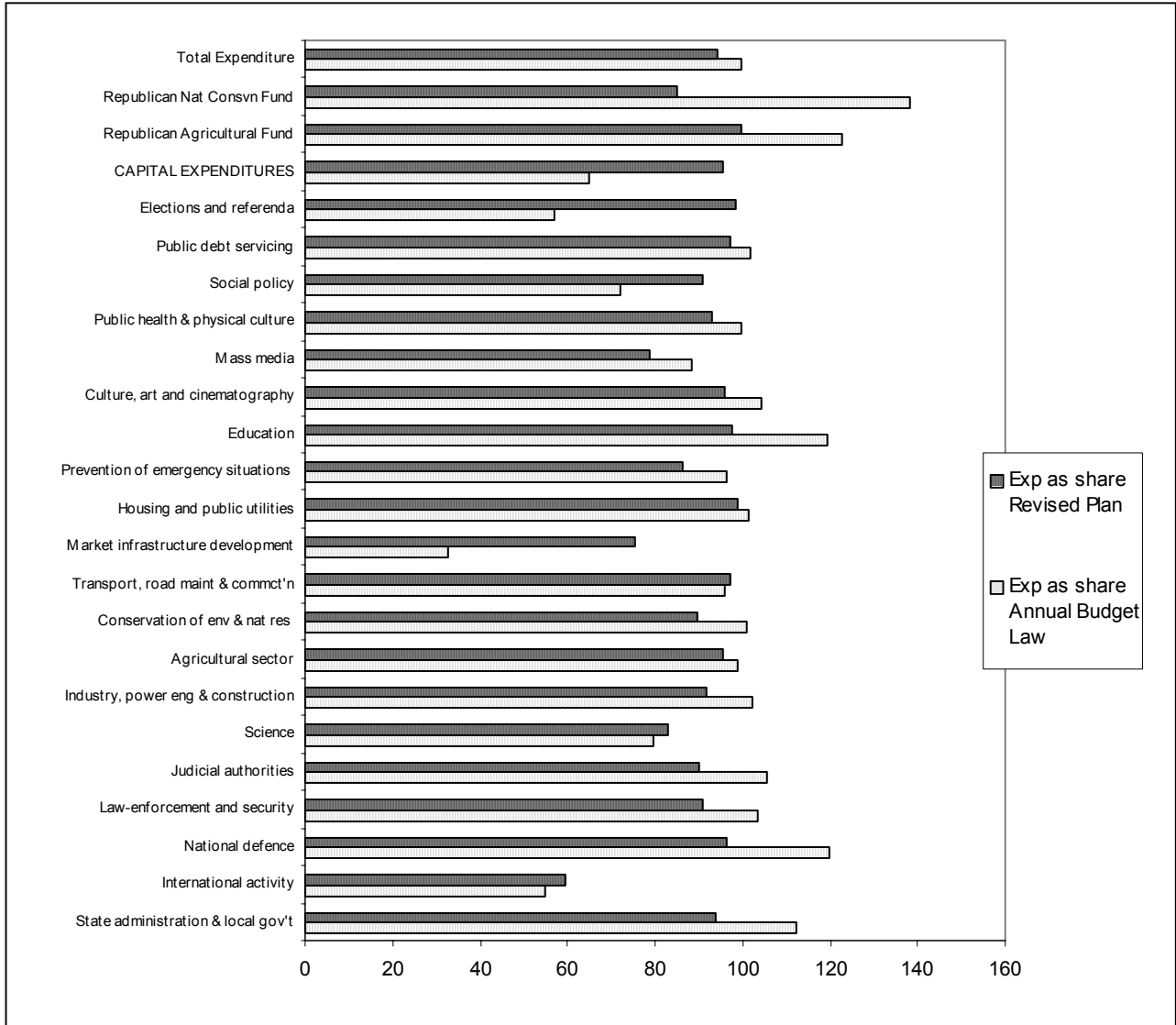
4.66 In Belarus, the annual budget is subject to frequent and extensive revisions over the course of the fiscal year. Figure 4.1 shows that relationship between the budget lines as approved in the budget and as finally implemented is weak. Fiscal pressures have brought on budget sequestration in recent years, which in practical terms means that formal budget appropriations succumb to a daily or weekly reprioritization and reallocation of available funds. In such circumstances, one could say the budget is subject to constant revision with a very short time horizon, though both MoF budget managers and their counterparts in spending units may still look to initial budget appropriations as a sort of guideline or justification for allocating sequestered funds. In particular, it is of great concern from the perspective of fiscal transparency that a small group of senior officials determine which spending units in the queue will receive a share of available funds.

4.67 The three objectives of budget management (aggregate fiscal discipline, allocative efficiency and operational efficiency) all call for a more transparent and balanced approach to interim budget revisions. For aggregate fiscal discipline, revisions must respect binding resource constraints and the risk of rising budgetary arrears being incurred. New policy initiatives, whatever the source, must only be pursued if the resources are available to fund them, without forcing other spending units to incur arrears for programs subject to funding cuts. For allocative efficiency, the distribution of any expenditure cuts should give due attention to established policy priorities and full, including medium and long-term, consequences of imposing cuts on selected categories of spending (e.g. reduced support for capital investment). For operational efficiency, budget revisions must avoid detrimental and costly interruptions in service delivery, must consider risks of not completing capital investment projects already underway, and must not undermine desirable efforts by spending units to engage in financial planning.

4.68 *Rules to carry over expenditures to the next year.* Where at the end of the financial year there is an under-spending on the budget caused by Treasury restrictions on expenditure (as described above) then the under-spending can be charged against the budget of the following year, in the first month of the next financial period. However, there is no corresponding increase allowed in the next year's budget. There is also an arrangement, which allows for an overlap of spending into the first part of January that can be set against the budget of the previous year. If a Ministry is for some reason unable to meet this deadline, after that the budget is lost. Overspends have to be

set against the next year. Underspends on 'own revenues' can be carried forward and Ministries are able to make their own decisions about this.

Figure 4.1: Actual Consolidated Expenditures as Share of Annual Budget Law and Revised Plan, 2001



Source: MinFin.

4.69 *Accounting for fee-for services and off-budget expenditures.* The ministries do maintain costing systems for services that are charged for. In the Ministry of Education, there are 29 such services. The regulations about cost recovery are laid down by the Ministry of Finance. The spending ministry estimates what the costs will be and then fix the level of charge. The process

allows for the making of a profit defined according to the rules. The authority to fix the charge differs depending upon the type of charge. For example, some charges can be agreed by the head of an establishment, others need the approval of the ministry and others need the approval of the minister personally. The costing system is also used to compare actual costs against the estimated costs used to calculate the charges.¹¹ In some ministries, as in for example Health and Education, off budget funds are important. The responsibility for the management of the off budget funds lies with the establishment that generates the funds. Therefore those establishments maintain the detailed bookkeeping systems for such off budget funds. They also operate their own bank accounts and may have several such accounts. The head of the establishment has authority to operate the bank accounts (which may include foreign currency accounts) but the Ministry of Finance does receive information about the state of those accounts. Where a profit is made on the off budget activities, that profit remains with the establishment generating the profit, i.e. it is not recycled for the benefit of the service generally.

4.70 *Procurement.* The quality of the procurement process for both capital investment projects and the supply of other goods and services is an important determinant of the efficiency and effectiveness of public spending. Procedures should allow an appropriate level of discretionary authority to be vested with spending units for purchases below a defined level of materiality. Moreover, spending units should also have a central role in managing contractual arrangements for purchases involving a more significant amount of funds, but subject to closer monitoring and approval by the MoF. Procurement must satisfy standards of transparency and tendering for contracts above an appropriate materiality level should be on a competitive basis. Still, spending agencies should take responsibility of the pure technical aspect of procurement. Contractual arrangements should be clear as to the rights and responsibilities of different parties, including quality standards, the timing of delivery, verification of goods and services received, the amount and timing of payments and legal recourse for resolution of any disputes.

4.71 In Belarus, there are materiality levels that define where the authority to approve a given contract lies. For purchases up to 10 million Rbl in 1991 prices, local executives can approve a contract. For amounts between 10 and 20 million Rbl, sector ministries must approve the contract. And for amounts above 20 million Rbl, the CoM or government must approve the contract. However, in all cases, the MoE will be involved in authorizing the tender and contract. At present, tenders are mostly awarded to state enterprises.

4.72 The MoE assumes primary responsibility for monitoring procurement processes, particularly for capital investment projects. The MoE completes a monthly analysis of capital spending, and the government prepares a quarterly report on project implementation. Regional governments must

¹¹ The definition of cost used for this purpose was not investigated and no one interviewed indicated that charges levied were used in any way to regulate demand.

report to the MoE on their use of capital investment funds when projects are jointly financed with support from the Republican budget.

4.73 However, given the reliance of many ministries and their spending units on off-budget funds for financing capital investment and other purchases of goods and services, there is concern regarding the scope of reporting to the MoE and MoF. Reporting standards, assuming adequate enforcement and compliance, may be adequate for monitoring outlays funded directly by the budget. However, there appears to be little reporting to central oversight agencies regarding the use of off-budget funds, although this seems to have been changing in recent years. In the absence of proper reporting on off-budget procurement, there are genuine concerns about compliance with contractual standards as well as whether resources are being allocated in line with policy priorities.

Auditing and Evaluation

4.74 Audit is a detailed review of financial and spending practices. Audits offer opinions at a detailed level to confirm that that fiduciary controls have functioned appropriately, and that rules have been followed and there has been no misuse of funds. They also confirm that spending was accomplished as planned – or highlight causes and deviations from the plan. Effective auditing and evaluation processes play a vital role in the budget cycle, both in their ex-post examination of budget execution to assure compliance with regulations and in the guidance they can provide for improving the efficiency and effectiveness of program activities in the future. There are a variety of different types of audits and assessments. Systems in most countries include both internal and external audit processes, with the principal distinctions being the audience for which the audits are performed and the relationship of the auditors to the agency being audited.

4.75 Traditionally, ‘audit’ focused on financial dimensions of expenditure activity, and ‘evaluation’ focused on the results of expenditure (i.e. outcomes). Understanding of ‘evaluation’ in budgeting has evolved substantially over the last twenty years, with the focus shifting heavily – but not exclusively – away from reliance on formal extensive evaluation of programs (essentially audits of outcomes, after the fact) towards more pervasive and flexible use of performance information throughout the budget cycle. There are no flawless systems, and experimentation continues around the world – supported by both conceptual and technological advances. Reforms have resulted in a wide variety of approaches and terminology, leading to some blurring of concepts – e.g. some governments use what they call “performance audits”, while others use “performance evaluation” and “performance measurement”. At base, there are now two tools available to policy makers interested in effective public expenditure management – i.e. performance information that can be used throughout the budget cycle to notionally gauge progress, and traditional evaluation which continues to be an important tool for use after the fact in more precisely establishing causal linkages.

4.76 Another important categorization concerns the primary focus of the audit and assessment processes. More specifically, audits may focus on financial management and its compliance with established regulations and appropriations. Alternatively, the process may focus on whether a given government department or program achieved predefined outputs in a cost effective manner. Both types of assessments can provide valuable information for senior management internally within the department being audited, as well as for government agencies overseeing budget implementation. In addition, effective external audit processes can make an important contribution toward the goal of strengthening accountability on the part of public officials for the quality of governance.

4.77 The quality of the audits, and hence their potential for contributing to better public sector governance, depends on the quality of information available to those carrying out the audits, as well as the qualifications of examiners themselves. In turn, the quality of information for carrying out audits depends on the quality of accounting and reporting systems used to produce information and the working relationship between examiners and those being examined. Auditors, both internal and external, must have full access to financial records and the full cooperation of an organization's management apparatus. Moreover, those carrying out the audit must have the requisite skills to know what to do with the financial information provided and to assess the decision-making process within the organization being audited.

4.78 Responsiveness on the part of departments can also be encouraged by making audit – along with performance and evaluation – results available to the public. Surprising as it may seem, senior officials in some countries suggest that public release of audit reports would somehow constitute a divulgence of sensitive information or jeopardize performance of their duties. On the contrary, the fundamental principal to recognize and reinforce is that the resources used to provide government services are public resources and that every government organization must be held accountable to the public for how it utilizes those resources. While the work of the internal audit agency may justifiably remain confidential within the senior management of executive agencies, the results of the external audit processes should be readily available to the public.

4.79 *Current Situation.* In Belarus, there are two principal entities involved in audit-type activities, one is comprised of a network of the internal control departments operating within ministries and the other is the State Control Committee (SCC). The two reportedly coordinate their activities. Also, the advances made in accounting for expenditures are a good base for auditing and evaluation in Belarus.

4.80 *Inspection and Control within Ministries.* The Ministry Department of Inspection and Control is responsible for the 'control' of both the budget and the off budget funds of the ministry and for ensuring that the procurement rules are properly followed. 'Control' for this purpose means ensuring that the funds are spent in accordance with the budget law. Departments of Inspection and Control in most spending ministries have regional control arrangements as well as a central control responsibility. The Ministry Controller supervises the methodology of the Ministry Regional

Controllers who have a dual reporting responsibility, namely to the Ministry Controller and to the regional governor. The Ministry Controller receives reports from each region. The Ministry Controller also has direct relations with the Committee of State Control and with the Ministry of Finance. The Ministry Controller will contribute to State Control Committee inspections into a region. Some of the key features of the internal control are:

- Control is ‘ex post’ and is carried out on a sampling basis. The aim is to cover each element of Ministry activity at least every other year.
- A report on the results of the control activity is made to the Ministry of Finance on a quarterly basis and also to the Minister. The Ministry Controller reports directly to the Minister.
- In addition to the control and inspection activities of the Ministry’s own Department of Inspection and Control, the State Control Committee (SCC) may also carry out its own inspections.

4.81 *The SCC.* The SCC has broader powers to investigate activities of any public sector entity including all ministries, state-owned enterprises and local governments. It also has the power to prosecute individuals and issue financial penalties for legal violations. The SCC reports directly to the president. The internal control departments also, until recently, reported to the president, but a recent change now has them reporting to the CoM. Both the internal control departments and the SCC have an organizational structure that includes departments at the national and local levels. It appears, however, that the SCC maintains a stricter organizational independence of its inspectors than do the internal control department inspectors serving within local administrations.

4.82 At present, the audit functions conducted by both the internal control departments and the SCC are largely devoted to assessing financial compliance, that is, that public funds are utilized by spending units in accordance with appropriations and legal regulations. There is no effort to evaluate the effectiveness of management, the quality of outputs or service delivery, cost effectiveness or other aspects of performance. Performance-based audits are not a part of their organizational mission. The MoF’s internal control department cited staffing limitations, both number and technical capacity, as a constraint on their ability to broaden the scope of audit objectives beyond financial compliance. Moreover, opportunities to conduct performance-based audits and program evaluations are constrained by the lack of explicit programmatic objectives and outputs for spending units.

4.83 While the combined efforts of the internal control departments and the SCC may well provide a thorough basis for auditing financial compliance, there are two apparent shortcomings with regard to audit functions in Belarus. One is the absence of any performance-based audits that could provide an important contribution to improving cost-effectiveness and the quality of service delivery. The second critical shortcoming is the absence of an external audit agency independent of

the government and reporting directly to Parliament. Here, Belarus should draft a strategy to put in place over the medium term an independent audit institution along best international practice (See Box 4.7).

Box 4.7: Guidelines for a Supreme Audit Institution

At a 1999 meeting of the Presidents of central and eastern European Supreme Audit Institutions (SAIs) and the European Court of Auditors, agreement was reached on a document listing the key characteristics for establishment and proper functioning of a supreme audit institution. The document includes eleven separate recommendations, as follows:

1. The supreme audit institution should have a solid, stable and applicable legal base that is laid down in the constitution and laws, complemented by regulations, rules and procedures.
2. The supreme audit institution should have the functional, organizational, operational and financial independence required to fulfill its tasks objectively and effectively.
3. The supreme audit institution should have the powers and means, clearly stated in the constitution and laws, to audit all public resources and operations, regardless of whether they are reflected in the national budget and regardless of who receives or manages these public resources and operations.
4. The supreme audit institution should undertake the full scope of government external auditing, covering both regularity and performance audits.
5. The supreme audit institution should be able to report freely and without restriction on the results of its work. Reports may be submitted to parliament and be made public.
6. The supreme audit institution should adapt to suit local conditions and formally adopt, promulgate and disseminate audit standards, compliant with INTOSAI Auditing Standards, the European Implementing Guidelines for INTOSAI Auditing Standards, and any relevant public sector auditing standards issued by the IFAC and accepted for application in the EU. Audit standards should be applied on a consistent and reliable basis to the work of the SAI to ensure that audit work is of an acceptable quality and competence. The SAI should therefore develop audit manuals and detailed technical guides to help promote the practical use and achievement of the standards.
7. The supreme audit institution should ensure that its human and financial resources are used in the most efficient way to secure effective exercise of its mandate. To this end, SAI management will need to develop and institute appropriate policies and measures to help guarantee that the SAI is competently organized to deliver high-quality and effective audit work.
8. The supreme audit institution should develop its internal organization as a supportive structure for the proper conduct of work related to the requirements of the pre-accession period.
9. The supreme audit institution must ensure that its staff are competent, capable and committed to help guarantee that effective audit work is produced in conformity with international standards and good European practices.
10. The supreme audit institution should develop the technical and professional proficiency of its staff through education and training.
11. The supreme audit institution should focus on the development of high quality, effective management (internal) control systems in audited entities.

Assessing Budgetary Outcomes

4.84 Chapter III highlighted the limited attention that is given to outcomes evaluation in Belarus. It also highlighted three areas that need work if improvement is to be obtained in this area. Mainly, these are: (a) a clear strategic vision (both global and sectoral); (b) identification of performance indicators to measure progress of outputs in achieving outcomes corresponding to the strategic vision, and (c) an improved understanding of the linkages between inputs and outputs, that is the technology of producing public goods. These points set the basis for a long-term strategy, which can be launched in full force once the basic concerns that have been identified in this report are addressed. Belarus can then focus on improving sector allocations and technical efficiency.

Summary and Recommendations

4.85 This review of budget institutions and management has identified areas where progress has been made and areas that need further work if Belarus is to improve the efficiency of its public spending, maintain fiscal discipline, and succeed in its goal of reducing the social costs of transition. There would seem to be two main challenges today around which to focus improving in budget management today in Belarus.

- First, there is the need to address the problem of budgetary arrears and the underlying causes: poor revenue forecasting, and discretionary mandate changes by the executive. Under the present circumstances, cash management becomes all important and at the end the main force driving budgetary allocations. The practice of protected items introduces further distortions. These developments undermine the importance and credence of the budget preparation process. Spending agencies seek to protect the allocations and the link between expenditures and national objectives is lost.
- Second, Belarus needs to improve the efficiency of its expenditure, both in terms of improving the alignment of allocation of the resources and the national developmental objectives and the effectiveness of sector expenditures. Only then, can Belarus reduce somewhat the fiscal burden, while keeping to its commitment to provide for the least advantaged and build its human and social capital.

Meeting these two challenges requires improvements in all of stages of the budgetary cycle as well as changes in the underlying legal framework. The main recommendations in each of the stages of the budgetary cycle are:

Legal Framework

In the context of drafting a budget code, the Belarusian government should focus on the revising the following elements of the legal framework:

- Require the government to produce a public budget policy statement;
- Reduce significantly the scope of off-budget activities and clarify the legal status of the republican level extra budgetary funds (Social Protection Fund) ;
- Expand access to information on fiscal performance to parliament and the public at large; and,
- establish a legal basis for an independent external audit agency reporting directly to Parliament. Restrict the issuance of exemptions and privileges and require a tax-expenditure budget;

Budget Coverage

The scope of coverage of the budget can be improved by including in the budget:

- Innovation funds
- Fee for services & off-budget activities
- Tax expenditures
- Contingent liabilities

As suggested in Chapter II, a comprehensive framework for identifying and measuring both quasi-fiscal deficits and contingent liabilities should be established, so as to help the Government better understand and address the fiscal risks that it faces.

Budgetary Calendar and Budget Circular

The budget circular could be amended to include,

- Binding sector ceilings or envelopes along best practice lines; and
- Require information from spending units that facilitates evaluation along alternative expenditure options—cost, cash, requirements, etc.

Budgetary Preparation

To improve budget planning, actions are needed on several fronts,

- Improvements in forecasting require: improving the overall consistency of the macroeconomic framework and focusing on likely outcomes (product growth, inflation, tax revenues, etc.) as opposed to government targets. The government should clearly differentiate between government targets or desired objectives, which may include mid-term objectives, and likely outcomes for the preparation for the next year's budget. There should not be a penalty if parameters for the budget differ from targets or objectives. The MoF should be given a greater responsibility during in forecasting. Also, greater attention should be given to short-term forecasting to fine tune cash-management and the operations of the treasury.
- An effort should be made to take account of the budget outcomes in budget preparation. To achieve this objective, incentives should be given to spending agencies to improve efficiency, and to phase out obsolete programs. "Efficiency" should be understood as a concept broader than 'expenditure as in accordance with the budget law.' Spending agencies should be allowed to keep part of the gains made from efficiency increases, and use these resources to advance priority sector objectives;
- It is necessary to improve the transparency of the budget negotiation process between spending agencies, MoF, MoE, and the Cabinet. This improvement will require a stricter use of sector ceilings or envelopes and clearer rules for the allocation of resources among competing ends. Although, sector ceilings are used today, their use does not follow best international practice. It is important that the actors in the budget process be satisfied that

their allocation is fair so as to avoid continued haggling for revisions, even during budget execution.

- Limiting executive discretion during execution bolsters the credibility of the preparation process.
- All investments made with budgetary resources should be included in the capital budget and the non-investment expenditures should be taken out. A clear delineation should be established between the capital budget of the public sector and the capital budget of the enterprises.
- Over the medium term one or more pilots can be conducted to consider together recurrent and capital budgets in meeting specific sector objectives.
- Pilots should also be considered to grant greater autonomy to the agencies in preparing and executing their budgets, along the lines of the health sector expenditure in the Vitebsk region.
- Gradually, the government should develop sector strategies and explicitly identify expected outcomes. Work on Chernobyl, health, and social assistance provide a good basis to begin with. Correspondingly, the Government should start developing a system of monitorable outcome indicators.

Budgetary Execution

- Improvements in budget planning and elimination of unexpected revisions throughout the year should improve budget execution;
- Greater clarity should be introduced for the allocation of resources in situations of cash scarcity;

- The system of commitment control and reporting should be improved—strict control on commitments should be to align expenditures with expected revenues during the year;
- Changes should be made to the procurement process to enhance competition. Also, monitoring of procurement with non-budget funds should be improved.
- All extrabudgetary funds, power ministries and local governments should eventually be brought into the treasury.

Budget Audit

- The whole legal, reporting, control and external review process should not be focused exclusively on whether or not expenditure follows the budget law; an attempt should be made to determine that resources are used well and not wasted.
- The concept of accountability of the spending agencies should be extended beyond the Ministry of Finance and other government bodies. The public should be informed of audit, performance and evaluation results, and mechanisms should be designed for its involvement;
- There should also be a more active and direct involvement of the Parliament in the oversight, performance assessment and evaluation of public expenditure. Eventually, there should be an external control body reporting directly to Parliament;
- Audit, either internal or external, should not be understood in the government and even the private sector as an ‘unnecessary expense’ by many managements with external audit being positively discouraged for some companies by the actions of the government;
- There should be increased awareness that improvements in the approach to audit, reporting and transparency are important in improving management efficiency in the use of public funds.

