

BOSNIA-HERZEGOVINA

USAID ASSISTANCE IN THE ESTABLISHMENT OF A MODERN GOVERNMENT TREASURY AND ACCOUNTING SYSTEM IN BOSNIA AND HERZEGOVINA

I. PROJECT DATA

Level of Funding: \$14 million (approximate)

Period of Assistance: 1999-2004

Types of Assistance:

1. Technical Assistance (in conjunction with U.S. Treasury and other donors)
2. Materials and Equipment
3. Training (including study tours abroad)

Areas of Assistance:

1. Economic and Systems Analysis
2. Institutional and Organizational Development
3. Automatic Data Processing and Information Management and Systems
4. Treasury Operations
5. Banking and Payments and Settlements Mechanisms

Main Counterparts:

1. Ministries of Finance
2. Central Banks

Author's Note: With regard to the creation of modern public treasury systems and implementation of the Financial Information Management Systems (FIMS), the work has been carried out in 13 discrete government jurisdictions. These are, with their activation dates included in parentheses:

- State level government of Bosnia and Herzegovina, the national government (May 2002)
- The Federation of Bosnia and Herzegovina, a sub-national Entity (January 2002)
- The Republic of Srpska, a sub-national Entity (January 2002)
- The ten Cantons of the Federation, similar to US counties (six in 2003, the remainder in 2004).

II. THE PROJECT: BACKGROUND, PRINCIPAL RESULTS AND IMPACT

Introduction

US economic assistance to Bosnia and Herzegovina (BiH) only began after the signing of the Dayton Accords in December 1995. The Dayton Accords represent the peace agreement among

the three major ethnic groups—Bosniacs (Muslim), Croats, and Serbs. They also form the BiH constitution. The Accords recognize two “Entities” in the country. One, the Republic of Srpska, is mostly populated by Serbs. The other Entity is known as the Federation of Bosnia and Herzegovina (sometimes called the Bosniac- or Muslim-Croat Federation). Bosniacs and Croats are the two main ethnic groups in this Entity. The Brcko District, a small sliver of land bridging two non-contiguous parts of the Republic of Srpska, was established later, in 1999. Its population includes the three major ethnic groups.

A. Background and Economic Context of the Project

Prior to the disintegration of Yugoslavia, a single Payment Bureau was responsible for all payment transactions in the country. All companies and individuals were required to keep their money on deposit with the Payment Bureau and almost all legal transactions between companies, with government and among government entities, took place within the Payment Bureau. Businesses were required to deposit almost all of their cash at the end of each day and would request permission to withdraw their cash the next morning. Each deposit and withdrawal was subject to a fee. Payments by one business to other businesses or to government were made as payment orders via the Payment Bureau, which again charged a fee for each transaction.

As Yugoslavia began to disintegrate, the formerly constituent pieces carved off their own payment bureau operations. Slovenia today still has a payment bureau. Montenegro and Macedonia had their own, too. The case is more complicated in the Federation, where the three major ethnic groups, Croats, Bosniacs and Serbs, who had fought violently against each other, had each created its own payment bureau.

The Payment Bureau also played the role of the Yugoslav Government treasury system. It took in monies for the government, such as the payment of fees and taxes, allocated those monies to the different levels of government in accordance with specific revenue sharing rules and transfer systems, and made budgetary outlays in accordance with the annual budget and ministerial requests.

Since all monies were supposed to be held in deposits with the Payment Bureau, taxes could be directly deducted from firms’ accounts. Since most of the firms in the country were public enterprises, tax payment was mostly an accounting entry. Tax enforcement was simple and the Public Revenues Department mainly occupied itself with the administrative aspects of taxation, such as the storage of forms and the calculation of tax assessments. Enforcement and audit were not important functions.

While the Payment Bureau’s official duties seemed conceptually straightforward, in practice there were problems in the execution of those duties. Reports show that the Payment Bureau imposed high transaction costs on government, sometimes executed payments that had not been authorized in the budget or for which there had been no authorizing appropriation, and made budgetary transfers among levels of government or others that had not been officially sanctioned.

The payment bureaus imposed severe constraints on development of a modern, market-oriented, private-sector based economy as the following regulations make clear.

1. All wholesale transactions had to be made through a payment bureau. (A wholesale transaction being any transaction greater than DM 99.)
2. All barter-trade arrangements had to be registered with a payment bureau and treated as a wholesale financial transaction.
3. All retail operations were required to deposit 100% of revenues at a payment bureau on a daily basis. They were not permitted to retain a portion of their cash to meet daily expense needs.
4. All payrolls were processed through the payment bureaus.
5. All tax payments were made through the payment bureaus.
6. All tax returns or declarations were made through the payment bureaus.
7. All deposits of any business with any bank had to be made through a payment bureau.
8. The payment bureaus were responsible for “controlling” all funds on deposit with the banks.
9. Businesses were limited to a maximum of DM 1,000 withdrawals on any given day.
10. Businesses were required to provide the respective payment bureau with receipts for the use of petty cash.

After the demise of the payment bureaus, the need to create unified public treasuries became urgent. Budgetary agencies were able to incur commitments beyond their budgets and were not constrained in how expenditures were made, other than to manage their regular transfers from the Ministry of Finance. There were pockets of wealth within the public finances, where some agencies were able to borrow from the fisc, while others experienced cash shortages. In addition, the government was forced to borrow while some budgetary agencies actually held cash balances.

B. Outcomes and Impacts in the Project’s Principal Areas of Assistance

1. Elimination of the Payments Bureaus

US Government assistance first focused on the need to eliminate the payment bureaus while creating the new institutions and organizations that would be needed to fill the void created by their dismantling. Initial assistance was spearheaded jointly by US Treasury and USAID in very close collaboration with the rest of the international community. It focused first on understanding the roles and operations of the payment bureaus. Focus then shifted to newly created and existing institutions that would take over the legitimate functions of the payment bureaus. This included, among other things, the development of a private, commercial banking system and its legal and institutional reform as well as the development of a uniform treasury system for governments.

Beginning in 1998, USAID, in coordination with other donors, began the technical work to eliminate BiH’s three “payment bureaus” and to replace them with a modern, functioning government treasury system and a “normal” banking system framework. USAID and US Treasury specialists studied the functions of the payment bureaus, developed a plan for the allocation of legitimate payment bureau functions that could be implemented by “normal”

institutions, and devised plans to create or strengthen these institutions and develop their capacity to take on these new functions.

USAID follow-on assistance focused on two areas: creating the institutional and operational framework for a modern, commercial banking system and replacing the government treasury role that had been played by the payment bureaus with one that would be managed by governments and would be based on private commercial banks.

U.S. and international community efforts to eliminate the payment bureaus reached an apex on January 5, 2001 when all the payment bureaus stopped processing payment orders and commercial banks took over this operation in its entirety. With the USAID grant, the Central Bank of BiH opened a new bulk payments Clearing House that allows commercial banks to provide payment services directly to their customers. Two clearing mechanisms are now operating: a large value clearing and settlement system (RTGS or Real Time Gross Settlements) and create a Clearing House for small value payments, both of which are now settled through transfers of bank reserves at the Central Bank.

To ensure that government revenues would be channeled to the appropriate jurisdictions—the State, the two Entities, Brcko, ten cantons, and the more than 120 municipalities, US advisors designed the payment order forms and issued instructions to direct revenue flows through the banking system to the appropriate government coffers. USAID provided the hardware and software that form the backbone of what is known as the Revenue Allocation System (RAS) for directing these flows to the proper accounts.

The RAS can be said to be the receipts side of a more modern treasury system. In the next section US assistance in creating the modern treasury systems in BiH, particularly from a public expenditure management point of view, along with the design and installation of the country's Financial Information Management System (FIMS), is discussed.

The following excerpt from the USAID contractor's close-out report indicates the transformative effect the elimination of the payment bureaus has had on the BiH payments and financial services system. The report's conclusions have been confirmed by other observers on the scene.

The end of Payment Bureaus marks the closing of a nontransparent institution that was open to corrupt and abusive practices. Its closing creates a more conducive environment for domestic and foreign investment in private sector enterprises, and its closing provides commercial banks with profit opportunities that should strengthen the banking and financial services.

Contractor completion report, Macroeconomic Technical Assistance Project (not dated).

Elimination of the payments bureaus, along with other assistance, was an absolute prerequisite for the establishment of a modern commercial banking system. Today, most transactions are facilitated through the banking system, whereas before, much more of the economy was cash-based as economic agents sought to escape the stranglehold of the payment bureaus. Banking sector deposits are high, consumer loans have been growing rapidly, and foreign banks have entered into the sector to compete for BiH deposits and transactions.

2. The New Treasury Systems

Prior to introduction of the Integrated Financial Management Information System (FIMS), responsibility for budget execution, particularly the cash disbursement of budget appropriations, was decentralized among the various spending units of BiH's constituent governments, of which there are thirteen (one for the State, one for each Entity, and one for each of the Cantons). Under this system, each government controlled its own bank accounts holding public funds, and accounting, reporting, adherence to the budget, and internal controls were very weak, if they existed at all. In part, this may help to explain why corruption was perceived to be so pervasive. (Today, the FIMS provides the respective ministries of finance with the tools to control these problems, but the willingness to control these problems will have to come from the ministries themselves.)

All government treasury operations had been managed by the Payment Bureau and later the three separate payment bureaus. The payment bureaus, as discussed above, provided control on governmental expenditures and provided governmental accounting for these same expenditures. The payment bureaus not only controlled governmental expenditures, but also government revenues, from all levels of government. It was because of this perception of tight control of the governments' finances that the IMF in 1996 had decided that it would not support the dismantling of the payment bureaus. It became clear only later that the payment bureaus had not performed their government treasury role with the efficiency that had been presumed.

The international community came to the conclusion that the payment bureaus needed to be closed because they impeded the development of a modern banking system, they were corrupt, and they allowed political leaders to siphon off money outside of the authorized budgetary framework. In addition, the payment bureaus were costly, taking charges or fees for every transaction, which greatly reduced the effectiveness of government finances. Eventually, the IMF came to agree with the rest of the international community.

Along with the assistance that was provided in the elimination of the payment bureaus came an effort to establish a credible public sector accounting and treasury system. This work was mainly carried out under the **Public Sector Accounting Project (PSAP)**. Prior to the U.S. assistance programs, each budgetary unit in government had its own account with a payment bureau. Each unit would request transfers from the respective ministry of finance on a regular basis, hold cash balances in these accounts, and make expenditures according to their own perceived requirements. The payment bureaus were responsible for handling all these transactions and for recoding or accounting for them.

Technical assistance was first provided by the U.S. Treasury (UST). UST advisors set up a new chart of accounts for all of government, i.e., both Entities and all levels. UST advisors created the legal basis for the new public sector accounting and treasury systems and developed the regulations, or 'Rulebook'. These were all largely in place before the USAID-funded PSAP began providing assistance in developing the organizational units and implementing the processes, automation, and data systems that are the backbone of a modernized treasury and accounting system.

USAID officers provided constant impetus for the elimination of the payment bureaus and worked in close collaboration with U.S. Treasury and U.S. State Department counterparts, as well as with the Central Bank and other agencies to build understanding and consensus on the need to eliminate the payment bureaus and to replace them with institutions that are more “normal”. Strong leadership was also provided by a U.S. Treasury advisor, who through force of personality and solid analytic argument was able to ensure that the international community stuck to its position. The head of the Central Bank of Bosnia proceeded with parts of the reform package, such as the implementation of the RTGS despite warnings that the payments replacement system was still not quite ready.

Once some form of leadership was established, the international community created an International Advisory Group for the elimination of the payment bureaus, which served as the central forum for discussion, coordination, and supervision of the various aspects of the payment bureau dismantling activities.

As the dismantling of the payment bureaus became a near reality, the various governments of BiH realized that they would have to create more normal treasury functions, or they would simply collapse. Hence, elimination of the payment bureaus not only necessitated the establishment of a government treasury function, it also pointed up the urgent need to have this happen without delay.

With strong government support, USAID assistance contributed a new integrated Financial Information Management System, which was installed and activated in all 13 Entity and cantonal governments between 2002 and 2004. The FIMS covers the following key processes of the treasury and accounting systems:

- accounts receivables
- accounts payables
- general ledger
- cash management, and
- purchasing

None of these processes had been automated prior to USAID assistance, nor were they part of an integrated system. The new FIMS centralized financial management of each of the 13 Entity and cantonal governments in their own, separate treasury organizations within the respective ministries of finance.

A modern treasury system is now in place in the Bosniac-Croat Federation, the Republic of Srpska, and in the Federation’s cantonal governments. Cash management has improved and non-budgeted expenses have been squelched. In 2002, the Acting Minister of Finance of the Federation reported that the FIMS had helped to avoid about 27 million KM (about US\$14 million) in expenditures that had not been included in the budget. Counterparts in the Republic of Srpska and State each reported similar ‘savings’, and of similar magnitudes.

Counterparts and others give some credit to the new treasury systems for overall better financial management, as well as for enabling greater overall fiscal discipline. For instance, the International Monetary Fund's Resident Representative to BiH reported to the U.S. Embassy's Economics Officer that public sector fiscal targets were being met and that USAID's assistance, especially the FIMS, helped to make this possible.

A number of "champions" for establishing modern treasury systems could be found among some of the political leaders in the BiH governments. However, with new elections at the mid-point of the PSAP Project, these "champions" were voted out of office. Fortunately, the international community and the PSAP staff were able to forge close relations with several new politicians, some of whom became the new champions for reform. This underscores the importance of having a project team dedicated to working patiently with counterparts—even some who had not yet entered into office—and to developing close, collaborative counterpart relations as an integral component of project operations.

III. FACTORS OF SUCCESS

Of the key factors that contributed to the success of these USAID assistance efforts in Bosnia and Herzegovina, two in particular stand out:

1. Consensus Building in the International Community. A tenacious effort to develop a uniform position among local leaders and international donors was probably a necessary condition for the work to proceed.
2. Attention to the Political Considerations and Sensitivities. The project required national political champions as well as a carefully constructed analytical rationale for both parts of the process—eliminating the payments bureaus and creating the treasury mechanisms. Without USAID's careful attention to this requirement, it is unlikely that the transformation could have taken place.