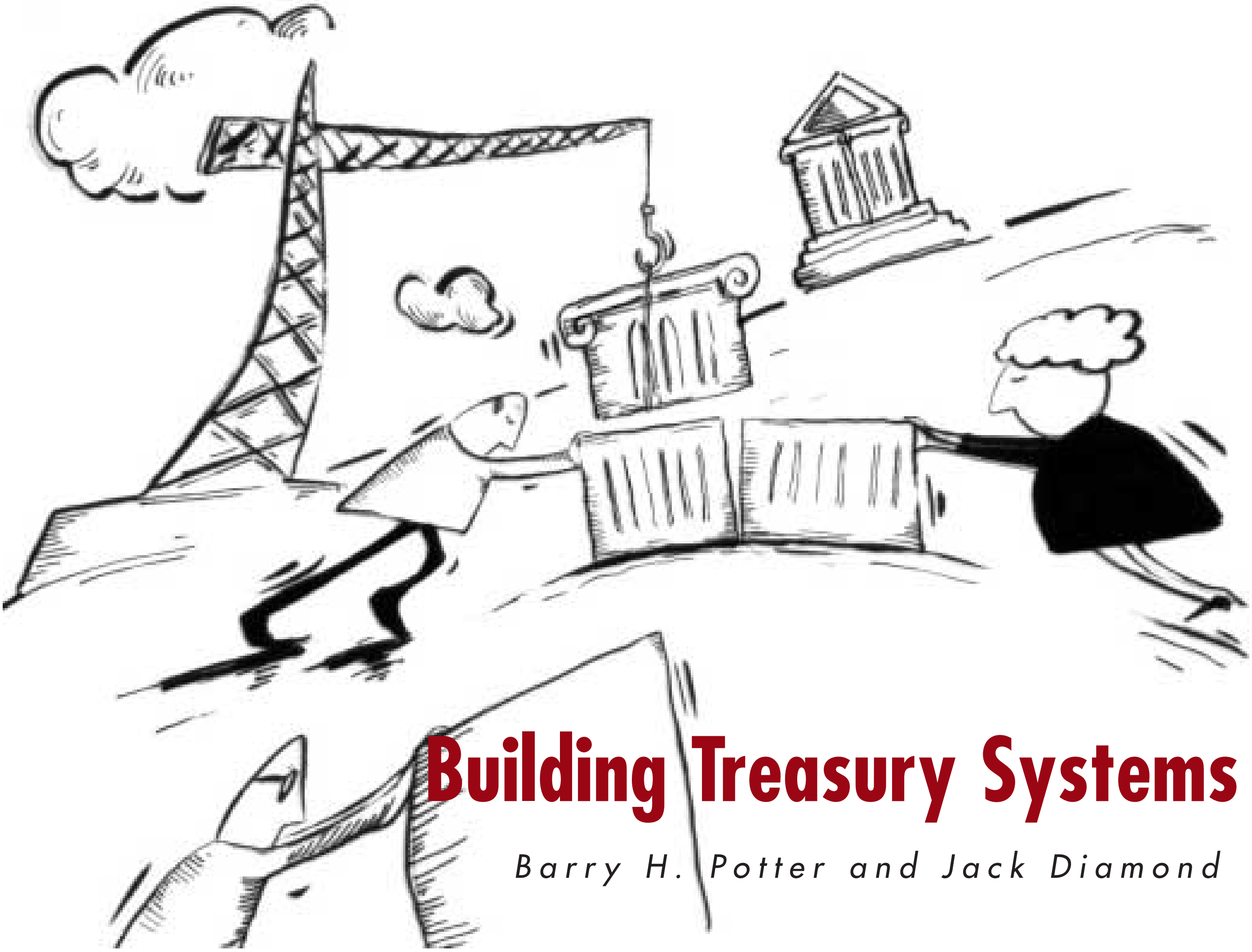

Building Treasury Systems

Barry H. Potter and Jack Diamond

Most OECD countries rely on treasury systems operated by their finance ministries to manage government finances. The Baltics, Russia, and other countries of the former Soviet Union, which did not have comparable systems, are building them from scratch.

TREASURY systems provide central governments with essential financial services—including the processing of payments, accounting, fiscal reporting, and financial management—on a comprehensive, often centralized basis. The most advanced economies have networked computer systems that integrate all of these functions for the finance and line ministries and their spending units; these systems may also include modules for budget preparation, debt management, extrabudgetary funds, local governments, and other functions.

Fourteen of the 15 former republics of the Soviet Union have now introduced treasury systems (Uzbekistan is the only exception). The IMF has provided technical assistance to all of these countries, although its involvement has varied from country to country.

Building a treasury system has four main components: (1) the creation, within the finance ministry, of a treasury department that, through its regional offices, collects revenues and makes government payments; (2) the consolidation of government financial resources in a "treasury single account" in the central bank; (3) the introduction of a better accounting regime for government operations through a "treasury general ledger"; and (4) the development of financial management and planning for the government sector.

In large part, the Baltics, Russia, and the other countries of the former Soviet Union have now set up treasuries, but, at the end of 1999, their systems were at different stages of development (see table). Overall, there has been much more progress in setting up treasury payment systems and basic treasury single accounts than in introducing treasury general ledgers or developing a capacity for financial management.

Latvia and Kazakhstan appear to have the most advanced treasury systems: Latvia has made particularly good progress on computerization, while the expenditure control regime in Kazakhstan is well advanced. Substantial reforms are under way, although not yet complete, in Estonia and Lithuania, as well as in Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, and Turkmenistan. All of the countries in this second group have made considerable progress with the first two components, namely, setting up treasury departments and treasury single accounts. Although Moldova and Ukraine are less advanced, they too have made solid progress, and Russia and Belarus have made some, albeit uneven, progress on the first two components. (Progress appears to have accelerated in Russia in 1999; information on Belarus's progress is limited.) Tajikistan lags behind the other countries but is rapidly catching up.

Difficulties encountered

Developing treasury systems has taken much longer than anticipated. Even Latvia and Kazakhstan do not yet have fully developed systems. In 1993, when the process began, the IMF may have underestimated the scale, complexity, and challenges of the task; it probably did not fully appreciate the magnitude of the resources and efforts required both to galvanize financial and technical support from other technical assistance providers (for example, for the purchase of computer hardware and software) and to persuade the authorities to undertake radical reforms.

Initially, Russia and the other large economies of the former Soviet Union followed a model based on developing the full range of treasury functions, through the creation of an OECD-style integrated, computerized government financial-management information system (see box). The model turned out to be both too ambitious and too centralized. A "gradualist," less centralized approach that was less dependent on a high-tech solution was then successfully adopted, first by the Kyrgyz Republic and Turkmenistan and, soon afterward, by the other small economies of the former Soviet Union.

As in all such systems, cash control was developed before liability control. Cash control and centralization of government financial resources have important benefits—not least in ensuring more control over credit to government. But the absence of commitment control (that is, control over the incurring of liabilities), financial planning, and—even more important—in many countries, realistic budget preparation has led to the treasury systems' being used for often crude sequestration (that is, cutting expenditure below the amounts authorized in the budget) through cash rationing. Inadequacies in these areas have been associated with the emergence of payment arrears.

With the benefit of hindsight, it is clear that it has been difficult to build fully effective treasuries because broader fiscal and expenditure-management problems have not been successfully overcome. No treasury system could have coped with the combination of unrealistic budgets and poor governance that characterized most countries of the former Soviet Union throughout most of the 1990s. The atmosphere of perennial economic crisis that reigned for much of the decade was a serious drag on progress. Correspondingly, by the end of 1999, despite considerable progress in the Baltics and Kazakhstan, the development of treasuries had not, in general, brought about as much improvement in public expenditure management or fiscal outcomes as expected. Progress is perhaps more evident in the countries' increased, if still limited, capacity for short-term crisis cash management and the avoidance of excessive borrowing from central banks than in the attainment of the classic goals of good public expenditure management—aggregate control, resource allocation based on expenditure priorities set out in the budget, efficient delivery of public services, and minimization of the costs of government financial operations. Thus, setting up treasuries has been a necessary yet by no means sufficient step in the transformation of fiscal and public expenditure management in the Baltics, Russia, and the other countries of the former Soviet Union.

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State of development of treasury systems

Most advanced	Well advanced	Good progress	Modest progress	Limited progress	Least advanced
Kazakhstan	Azerbaijan	Lithuania	Russia	Tajikistan	Uzbekistan
Latvia	Kyrgyz Republic	Turkmenistan	Ukraine		
	Armenia		Moldova		
	Georgia				

Source: IMF staff.
Notes: As of December 1999, Estonia developed its treasury system using external consultants and is considered to be well advanced; information on Belarus is patchy, but that country is thought to have made modest progress.

Budget formulation problems

Many of the problems these countries experienced in executing the budget through treasury systems have their roots in poor budget formulation. In the immediate post-Soviet era, uncertainty and high, volatile inflation severely curtailed the scope for good budget prepara-

Government financial management information system

An integrated government financial management information system—or treasury system—is a networked payment, accounting, and financial management information system to which the finance ministry, treasury department, and line ministries and spending agencies have access.

The accounting system comprises a shared database from a treasury general ledger; budget appropriations by line item; changes in these appropriations in-year; commitments against these authorizations; verifications; payment orders (often electronic, for direct payment into suppliers' bank accounts); and cash payments.

Although line ministries, spending agencies, or the treasury department itself may draw up payment orders, only the treasury department can approve such orders for payment. A "stop-payment" facility prevents any overspending.

The payment operations of the treasury and the accounting operations of the line ministries, spending agencies, and the treasury provide the basis for a common financial-management information system. Different types of reports can be generated reflecting the different accounting, fiscal, budgeting, financial, and operational management interests of network participants.

Only with a high level of computerization is such a centralized approach feasible.

For a fuller treatment, see Barry H. Potter and Jack Diamond, 1999, Guidelines for Public Expenditure Management *(Washington: International Monetary Fund).*

tion. But with the unwinding of inflation, particularly after the mid-1998 devaluations, budget preparation should have become more systematic. However, some or all of five basic weaknesses can still be found in most of the former Soviet republics.

First, outside the Baltic countries, expenditure, revenue, and financing estimates in the annual budget are not normally driven by a macroeconomic framework (unless required by an IMF-supported program). Many finance ministries are not yet strong enough to secure "top-down" aggregate control based on whether expenditures are affordable from a macroeconomic perspective. Nor have they set firm constraints on line ministries by establishing total expenditure guidelines or envelopes—normally the first step of the budget preparation process in OECD countries.

Second, many finance ministries still lack some of the basic skills needed for budget preparation. Some sections within finance ministries still see their role as one of making the case for more resources for "their" particular line ministry or spending agency. Too many finance ministries view themselves as "collators"—or even "backers"—of "bottom-up" budgets from line ministries, rather than as supervisors, much less masters, of the budget process. How accurate line ministries' assessments of their expenditure needs are is also unclear. After several years of seeing their budget plans unfulfilled and radically distorted by cash rationing, they no longer have an incentive to take the annual budget preparation exercise seriously. Budget estimates often do not seem to be prepared with care or precision. Yet budget departments within the ministries of finance have a limited capacity to challenge the affordability, desirability, and costing of expenditures.

Third, the information base on spending patterns is weak. With the exception of the Baltics, many countries typically have very little information about the expenditure base, a reflection of the decentralized Soviet system, where the line ministries bore this responsibility. Information on outputs is nonexistent. A poor organizational budget classification with too many spending units using budget resources, loose supervision from a line ministry, and a cumbersome appropriations structure further complicates the picture. The worst feature is continued reliance on the Soviet-style functional classification for appropriations, where an individual spending unit may receive funding from different functional sources. A better, more transparent and accountable system would base appropriation approval on individual spending units or line ministries, as in OECD countries. Also, the absence of an OECD-style program classification (not the quasi-functional system used under the old Soviet system) that would readily generate activity-based costing and analysis is a significant weakness.

Fourth, there has often been a disconnect between the legislature and the executive branch; the latter has found it possible to avoid conflict on difficult policy and resource allocation decisions by allowing one budget to pass through parliament while implementing a different budget in practice. Parliaments do not have an established budget review function that would allow them to challenge the executive branch. The absence of any kind of budget review may be partly responsible for the lack of care when budgets are prepared.

Finally, another crucial problem is the observed lack of cooperation between the treasury and budget departments in many finance ministries. Officials responsible for preparing budgets take as their starting point the previous budget, rather than the latest actual or estimated outturn from the treasury system. Admittedly, lags in information are a constraint in these countries (as they are in other countries). But budget departments often do not cooperate closely with treasury departments. At its worst, each unrealistic budget becomes the starting point for the next, equally unrealistic budget.

Budget management

While the combination of unrealistic budgeting and a treasury control system that is applied mainly to cash rather than to commitments has tended to lead to cash rationing and payment arrears, this is not the only weakness. Unfortunately, there are other aspects of budget management that create problems for public expenditure management, many of them related to poor governance—that is, governance that is neither transparent nor accountable—such as the excessive number of off-budget accounts; the prevalence of barter, netting (often at artificial prices), and in-kind transactions; and the scope for rent-seeking by officials (and even ministers). Again, the severity of the problems varies from country to country, with the Baltics generally now overcoming such problems, while some of the former eastern Soviet republics continue to grapple with them. Although these problems should recede as treasury systems develop, enhanced transparency and accountability will be necessary for both budget preparation and budget execution if overall budget management is to be improved.

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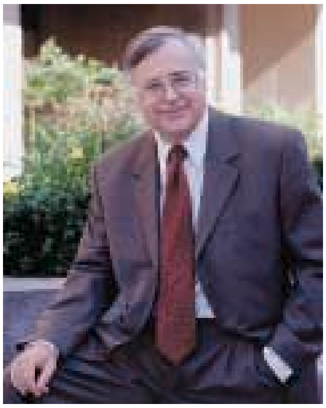

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Future work

Remedying the above problems will require a two-pronged approach and external assistance from several sources. On the one hand, some continuation of IMF technical assistance on budget execution and treasury work is still needed to develop better interim control systems over commitments and arrears. Measures to improve governance (for example, regularizing and "encashing" barter, noncash, and nonbudgetary transactions within the treasury system) will also be necessary. On the other hand, the IMF plans to shift the emphasis of its technical assistance more toward budget formulation and to give more attention to the deep-rooted problems in budget preparation and fiscal transparency. An illustrative standard for budget preparation, based on the IMF's Code of Good Practices on Fiscal Transparency, is being drawn up. But there is still a long way to go. F&D