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Fiscal transparency, accountability and institutional performances as a foundation of inclusive and sustainable growth in Macedonia

1. Introduction – transparency and accountability vs. socio-economic context

According to the International Monetary Fund (IMF), the Organization of Economic Cooperation and Development (OECD), and numerous other studies, *fiscal transparency and accountability in public finances is one of the main prerequisites for better macroeconomic and fiscal stability, better credit ratings and better fiscal discipline (lower public debt and deficits), reduced levels of corruption and a determinant for higher rates of economic growth* (see IMF factsheet, 2014). Fiscal transparency as well as accountability are key elements in the effective management of public finances/funds, determining the fiscal risks, rational financial decision-making, increasing accountability by policy makers, and improving fiscal policies. Why fiscal transparency and accountability: - A major element of good governance, an important element for the quality of institutions which will lead to macroeconomic and financial stability and is a determinant for higher rates of economic growth (Knack and Keefer 1995; Williamson, 2000; Acemoglu, Johnson and Robinson, 2002; Kaufman and Kraay, 2002); - Extremely important for democracy (taxpayers, citizens and society in general) - transparency and dissemination of information is critical for the participation of different social groups in decision-making / budgetary process (Bellver and Kaufmann, 2005); - Increased transparency reduces (impedes) corruption by providing better management and environment for economic growth, efficiency and development (Blumkin and Gradstein, 2002; Lindstedt and Naurin, 2010; Peisakhin and Pinto, 2010); - From an economic point - increases the efficiency in the allocation of resources through reduction of principal-agent problems (Holmström, 1979), discouraging rent-seeking and improving the functioning of markets.

There are number of studies mainly focuses on the effects and connections between the level of transparency and accountability with other economic and social variables. In his research for connections between fiscal transparency and economies outcomes, Hameed (2005) finds out that more transparent countries are shown to have better credit ratings, better fiscal discipline, and less corruption, after controlling other socioeconomic variables. Glennerster and Shin (2008) identify that countries experience a statistically significant decline in borrowing costs (on average a 11% reduction in credit spreads) when they are more transparent, and the magnitude of the decline is inversely related to the initial level of transparency and the size of the debt market. Weber (2012) identifies that the contribution of stock-flow adjustments to increases in debt is likewise smaller in countries with above average fiscal transparency. Irwin (2012) notes a positive relationship between the use of accounting devices and perceptions of sovereign credit risks as measured by credit default swap spreads. Arbatli and Escolano (2012) find that fiscal transparency has a positive and significant effect on ratings, but it works through different channels in advanced and developing economies. Moreover, in advanced economies the indirect effect of transparency through better fiscal outcomes is more significant, whereas for developing economies the direct uncertainty-reducing effect is more relevant. Other analyses, by Pappas and Richter (2013) and Rajan et al. (2015), regarding fiscal sustainability and providing information about fiscal stance and prospects note that the rating agencies, by informing (transparently revealing) that investors will invest in

bonds of high risk, can therefore create a downward spiral or self-fulfilling prophecy with regards to the sustainability of the public deficit. Gelos and Wei (2005) find that more (fiscally) transparent countries attract more foreign equity investment and are less vulnerable to withdrawals during times of economic downturns. Dabla-Norris et al. (2010) provide empirical support for the hypotheses that strong budget institutions help improve fiscal balances and public external debt outcomes. Similar results are provided by Alt and Lassen (2006), who discover that a greater fiscal transparency is associated with lower public debt and deficits in 19 advanced economies.

Regarding the accountability of fiscal institutions, analyses and studies that address the concept of performance-based budgeting (PBB) are very important. Often, the PBB concept is associated with productivity and efficiency of budget units, aggregate fiscal discipline and control, allocation efficiency and prioritization of strategic goals, as well as transparency and accountability (Robinson and Brumby, 2010). In this context the studies by Aristovnik and Seljak (2010) and Aristovnik (2013) are one of the most relevant in the region, which elaborate what the main challenges and obstacles regarding implementation of this concept are, how useful this tool is for performance accountability and budget transparency in budget users (ministries), the level of support of this concept by state administration and management in budget institutions, etc. The analysis of Maksimovska-Veljanovski and Stojkov (2014) presents the institutional capacities and readiness of individual SEE countries, for implementation of PBB and improving budget accountability.

Bearing this in mind, *we have a number of reasons to dedicate our efforts to and start researching and analysing the transparency and accountability in context of socio-economic trends and consequently economic activity. Having in mind the limited space for this short paper our goal is only to set the base for understanding and taking into account the transparency, accountability and institutional performance as an important determinant of inclusive and sustainable economic activity, beside traditional economic factors.* The short paper will be based of previous research/studies, international evaluations, analyses of public information and dominantly by elaborating the result of previous studies by the author. In accordance with some of the previously stated benefits of fiscal transparency and accountability this paper aims to address three key areas/questions:

1. The importance of fiscal transparency, accountability and institutional performance for number of socio economic variables and ultimately on inclusive and sustainable economic activity;
2. The Relations of the Fiscal Transparency and Accountability with the Socio-Economic Situation in Macedonia and need for improvements and reforms in this area;
3. Accountability and institutional performance in Macedonia – challenges and need to measure institutional performances/output (Performance Based Budgeting as one solution).

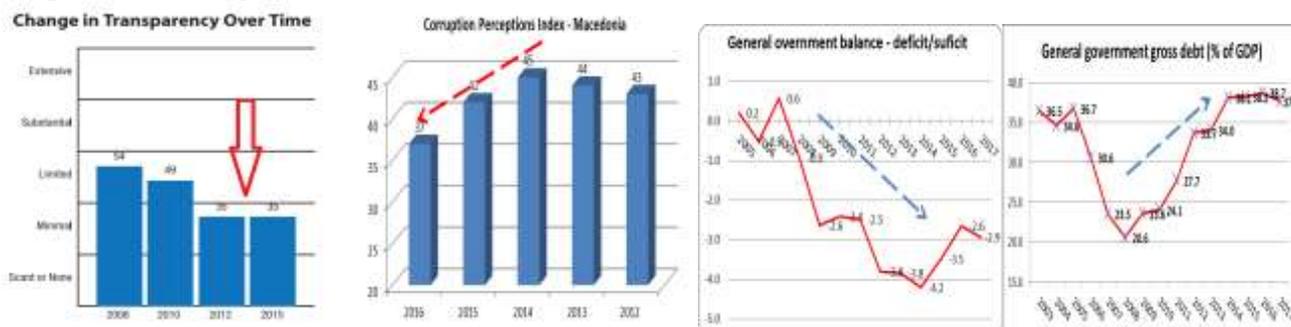
2. The Relations of the Fiscal Transparency and Accountability with the Socio-Economic Situation in Macedonia

According to OBI index (Open Budget Index 2015), R. Macedonia is located in the pre-last group of countries (with the index value of 35), and is in the group of countries that “provide minimal information for budget documents and budgeting process”. If we compare the place of R. Macedonia’s index for budget transparency in relation to the previous two surveys conducted in 2008 and 2010, we will note that R. Macedonia at that time was in the middle group of countries (OBI from 41 to 60), i.e. in the group of countries “that provided data for budget documents and budgeting process.” Starting from 2008 to the final calculation of OBI in 2015, R Macedonia has shown a continuous decline. Compared with the other Balkan countries, in 2015 R. Macedonia has the lowest value of the index (35), followed only by Albania (38). But what have been the effects of the continuing decline of budget transparency and accountability in R. Macedonia in the last nine years?. One of the first studies that evaluates transparency and accountability of budget users in Macedonia (see Trenovski at all, 2016) confirms this trends and indicated that all monitored budget users in the country have a very low level of transparency (on average

12.62%) and average accountability of the budget users' performance is almost five times higher than their average transparency (amounting to 64%).

Firstly, since 2006, there has been a clear trend of increasing budget deficit and public debt, i.e. a lower fiscal discipline. Although some of these tendencies can be linked to global economic developments, nevertheless, there is also a relevant connection with transparency (see graphs below) – the decrease of transparency index is followed by significant increase in budget deficit and public debt.. The IMF Executive Board Concludes in 2014 Article IV confirms the previous: *“The overall policy framework would benefit from greater fiscal transparency and a well-articulated debt management strategy that takes into consideration both domestic and external sources of financing while maintaining macroeconomic stability and supporting growth.”*. EU recommendations are very often focused on improvement of the fiscal transparency- *“Budget transparency is not ensured, because clear, comprehensive, timely and reliable budgetary and statistical information is not publicly available”*.

Secondly, the relationships among the downward trend of fiscal transparency, the credit rating of the country and the possibility of borrowing on the international capital markets - on May 24, 2013, the long-term credit rating from Standard & Poor's (S&P) for R. Macedonia was reduced from "BB" to "BB-", because, as noted by S&P: *“increased regional economic pressures and less anticipatory prospects for growth, increased unproductive public spending in parallel with reduced fiscal transparency. S&P indicated that the ratings could in future be increased, if the reforms are being made to increase the potential for economic growth comply / accompanied by increased efficiency and fiscal responsibility, government and public institutions”*¹.



Source :Open budget Index - MK, 2015. Source: Transparency International Source: Ministry of Finance - Macedonia

Finally, according to the World Economic Forum's Global Competitiveness Report for 2013-2014, the surveyed executives from the business sector chose corruption as one of the most problematic factors for running a business, in addition to access to finance and insufficient infrastructure (World Economic Forum, 2013). According to the Country Corruption Assessment Report for R. Macedonia, corruption is ranked as the fifth biggest problem in the country (27.9%) behind unemployment, poverty, low incomes, and high prices. In a number of previous surveys corruption had ranked among the first three main problems (Macedonian Center for International Cooperation, 2014). On the Transparency international's Corruption Perception Index 2016, showing the perceived level of corruption, Macedonia ranked 90 out of 176 countries, with score 37, having the second worst ranking in the region (only Kosovo had lower ranking – 95, with score 36). What's more worrisome is the fact that Macedonia's score dropped from 45 in 2014 to 37 in 2016, indicating higher corruption perception.

In addition the Bertelsmann Stiftung's Transformation Index (BTI) 2016 (which covers the period from 1 February 2013 to 31 January 2015) assesses the transformation toward democracy and a market economy as well as the quality of political management. The Index shows better performance both in the political and economic transformation in 2010 compared to 2006. However, the score for 2016 shows a weakening performance in both areas. It shows a particularly weak performance in the freedom of expression (score 4).

¹ See S&P report of May 24, 2013 at : <http://www.standardandpoors.com/prot/ratings/articles/en/us/?articleType=HTML&assetID=1245352109145>.

3. Accountability and institutional performance in Macedonia – needs and challenges

Some of the most frequently asked questions regarding the public sector and the fiscal policy issues and their impact of economic activity is primarily relate to the size of the public sector or state budget as well as the more prominent dimension concerning the efficient allocation of public resources. More recently, the issues of transparency and accountability of public consumption have also raised some questions. These issues are of utmost importance, given that the public revenue generation and the provided public goods are directly related to the life of any economic agent in the country. Therefore, in order to assess these realistically as more or less successful, it is particularly important to identify the performances for each budget activity. This process is not an easy one considering factors such as the political context, the administrative capacity, the level of transparency in determining the outputs and results or performance of each activity, an independent audit of the performance and results, or the integration of the performances in the political decisions. The academic literature and research on budget institutions and transparency issues in a number of emerging and low-income countries is nascent. In general, the evidence from fiscal institutions suggests that usually lack of capacity, ineffective institutions of civil society, and political economy factors act as a severe constraint on the progress of modernizing institutions (Allen, 2009). In these countries numerous targets and formal constraints on spending and fiscal deficit, which often exist on paper, may not be binding in practice. The reason for this is because mechanisms that make a commitment to budget rules, the transparency of procedures, and ensure that government ministers and officials are accountable for their decisions, are usually not well established (Campos and Pradhan, 1996). But why measuring institutional performance is necessary for strengthening accountability and efficiency of Macedonian public sector, which is closely connected to economic activity?

A simple analysis of the current status of all budget users and their output indicators (listed in the Budget for 2017) which are the most important part and the foundation for implementation of PBB indicate²:

- 47 out of 92 budget users (including the Health Insurance Fund, Pension Fund and the Employment Agency), which is 51% of all budget users, have not specified output indicators in the 2017 budget. (the situation is the same or even poorer in the budgets for previous years);
- large number of the budget users which are employing the dominant part of the public administration (in the budget for 2017.) and absorb a significant part of the budget, have not set any output indicators: Ministry of Finance, Ministry of Interior Affairs, Ministry of Foreign Affairs, Ministry of Justice, Ministry of Education and Science, Agency for Foreign Investments and Export Promotion, Ministry of Environment, Government of the R.Macedonia etc.
- The output indicators that should measure the performance of the budget users (the remaining 45 budget users) are poor and inconclusive (usually only one output indicator is referred) and cannot determine the performance, achievement and fulfillment of the planned objectives/goals. The most commonly encountered indicators are the number of procedures, reports, projects, or permits to be issued/ or their issuance initiated, nevertheless the output indicators do not include a part referring to the successful accomplishment of the goals.

One research conducted by CEA and IDSCS which cover 60 out of the 91 budget users in R. Macedonia (66% of all budget institutions in the country) that manage/allocate around 91,7% in 2013³ notice (see Trenovski, 2014): even though ½ of the institutions in Macedonia are not acquainted with the exact meaning of institutional performance measuring system it does not pose a great obstacle, as much

²See Budget of the Republic of Macedonia for 2017, available at: <http://www.finance.gov.mk/mk/node/4105>

³ The budget users were firstly monitored and analyzed through the web sites and the published documents, and secondly through direct interviews with the budget user's representatives responsible for the preparation of the budgets for each of the institutions, providing answers to specific questions on the implemented procedures of accountability and transparency.

as the fact that none of the institutions does not publish a budget that contains output indicators, nor are these used together with results indicators; only 26,7% of the monitored institutions classify the budget expenditures by program classification; the annual accounts of the institutions do not explain the differences between the original projections of the output indicators and the specific outcomes; 70% of the institutions do not publish their strategic plan; only 21,9% of institutions use a specific methodology for evaluation of the achieved program outputs; only 18,8% of the institutions conduct analyzes of the changing needs of the program users; 38,7% of the institutions do not publish any explanation for the difference in the projected and the actual expenditures; 2/3 of the institutions are facing difficulties in linking the budget plan with the goals of the strategic plan.

Another study focused on needs and benefits of Performance based budgeting (PBB) for strengthening the transparency and accountability in the country conclude that (see Trenovski and Tashevska 2014): performance budgeting will have a significant impact on strengthening and continuous development of the strategic sectors within the ministries; PBB will allow for focus alteration of the fiscal management from control over the limits of the budget users' resources, towards control of the performance and results that can be achieved with the resources ; the data and information, in the form of indicators coming out of the performance budgeting process, will enable continuous implementation of comprehensive impact assessment analyses, risk analyses, analyses of the life cycle of public expenditure etc.; PBB will be an especially important leverage mechanism for implementation of the developmental part of the budget, which has large and numerous expected results, since it will enable comparison with the budget expenditure. Concerning fiscal transparency in R. Macedonia, PBB will enable public presentation and availability of important information (data, program elaboration, etc.) on the implementation of the budget activity, will enable access to budget activities' results information, will encourage public (or scientific) debate about the results and the effectiveness of a particular budget (programs, activities, users), and will enable the public to monitor the effects of the budget more easily and to create an image and an opinion on the fiscal position of the policy-makers.

In this regards we want to mention one of the first study in the region based on a developed methodology which focuses on estimation of costs and benefits of the overall policy reform for implementation of PBB in Macedonia (see Trenovski and Nikolov, 2015) – as a process for improving fiscal accountability in Macedonia. This study is especially important for a number of emerging and developing countries providing platform to estimate whether benefits are higher than the estimated costs of the reform and to have a solid base to decide whether they should or should not implement PBB. Results of the study clearly indicate that the estimated benefits are higher than the estimated costs for the same period with a net present value of 99 million euro. Or, for every denar/euro invested in this reform there are additional 2,600 denars/euros of gross value added in the Macedonian GDP expected, if there is 13% technical efficiency improvement or for every denar/euro invested in this reform there are additional 8.000 denars/euros of gross value added in the Macedonian GDP expected, if there is 40% technical efficiency improvement.

The absence of the public availability of the institutions' strategic plans, the lack of linkage with budget, the inexistence of methodology for performance evaluation, the lack of output indicators in almost all institution, the lack of analyses of the differences in the allocated resources and the achieved results, including the political rigidity in the country when it comes to fiscal reforms/changes, indicates of the possibility of serious challenge, and numerous potential obstacles for implementation some institutional performance measuring system. But from the other side these challenges are also a causes for developing and implementing such system in the country. A preferable direction (based on the previous studies) could be developing PBB which is a concept that will provide us access to information and data showing us when and if the budget programs, the agencies, and the other institutions providing public services, are efficiently and effectively fulfilling their obligation. Furthermore this will improve the efficiency and effectiveness of spending public resources which is main precondition for sustainable economic growth.

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