

Chapter 1

Case Study on ALBANIA

prepared by

Blerta Zilja & Edlira Kalaja

Blerta Zilja is a lecturer in cost and management accounting at the University of Tirana. She graduated from the university's Faculty of Economics in finance and accounting, finished her master's in accounting and auditing, and is pursuing her Ph.D. in public investments appraisal and evaluation. Her research fields include public finance management, cost benefit analyses, decision-making on public investments, and public auditing. She is the author of many scientific articles and participates in international scientific conferences.

She has worked for three years as a budget specialist for public investment management at the Ministry of Finance. Since 2011, she has been an Expert Associate at the Albanian Institute of Science (AIS), engaged in projects on public finance and data transparency. Her articles and studies on the country's budget indicators, economic performance, education sector, and other topics have been published on the Albanian open data website, a project of AIS. She is also a Finance Expert in the Monitoring of Public Finance project of the Open Society Foundation Albania, where she prepared reports on the state's budget preparation and execution, the performance of the Supreme Audit Institution and the Public Procurement Agency, and the reflection of European integration priorities in the state budget.

Edlira Kalaja has extensive experience in public finance, especially budgetary programming and policy analysis. For the last seven years she has worked in budget policy analysis at the Ministry of Finance of Albania, also participating in several working groups focusing on budget issues. In the past year she has also contributed as an Associate Expert on public finance projects at the Albanian Institute of Science.

She graduated as an honor student from the University of Tirana, where she received her BSc and MBA degrees, majoring in finance. She is finishing the Ph.D. program at the university, focusing on sustainability of public debt in Albania.

For several years she has been a member of the University of Tirana faculty, teaching finance courses to students of all levels. Since August 2012, she has been a consultant to the World Bank and also holds the position of Country Coordinator for Albania for Europa Re, a company that deals with catastrophe and weather risk insurance for South East Europe.

1. Introduction

The budgeting process is vital to getting the full advantage of benefits from public spending given available resources. For this reason Albania has made enormous steps in strengthening budget procedures and reforms, which are nowadays oriented beyond a one-year process, reflecting objectives and policies undertaken by the government. This case study gives a clear picture of the structural reforms undertaken in Albania and how effectively their costs are included in the state budget.

It also tries to identify the bottlenecks of the process and the institutions involved, emphasizing at the same time the progress Albania has made in this area. An important part is dedicated to the problems and issues which should be the future focus for budget institutions responsible for the process and the implementation of reforms.

For this study, the working group focused on the most important structural reforms undertaken over the last 10 years in five sectors: Enterprise, Financial, Human Resource Development and Labor Market, Administrative Services, and Network Industry.

For each case of reform, the group verified whether its cost was integrated in the state budget, analyzing the budgets of relevant ministries, their programs, the Medium-Term Budget Programme documents in relevant years and their accompanying reports, the consolidated fiscal table budget, annual reports of the line ministries and all other budgetary institutions, monitoring reports, reports audit, the Economic and Fiscal Programme documents, and others. Time series were analyzed mainly by program classification, but in some cases functional classification was used.

The main sources of data were taken from the Ministry of Finance, the Institute of Statistics, the Bank of Albania, line ministries and other responsible institutions, sector strategies, and the related legal framework in the five sectors examined, as well as signed agreements with other countries or international organizations. The European Commission's progress reports on Albania and the reports from international organizations, such as the World Bank and UN, were also taken into consideration.

This case study consists of four sections. The first introduces the methodology used for this case. The second introduces the process of budgeting, not only its importance but reforms made during recent years, the legal framework, detailed procedures, and the main actors of this process. The third section focuses on the reforms undertaken in key sectors, institutions, and processes to include the cost of structural reforms in the state budget. The last section gives some conclusions and recommendations for all of the issues treated above.

2. Main institutional features for annual budget and medium-term fiscal programming

2.1. Legal and other relevant framework

One of the main features in Albania's budgeting process is that the whole system is top-down, meaning that the government firstly determines the level of total expenditures to be allocated among the main policies. The setting of these ceilings is a critical step in ensuring that the process of program expenditure planning is consistent with macro-fiscal stability and the strategic priorities of the government. In this context ceilings are an upper limit of the total amount of money that can be spent, or planned to be spent, for a particular purpose. However, the budgeting process has at the same time some elements that are bottom-up, as the Ministry of Finance (MoF) after analyzing a budgetary request can be flexible in adjusting ceilings of the respective institution.

The perception of the budgeting process changed during 2008, on approval of the new organic law on the budget system.⁵ This law specifies in detail the budgetary system in Albania: its structure, principles, the foundations of the budgetary process, intergovernmental financial relations, and responsibilities for execution of the entire budgetary legislation.

This law was the aftermath of the Medium-Term Budgeting Process, which started in 2000 in some pilot institutions and brought several innovations such as: (i) orienting the budgetary process beyond an annual thinking process, (ii) shifting to Programme and Performance Budgeting outputs, (iii) defining clear roles and responsibilities, and (iv) making explicit the linkages of the budget process and policies set by the government. The need for a new law derived from the modernization of the treasury system that started in 2004, establishing a real-time operational treasury system.

A key component of the budgeting process is the Integrated Planning System (IPS), which provides a broad planning framework within which the government's policies and financial planning processes function in a consistent way. The IPS helps the government in harmonizing core processes such as the National Strategy for Development and Integration (NSDI), the Medium-Term Budget Programme (MTBP), European integration and NATO membership, and external assistance. The quality and coherence of these technical processes significantly affect the government's ability to achieve its policy goals and objectives and thus keep its promises to the public.

As part of IPS, an important document in the budgeting process is the National Strategy for Development and Integration (NSDI), which presents the medium- to longer-term policy direction for the government over a seven-year period. The linkages between the NSDI and the MTBP are shown in Figure I-1

5 Law on the "Management of the Budgetary System in the Republic of Albania" (No. 9936), enacted on June 26, 2008.

in the Appendix. The NSDI is founded on a national vision and a comprehensive set of sectoral and cross-cutting strategies. Sector strategies consider strategic policy commitments from the Government Programme, European and NATO integration requirements, and any major public investment or external assistance priorities.

On the other hand, the law on the 'Management of the Budgetary System in the Republic of Albania' explains in detail the procedure that all government units and special funds should follow during the year. The annual budget procedure itself follows the specific dates set in the organic budget law, followed by the Permanent and Annual Instructions of the Ministry of Finance, which specifies the rules of Budget Preparation and Budget Execution during the year. Those documents are issued by the MoF at the end of February on behalf of the Council of Ministers. The Budget Preparation Instructions is the document which officially begins the first of three rounds of the Medium-Term Budget Planning process, advising budgetary institutions in preparing spending plans.

Additional guidance for preparing the budget is issued in July, starting the second round and requiring appropriate review of plans prepared during the first round. In cases where the ceilings are higher than those of the first round, instructions can specify the products for which these additional resources are given. Other guidelines are prepared to explain the monitoring and execution part of the budgetary process. The third round is a process which must be accomplished by all budgetary institutions at the end of the year, the period in which the ceilings of the first year of the MTBP—the future annual budget—are already set and cannot be changed. This round can be something of a paper exercise, as a result of the short time remaining or problems in the programming.

Guidelines of the Policy Priorities, prepared by the Department for Strategy and Donor Coordination of the Council of Ministers, is another document that helps the budgetary institutions identify new policy priorities that have not been previously funded and that are now a major possibility, so that they can take advantage of resources that may remain available after calculating the costs of existing policies.

Another important step in improving the effectiveness of government's expenditures plans is the process of monitoring, which provides feedback on the implementation of policies. To achieve a successful evaluation of commitments undertaken by ministries, each of them prepares an integrated plan, an annual document that highlights the key MTBP commitments, including European integration commitments, planned legislation, major public investments, anti-corruption measures, and external assistance projects.

Another significant document drafted by the government is the Economic and Fiscal Programme (EFP). As a potential candidate country aspiring to join the European Union, since 2006 Albania has annually submitted this document to the European Commission. It presents Albania's economic and fiscal policies and the main structural reforms with a medium-term perspective. The program outlines also the preparation of institutional capacities to participate in the

economic and monetary surveillance procedures of the European Union by giving a detailed assessment of the current year's economic and financial situation in Albania and articulating the medium-term economic policies and structural reforms to be implemented during the three years for which the document is drafted. The EFP is based on the Budget Law of that year, the Macroeconomic and Fiscal Framework for the next three years, the Medium-Term Budget Programme, the latest Monetary Policy Report, and the Public Finances Strategy. At the same time it is fully in line with the National Strategy for Development and Integration (NSDI). The EFP is approved by the Council of Ministers.

One of the most important principles for the budget process in Albania is transparency, which implies that everyone can read, see, and examine not only the procedures but also the funds allocated to each public institution by using the section for budget documents on the official website of the Ministry of Finance.

2.2. Procedures

The following section lists the procedures for preparing the Annual Budget, which is the first year of the Medium-Term Budgeting Programme. All budget institutions strictly follow procedures as set in the organic budget law. In cases where these procedures are not followed, clear sanctions apply. As part of the Integrated Planning System calendar, it is the task of the Minister of Finance—as the main actor in the budget process—to prepare each December the Public Expenditure Management calendar (including detailed deadlines) and to propose it to the Council of Ministers. The calendar is approved as an important element of strategic planning by the Council of Ministers and comes into effect on the first day of each year.

In January, the Minister of Finance prepares a report on macroeconomic assessment and forecast. After approval by a decision of the Council of Ministers in February, the report is sent for information to the National Assembly by March 10. Upon approval by the Council of Ministers, the Minister of Finance approves and issues instructions for budget preparation to authorizing officers of budgetary institutions.⁶ All budgetary institutions should provide their budgetary request in line with the proposed format and budget ceilings (comprising the level of wages, other current expenditures, capital expenditures financed from the state budget, and foreign capital expenditures for the next three years). Budgetary institutions are responsible for allocating funds to their program and detailing them according to their needs, following the procedures set by the law and other legal documents.

Under the guidance of the principal authorizing officer, the MoF's Budget Department reviews and assesses medium-term budget requests and additional requests, and prepares a report with conclusions and recommendations for each government unit. This report is presented in hearings held in the MoF

6 Figure I-2 in the Appendix provides details of the required steps.

with each government unit according to a pre-established calendar. The conclusions of hearings are consolidated into a draft of the Medium-Term Budget Programme, which is later subject to a Council of Ministers decision.

The Council of Ministers revises and approves the draft Medium-Term Budget Programme and its expenditure ceilings in July (the second round of the process). In this round, the MoF prepares another macroeconomic assessment and forecast, from which ceilings are prepared that are then sent to all budgetary institutions. These ceilings might be unchanged from those set in the first round, or might be higher or lower depending on the macroeconomic forecast approved. However, if the overall ceilings remain unchanged, allocation of funds between institutions must be applied according to the budgetary requests prepared by the institutions in the first round of the MTBP, emphasizing the significance that complete budgetary requests have in arguing the importance of reform projects that might be initiated in the near future. In this second round of the process, the budgetary requests fulfilled by all budgetary institutions are mainly focused on the first year of the MTBP, which is nothing less than the annual budget of the following year.

By October 25, the Council of Ministers revises and approves the Draft Annual Budget and the revised Medium-Term Budget Programme. By November 1, the Prime Minister, on behalf of the Council of Ministers, submits the proposed annual budget to the Assembly.

The annual state budget must be approved by December 31 at the budget program level for each general government unit. The Council of Ministers may propose annual state budget approval at a level more detailed than at the program level, in compliance with the principles stated in the budget organic law. The annual budget law and all its components are published in the Official Gazette.

In January, after approval of the annual budget law by the National Assembly, the principal authorizing officer consolidates any changes in the final Medium-Term Budget Programme document. In February, the MoF publishes the final document.

2.3. Institutions

The budget process allows all budgetary institutions to be part of the process. Main actors in these procedures are as follows.

- *The National Assembly*: This institution has the right to enact the annual law on 'Budget', after it has followed the necessary enactment procedures.
- *The Council of Ministers*: The Council is one of the main institutions that approve the Macroeconomic and Fiscal Framework and the ceiling for each budget institution after all documents are revised first by the Strategic Planning Committee. The Council is responsible also for approving and coordinating policies as well defining the main policies to be financed.
- *The Ministry of Finance*: The Ministry makes proposals to the Council of Ministers for total expenditure ceilings and MTBP preparation ceilings; carries out the tasks that are necessary for launching the program expenditure

planning process; revises the entire budgetary request submitted; and prepares the MTBP document and the annual budget.

- *The Ministry of European Integration:* In revising procedures and conducting hearings, the Ministry has a specific role in assessing whether policies that are going to be financed are part of the policies approved by the government in support of EU integration.
- *The Department of Strategy and Donor Coordination (DSDC):* The DSDC ensures that government expenditures are planned in a way that is consistent with its desired strategic allocation of resources. The DSDC is one of the institutions that participate in the MTBP hearing.
- *Budgetary institutions:* All budgetary institutions prepare MTBP requests.

At the beginning of the MTBP preparation process, each budget institution is asked to prepare (for each program) the respective Programme Policy Statement, which should include:

- The mission or goals of the central government units
- A description of programs and activities of this unit
- A presentation of program policies (including their goals and objectives)
- Policy standards that shall be achieved by each unit and program
- An explanation of how each program's outputs contribute to achieving relevant policy goals and objectives
- The actual indicators
 - for the two previous budget years
 - budgetary funds planned for the current budget year
 - adjustments made by reallocations
 - approved requests for additional funds
 - the distribution of the total MTBP expenditure ceilings across programs (for the next three budget years)
- The capital expenditures (listed by capital project and program)

In this process, it is important that the policies expressed in the above mentioned Statement are clear, understandable, and periodically revised (on an annual basis) through a process called the *Programme Policy Review*, which should be fully integrated with the other processes.

Designing a reform is a process that takes time and must be in compliance with the NSDI, the Government Programme, European integration, and NATO membership. Each reform must be translated into an Action Plan, costs of which should be reflected in the MTBP of the respective budget institution within the ceilings approved.

3. Incorporation of structural reforms' fiscal costs into fiscal programming documents

The rapid developments in Albania necessarily brought about a series of structural reforms to support the vision of the country's development as an open economy. All main sectors were subject to the drafting of regulations, laws, or procedures which aimed to improve the country's economic situation. Most of these reforms were supported from the state budget, while others remained formulated on paper, waiting for funds to be implemented.

3.1. Assessment of the overall framework

3.1.1. Enterprise sector reforms

The most important challenge for Albania was the transition from a closed, completely centralized economy to a market economy under the conditions of free competition. The country implemented many structural reforms toward realization of these objectives, such as privatization, land reform, price liberalization, etc. Albania is nowadays an open economy, with liberal trade and investment, and tries to support the development of local private business and increase foreign investment. Since 1993, Albania has a framework to encourage Foreign Direct Investment (FDI); however, it does not provide specific incentives for foreign investors. Thanks to a favorable business environment, legal conditions, and opportunities opened up by the privatization of state-owned enterprises, Albania has managed to increase the inflow of foreign capital. Many foreign investors have taken part in the privatization of small and medium enterprises (SMEs) and large enterprises in strategic industries, such as banking, telecommunication, and energy. On the other hand, revenues from privatization have served as a good support to reduce the budget deficit and to fund capital expenditures. Further growth of FDI has been achieved through concessions and the establishment of industrial parks and free zones. The state budget has funded research projects in these areas, but the lack of local investments has meant a low standard of services so far. Consequently, interest in these areas has been low.

Despite the evolution in FDI growth,⁷ overall this inflow is modest due to the small size of the economy. Problems have come mainly from delays in the completion of reforms in areas such as corruption, tax regulation, infrastructure, energy supply, labor market and human resources, land reform, and construction permits.

⁷ According to UNCTAD and UNDP's *Report on Foreign Investments in Albania, 2011*, page 16, Albania's ranking in Inward FDI Performance Index was 18th of 141 countries in 2010, while in 2005 it was 68th.

Among these, the land reform has not had adequate support from the state budget. Ongoing changes in the responding institutions or procedures and delays in compensation of former owners have made this issue one of the most problematic concerns for the Albanian society and a major obstacle to development of various economic sectors.⁸

To support economic growth and the business climate, Albania has undertaken many reforms in the tax system by reducing tax norms several times or by enlarging the taxable bases. These measures have served not only to ease doing business in Albania, but have helped also decrease informality and boost tax revenues, which are the main source of budget revenues. For instance, the profit tax rate declined from 23% in 2005 to 20% in 2006, and further to 10% in 2008. The social insurance rate fell from 42.5% before 2000 to 38.5% in 2002, to 29.5% in 2006, to 26.5% in 2009, and further downward since. All these reforms were reflected in the projections of budget revenues of the upcoming year and in the MTBP or the EFP as well.

3.1.2. Financial sector reforms

The financial system in Albania has two main actors that accomplish the supervisory process: the Bank of Albania (BoA) and the Financial Supervisory Authority (FSA). Both seek to guarantee that the operators in the financial sector carry out their financial activity firmly and in accordance with the legal, regulatory and supervisory framework. The BoA supervises the banking sector and other financial institutions, while the FSA focuses on the insurance, securities, and private pensions markets.

The BoA is the central bank of Albania, with the attributes of a modern central bank only since 1992 and the transition of the political system. It has played a key role in maintaining the banking system's soundness by introducing and adopting necessary supervisory, legal, and regulatory measures in response to identified risks. Generally, the entire supervisory process has emphasized measures for enhancing responsibility, rigorously managing banking system risks, and observing prudential norms set by the Bank of Albania. A stable bank system helps the business climate in the country and increases the possibility of funding.

The FSA was established in 2006, as a regulatory and consolidated entity to supervise financial non-bank markets in Albania. It supervises three fields: insurance, securities, and the supplementary private pension scheme. These functions were previously carried out by three different institutions, which led to fragmentation of authority and responsibilities, sharp differences in standards, and inefficient use of regulatory and supervisory skills. The fast development of the overall non-banking financial sector caused an overlapping of

⁸ Access to land in Albania poses a major problem for foreign investors due to various factors, including lack of ownership documents, overlapping claims, and unpredictable court decisions.

these markets' supervisory coverage. That is why a fully integrated supervisory structure is better than a fragmented one. Its main concerns are to protect consumers' interests; to promote sustainability, transparency, and reliability of non-banking financial institutions; and to ensure law enforcement. Meanwhile, the change in the non-banking financial market regulatory and supervisory structure made it necessary also to amend the entire legal and regulatory framework related to different areas of this sector.⁹ Among the non-banking financial sectors, the insurance market is the most developed one, while the other two, private pensions and the securities market, are in their early stages.

Another very important institution in the financial market is the Tirana Stock Exchange (TSE). Its mission is to organize and develop the Albanian securities market by creating the most favorable conditions for issuers, investors, and financial intermediaries to exploit the capital market; but until now, no company has registered itself at the TSE to sell its shares publicly. Reforms to make the TSE functional have been put off, making the TSE simply a budgetary institution spending tax-payers' money. This means that the only sources for providing funding for companies in Albania are banks, or stock exchanges abroad.

3.1.3. Human resource development and labor market reforms

Albania is a country with a young population, with about 68% aged 15–64 years, the allowed age range for working. A younger population provides a competitive advantage for Albania in domestic and international markets. However, despite broader labor market opportunities, Albania suffers from a high rate of unemployment. The private sector employs most of the labor force, and economic development is considered a way to improve the performance of this indicator. Analyses of unemployment in Albania show there is a direct link between employment and education. In 2009, 53.6% of the registered unemployed had only elementary education, 43.8% had attained a secondary education diploma, and only 2.6% had higher education.¹⁰

a) *Education reforms:* Generally, all Albanian governments have declared education one of their priorities. However, if we analyze the funds allocated over the years, Albania ranks among the last countries in the region for education expenditures as a percentage of GDP (around 2.8% in 2011).

To improve the quality of the labor force and increase the chances of better careers, the Albanian society is strongly oriented toward education, especially higher education. The development of this sector has had two phases. During the period 1991–2003, the main concern was to reorganize the education system in line with new developments in the market. Most funds went to the drafting of texts and curricula. Meanwhile, as a result of

9 One of the most important change was the amendment made in 2004 to the law on the 'Activity of Insurance, Reinsurance and Intermediation in Insurance and Reinsurance', which reflected an EU directive about the insurance companies guarantee fund. The directive increased the fund to 3 MM EUR.

10 This data does not include undeclared private work. Source: INSTAT.

high demand for education, many universities were opened throughout the country, supported by the state budget. The most important reform during the second period (2003–2011) proceeded on demand for higher education; while the quotes approved for the public universities were increasing rapidly, this initiative was not supported sufficiently from the state budget for infrastructure and staff. An important reform in higher education was its financing scheme. Since 2007, public universities are autonomous institutions; hence the entire funding for them (other than investments) is allocated in the form of a grant; this is in order to enhance their institutional and financial autonomy. Particular emphasis was given to professional education. The relevant program within the Ministry of Education and Science has received continuous support from the state budget; however, the efforts made to turn it into a successful and effective sector have failed.

- b) *Strengthening social safety nets*: Albania is attempting to implement reforms for strengthening social safety, but not all of them have been successful. Albania has a *pay-as-you-go* pension scheme, which has an absolute dependence of the state budget. Its deficit is becoming a black hole for the budget, mainly due to the high degree of informality and the low number of contributors. In the early years (1993–1996), revenues were rising at a fast pace, averaging 45%. This reflected economic stability following the developments in 1990–1993, when many factories were closed, unemployment rose to alarming figures, and GDP fell drastically. However, contribution figures were low, and the high degree of informality in the years that followed prevented the scheme revenues from maintaining high growth.

After 2000, the need for a radical reform of the scheme became vital. At that time, the market lacked information on the effectiveness of economic activity, private entities, and their employees. The construction industry especially showed a high degree of informality. Markets also saw a discrepancy in the number of licensed firms and the number of those who shed social contributions, and a lower participation in the scheme by workers in the agricultural sector.

Unsatisfactory performance required a change in the contribution rate, which had been at 42.5% since 1993. Considered too high, this led to a distortion of the market, increasingly high evasion, and hiding of actual salary. In 2002, the rate dropped to 38.5%. The negative effect of lower rates was offset by an increase in the number of people involved in the scheme. In 2003, revenues grew by 11% compared with 2002, while in 2004, the negative effects faded away completely, as revenues increased by 16%. In 2006, the contribution rate decreased to 29.5%, accompanied by an even greater rise in the number of people involved in the scheme. However, despite the measures taken, revenues from contributions continue to be low compared to the cost of social insurance, making the scheme very dependent on the state budget. Over the years the growth pace of expenditures has been significantly higher than the growth of revenues. In addition, the pension increases have been fully funded from the state budget. Another important

aspect of the pension reform is the rate's growth over time. Albania has been characterized by a large difference in pension levels between urban and rural areas. To reduce this gap and equalize the areas, in 2012 the government applied a higher growth rate for the countryside's pensions than for the city's. In 2009, for instance, the pensions of urban areas increased by 10% and those of rural areas by 20%. These funds were included in the budget, at the beginning as a contingency fund, administered by the Council of Ministers and reflected in the EFP 2008–2012 document.

However, according to the EFP 2010–2012, one of the strategic priorities is restructuring and reforming the *pay-as-you-go* system to establish a direct connection between the contributions and the pensions. But there are no cost estimations about this policy in the document, and no budget implications.

In the health insurance sector, a key role is played by the Health Insurance Institute (HII). In past years this institution was responsible for providing health services in the country. As contributions collected by the HII are very low compared to its expenditures, also this scheme is steadily financed by the state budget. In 2007 HII began to support primary health care, and in 2009 hospital services as well. These initiatives were associated with an increase of HII funds from the state budget; funds grew from 2.7 billion Albanian Lek in 2006 to 4.6 billion in 2007, and to 20.7 billion in 2011. This means that in the 2007 budget support for the HII grew by 73% compared to 2006, whereas in 2011 it was 7.7 times higher than in 2006.

Another institution that plays an important role in active employment policies is the Ministry of Work, Social Affairs and Equal Opportunities. It carries out its policies through the Labor Market program and aims to strengthen the stability of the labor force, increase workers' productivity, and develop national human resources by strengthening training to increase the skills of the general labor force. Support for this program has been growing steadily, as reflected in the EFP document each year. Furthermore, the Albanian state budget supports also the disabled.

3.1.4. Utilities and network industry reform

Scarce infrastructure has long been a serious obstacle to developing Albania's economy. Hence investments in telecommunications infrastructure have become a priority, especially since 2000. This initiative gets full support from the state budget and other international financial sources. At the same time, increasing investments in road projects has become one of the priorities of the government, absorbing high levels of capital budget expenditures. Regardless of the higher investments in road construction, the government has problems in planning funds for road maintenance, turning billions of Albanian lek in investments ineffective after a short period. Reforms have also been made in the urban water supply and sewerage sector, increasing the level of decentralization and private sector participation. However, the state budget still finances

investments in the sector, mainly in cost recoveries because of the high level of depreciation of the water and sewerage systems, but also through subsidies for operating activities. While the level of investments remains high, the level of subsidies is decreasing each year.

Meanwhile, Albania is trying to develop port and air infrastructure to benefit from its favorable geography. The country has substantially upgraded its Information and Communication Technology (ICT) infrastructure, through the Cross-cutting Strategy of Information Society. Legislation has liberalized the telecoms industry, bringing it into line with the EU regulatory framework for communications, which encourages competition. For this purpose, in 2007 the National Agency for Information Society was set up to accelerate the development of an information society and e-government services.¹¹ Despite the ICT sector's development in the last few years, there are still important objectives to be achieved, such as country-wide internet coverage and a faster and more reliable network infrastructure. Significant improvements have been made in access to mobile devices as well. A reduction of tariffs, as a result of the regulatory framework implemented by the Authority of Electronic and Postal Communications and thus increased competitiveness, has led the industry to expand rapidly.

Another important development in utilities involves electricity. Albania has numerous problems in this sector, not only in financial terms but mainly in management. Only after 2006 has it been possible to provide uninterrupted power for most of the country; however, net technical losses continue at high levels (about 32% in 2010), and so do the indicators regarding unpaid bills. A continuous power supply improves the business climate, but it has been achieved at a high cost, deteriorating the state budget. Positive developments have been observed mainly after the privatization of the Electricity Distribution Company, but the high level of unpaid bills has made recovery difficult, requiring continuous budget support. On the other hand, the government is giving priority to concessions for hydro-power plants to help develop private sector power production, which is not yet significant for the sector (at only 2–3% of total energy production in the country).

3.1.5. Administrative sector reforms

Albania has undertaken many structural reforms to mitigate procedures and shorten the time to register and license a business. Numerous reforms in the fiscal sector promote economic development as well as facilitate business procedures in payment terms. In 2006 an action plan for regulatory reform was approved by the Council of Ministers, with four pillars: (i) development of a

11 As a result of technological development, Albania has substantially increased the availability of e-services across most basic government services. Almost 80% of such basic services at the central government level are now accessible as e-services at the first or second level of sophistication (UNCTAD and UNDP's *Report on Foreign Investment in Albania, 2011*, page 36).

regulatory management system (institutions and procedures); (ii) improved quality of existing regulations (reduction of administrative and regulatory barriers); (iii) improved quality of new regulations (through impact assessment of the regulatory framework); and (iv) set-up of a framework for periodic monitoring and assessment of reforms. A loan of 9.3 MM USD to support parts of the action plan was approved by the World Bank.¹² Meanwhile reforms in increasing trade openness and reducing obstacles to the trade of goods and services have been applied thanks to free trade agreements that Albania has signed.

- a) ***Strengthening the legal and administrative framework:*** International organizations and institutions have criticized Albania's hurdles to opening a business. To improve this aspect, the government created two important institutions, the National Registration Center (in 2007) and the National License Center¹³ (in 2009). Both are central public institutions reporting to the minister responsible for the economy and functioning as a one-stop shop. This has made it easier to start a business by streamlining procedures, making them simpler or faster by introducing technology, and reducing or eliminating minimum capital requirements. As a result, there have been more registered businesses, financial resources, and job opportunities. The number of days required to open a business in Albania decreased from 41 in 2004 to only five in 2012. Another area that has experienced numerous reforms is tax legislation: among the changes here, the online tax declaration system remains one of the most important steps to facilitate administrative procedures.
- b) ***Trade openness:*** Albania applies a liberal trade regime. Foreign trade was liberalized in 1990 and follows guidelines set by the European Union and World Trade Organization (WTO). Since becoming a WTO member in 2000, Albania has implemented full liberalization of its import-export regime for goods. Imports and exports of commodities are not generally subject to special authorization requirements. Exceptions apply to quotas or control requirements imposed through bilateral or multilateral agreements. At the same time, exports are not subject to any taxes, fees, or other barriers. The Stabilization and Association Agreement (SAA) signed in 2006 contains an interim free trade agreement with the EU, which was implemented in 2009. This is expected to open new opportunities for development of the country. Since 2004 Albania has completed and started to implement a full network of free trade agreements in South East Europe, followed by the liberalization process and the adoption of a joint agreement on free trade. In 2006, the Central European Free Trade Agreement was signed by all parties listed above, and it has been fully operational since November 2007. The liberalization policy has continued with a free trade agreement with Turkey, and another one with the European Free Trade Association states.

12 Fiscal Economic Report 2006–2008, page 34.

13 The NLC aims at improving the business climate, through reduction of administrative barriers regarding free initiatives to conduct economic, commercial, or professional activities, or regarding the use of public goods, guaranteeing at the same time the safeguard of public interests.

All of these measures have been accompanied by assessments of their impact on budget revenues, and the level of revenues from customs duties has decreased. During 1993–2003, revenues from tax offices and customs represented on average 20% of the revenues in the state budget, whereas after the implementation of several free trade agreements, they are only a modest source of state revenues.

3.2. Assessment of the institutions

Albania has a top-down, flexible budgeting system, which starts from the Council of Ministers, followed by the MoF (which plays a key role in the entire process), and then by all budgetary institutions. Approval of the National Strategy for Development and Integration has also helped to reflect the cost of structural reforms in the state budget. This document defines the goals and objectives that every sector must follow, serving as a starting point for line ministries to break down and realize their missions. Within the ceiling set by the MoF, the line ministries are free to allocate funds between programs, which helps them in distributing the money according to their needs to achieve structural reforms. However, LMs often encounter difficulties to include all the cost of structural reforms needed in the budget process and their MTBP requests.

The MTBP is the key component for a successful budget, which reflects all the policies of a sector and of LMs. A correct MTBP starts by assessing the mission, the programs needed to fulfill it, and their broad description. Generally, all the budgetary institutions meet these requirements. The problems begin when the institution is asked to define the aim of the program, its objectives, and furthermore the standard of the program policy. These problems stem from the inability of LMs to define policies in cases where there is not a directly responsible person in doing it. A vague definition, especially of the objectives, brings out difficulties in assessing a program's products. That is why many budgetary institutions fail to complete all the fields of the MTBP. The MTBP form proposed by the MoF requires a clear assessment of the policy, objectives, and outputs that will be accomplished in the next three years. The last element (products) is very important, because the LM can provide a product's quantification only if they have made prior estimates of their plans and of structural reforms as well.

Determining the standard program's policy (which is also required to be filled in by the LMs) allows the MoF to judge if the proposed products and their costs meet the standards in comparison with those of other countries. Differences between standards and drafted documents are detected even for the MoF's own MTBP document, which underscores that the quality of submissions is still not at the desired level.¹⁴ Reaching those quality standards will remain a challenge for the MTBP process in coming years. However, despite the difficulties that some budgetary institutions encounter in achieving the

14 Ministry of Finance, *Project document of MTBP 2012–2014, Phase II*, page 1.

quality requested, some LMs have made considerable progress in drafting a correct MTBP that reflects the costs of the structural reforms. This is mainly the case for ministries with a high level of budget allocated, which at the same time have more human resources, such as the ministries of Public Affairs, Transport and Telecommunication, Interior, and Education and Science.

Although the law or guidelines have clearly defined the responsibilities for each directorate in preparing MTBP requests, this process is mostly handled by the economic directorates of the institutions. Directorates that do not know in detail the entire policies, strategies, or reforms to take place in their institutions fail to comply with the requests of the MTBP as required by the MoF. For example, in defining the costs of products within a program, LMs often focus more on assessment of the costs in the first year without paying the necessary attention to the two years following.

In most cases, even though the LMs may have drafted a reform, the implementation of which requires several years, they fail to deliver accurate financial costs for all years in which the reform is going to take place, even where costs and products are determined in relevant action plans. This makes it difficult for the MoF to evaluate the requests prepared from budgetary institutions. Another problem for the MoF's review is to assess additional requests on the policies and objectives of the institutions that were presented as less important when ceilings were set.

In 2006, the MoF began to implement new procedures for preparing MTBP requests in terms of objectives, outputs, activities, and evaluation of public investments, which was an entirely new methodology for budgetary institutions. These new procedures were necessary to ensure the efficient use of public funds. However, this reform was not accompanied by training of all employees on their role in the process. Since the MoF has continued to help budgetary institutions in preparing the requests, it seems that trainings have been insufficient. On the other hand, LMs have turned this into a routine process, and their commitment to this process could be better.

Another serious problem for the Albanian administration is the frequent change of staff, especially after the change of political direction of the government, hampering effective administration for all budgetary institutions. This has demotivated staff to be committed to a particular duty and perform it with responsibility, because staying in the institution and developing their career are not necessarily related to merit. Another problem remains the recruitment process for public administration, which is mainly accompanied by formal procedures.

Another important issue is the process of preparing the structural reforms themselves. They are often formulated without detailed elements of their implementation and without determining the respective costs for each stage. Consequently, their integration with the budget becomes very difficult.

3.3. Assessment of the processes

Despite the budget drafting process being top-down, LMs have the opportunity—within the limit set by the MoF—to reflect the costs of their budgetary reforms in the distribution of budget funds. The MoF does not interfere in the way funds are allocated by LMs, as long as the set limit is applied for capital and recurrent expenditures. However, the MoF remains one of the key links for help throughout the budgeting process.

By determining the number of employees for each central government institution (which since 2011 is defined in the annual budget law) and the accurate assessment of funds for personnel expenditures, the MoF influences both directly and indirectly the implementation of reforms. Based on the legislation in force,¹⁵ it is the MoF and the Public Administration Department (part of the Ministry of Interior) which evaluate and approve requests on establishing new organizational structures, which in most cases coincide with implementation of the reforms to be undertaken.

Overall, Albania has had a persistent lack of coherence between reforms and their translation into budgetary costs, and often the MoF has been blamed for this; despite its role in the whole process of budgeting, the MoF remains an institution that implements laws drafted by legislative bodies. It is the task of each budget institution to analyze the reforms developed in their respective areas to achieve the desired outputs in a cost-effective and efficient way, and within the determined limits.

Another important part of the budget process is the proper definition of capital expenditures. Albania has established new procedures for such expenditures. However, the selection process for investment projects is still not very clear. Despite a clear determination of the priority sectors where the government intends to invest in the next few years, the selection of specific investments is not clearly defined yet. It reflects the political will rather than the result of analysis of the reforms undertaken. Concurrently, the implementation and the deduction in cost of cross-cutting reforms remains a problem, with a consistently low cooperation between responsible institutions. This brings even greater financial implications, because any cooperation that is wrongly timed contributes to funds not accomplishing the mission they were approved for.

To reflect the costs of structural reforms in their budget, all budgetary institutions should start with correct and accurate budgetary requirements. In a budget hearing session with the MoF, they explain the importance of additional requirements in terms of priorities for the future. The MoF considers the budget request of the institution and, along with all the other requirements, submits it to the Council of Ministers. The decisions on additional budget requests presented by budgetary institutions are taken based on macroeconomic forecasts for the following period. However, for the LMs and other independent budgetary institutions, trying to reflect their requests in the annual budgets

15 Law on 'Competencies of defining wages and bonuses' (No. 10405), enacted on March 24, 2011.

remains the option of parliamentary commissions. Being one of the links that the budget passes through to its final approval, these commissions ultimately decide whether or not to consider the requests.

As mentioned, an MTBP document completed according to all the requirements increases the probability that the budget will reflect the costs of structural reforms. The MoF has noticed a progressive growth in attention to the MTBP process, suggesting that the capacity for managing the process is improving over time.¹⁶

Another document which is important in summarizing and reflecting the cost of structural reforms is the Economic and Fiscal Programme, which reviews economic and fiscal policies and the main structural reforms to be implemented. More specifically the EFP (i) describes the policy framework for the medium term and spells out the main policy objectives imbedded in the program; (ii) describes the economic developments of the real and monetary sector during the past year as well as presents the medium-term perspective of the economy and articulates the project macroeconomic policy mix; (iii) describes in detail the framework of public finances, paying attention to the income and budget expenses for the medium-term period as well as a treatment of the public debt strategy; and (iv) presents the most important structural reforms which have been or will be undertaken in the fields of entrepreneurship, competition, climate for foreign investment, the labor market, the financial sector, and public administration. The EFP tries to link the budgeting process (starting from the macroeconomic framework) with the structural reforms to be implemented during the budgeting period. Generally, the document focuses on describing reforms without giving details on their implications in the budget. Starting with the EFP 2008–2010, the document has a sub-chapter called *Budgetary implication of the main structural reforms*, though this has very poor information about the reforms addressed (not more than 2–3 reforms) and their costs, whereas the whole document typically mentions only 30 structural reforms.

4. Conclusions and recommendations

4.1. Conclusions

Albania has significantly improved its budgeting process. It has strengthened budget procedures and the legal framework, setting out clearly the roles and responsibilities of all the stakeholders. Moving to three-year planning, through drafting of the Medium-Term Budget Programme (MTBP), has changed budgeting from an annual thinking process, as well as ensured the link between the budget process and policies set by the government. Achievements from medium-term planning were reinforced even more by the enactment of

¹⁶ Ministry of Finance, *Project document of MTBP 2012–2014, Phase II*, page 1.

the law on the 'Management of the Budgetary System in the Republic of Albania', which specifies in detail the budgetary system, its structure, principles, intergovernmental financial relations, and responsibilities for budget preparation and execution.

During the drafting of macroeconomic scenarios, one of the most important elements taken into consideration by the MoF is the reflection of government priorities and of ongoing or expected reforms. This is the first step that attempts to integrate the costs of structural reforms into the budget.

Several factors—the incorrect evaluation of drafted reforms' future financial effects, the failure in implementing the steps every institution has to take for their accomplishment, as well as the timing of their implementation—may lead to wrong calculations and, therefore, undermine the inefficiency of financial resources that are reflected in the respective budgets. The main problem is a lack of coordination between the LMs responsible for implementing reforms, particularly in the case of cross-cutting reforms that involve multiple sectors' priorities. The LM directly linked with the implementation of the reform includes it in the budget, whereas the other LMs may not necessarily set available funds for a reform that is not a priority for their sectors. This non-cooperation means that structural reforms may be initiated but may not be operative if all their components do not align.

The MoF is the main actor in coordinating the budget process, but the LMs themselves settle the objectives of their work within the limits the MoF sets. Regarding the allocations that the LMs make between programs or projects, the MoF may give its opinion or advice, but cannot make decisions. This means that the drafting of the budget is a very good tool in the hands of the LMs to ensure the funding of ongoing or planned reforms. An accurate assessment of costs and an appropriate distribution of available funds in many cases enable the LMs to meet their goals.

To facilitate the budget preparation process by the LMs and other state institutions' budget, the MoF has issued guidelines for the duration of the process. It specifies the rules to follow for budget preparation and execution, as well as for monitoring the process. Together with the guidelines of the Policy Priority—drafted by the Council of Ministers, the MoF, the Department for Strategy and Donor Coordination (DSDC), and the Ministry of Integration—budget institutions have a good basis to identify new priorities which were not previously included in the budget. All of these documents try to ensure that the LMs are distributing funds in accordance with governing policies and priority strategies for the country's development. The control of the MTBP carried out by DSDC, verifying if the planned budget reflects the development priorities and undertaken reforms, also supports this process. Meanwhile, the MoF verifies whether the costs submitted by the LMs are reasonable, justified, and within funding opportunities.

Based on macroeconomic forecasts for fiscal parameters performance and the MTBP, the MoF determines the limit for current and capital expenditure for each budget institution. This gives high importance to the accountability of

MTBP preparation. Being a medium-term plan, it should reflect the costs of all LMs' structural reforms, especially new reforms that will be undertaken within the period. Experience shows that the LMs devote more attention to the first year of the MTBP (as it is the next year's budget) but tend to neglect the next two years. As a result, the cost of ongoing reforms is included and forecasted. But there is no accurate estimate on reforms that will begin in the second or third year of the MTBP, making this one of the main problems in the inclusion and reflection of structural reforms in the budget. There may be several reasons: negligence by the LMs or their institutions, a lack of penalties when the MTBP is not a document completed with accountability and according to the parameters required by the MoF, a lack of vision and insufficient understanding by the LMs of the importance of an accurate medium-term prediction. However, there are also cases where the LMs are aware of the necessity for an accurate budgeting process, but fail in translating the reforms into monetary implications, due to the lack of a clear understanding of the reform or inadequate human resources capacity.

Despite the development of the MTBP as a process that should involve all levels and structures of an institution, requiring the establishment of management teams for every program, it often still ends up being a task for the economic departments of various institutions. Careful budgeting requires time and high commitment from many people, especially the program management team, who know better the reforms that need to be undertaken. The budgeting process requires work, time, good knowledge of program details, goals, objectives, and, as a result, delegating of some of its drafting to other chain actors, who are unable to fulfill budgetary requirements. The instability of the Albanian administration has not helped either, although the government has tried to take measures to improve the situation (especially through the drafting of the civil servants' law and the law drafted for the first time on the Organization and on the Functioning of the Public Administration, which does not yet have cost assessments). The frequent replacement of staff decreases motivation for a demanding set of tasks that may be perceived as "outside" the program's mission, which means that there is little consolidation of the experiences accumulated over the years. All of these factors lead, in most cases, not only to a document that does not meet the MoF requirements, but also to a budget that does not address the costs of structural reforms.

However, while identifying the problems encountered in the continuous inclusion of the structural reforms' costs in the annual budget or other fiscal documents, we should not overlook that the very process of drafting a detailed budget and drafting the MTBP is in its beginnings. Albania started the MTBP draft as a pilot project in 2001, but it became mandatory for all LMs only in 2006, and for the rest of the institutions in 2009. The lack of experience brings many problems, but at the same time, there has been some improvement of quality in budgetary requirements. Those recent efforts show that Albania is trying to improve coordination between structural reforms and the budgeting process.

4.2. Recommendations

A good budget starts with a good macroeconomic framework. In this regard the MoF takes into consideration the comments and suggestions that international institutions such as the IMF make, while preparing its macroeconomic framework. Better and more realistic assessments are very important in not distorting the whole process of planning and medium-term budgeting. It is also important that the budgetary institutions have a clear priority list of reforms and projects to be initiated, so that if there are changes in the budget allocated for undertaking them, any cuts in funding might be more easily determined. Otherwise reforms and projects may remain without proper budget funds for a long time. This entails invisible costs that turn into a drain on the budget for many years beyond the stipulated deadlines.

All budgetary institutions that are directly responsible for implementing structural reforms should determine efficient and concrete steps that need to be taken and identify the costs for each case. To achieve this, responsible persons, who have good knowledge of the plans and priorities, should conduct the process. It is also strongly recommended that, while preparing the structural reforms' cost, budgetary institutions analyze cost deviations at the beginning and at the end of the reform, identifying the actors responsible for exceeding the estimated cost and then applying sanctions set in the law. Certainly good estimates and assessment of costs and begin with a proper identification of whether the project itself is a structural reform, and with measuring the opportunity cost of the structural reform that is going to be materialized.

There must be better coordination among the LMs that participate in the implementation of a given reform, despite the fact that the priority level may differ for them. In this case, it is important to ensure that the funds allocated for the fulfillment of a ministry's obligation are associated with the respective estimate in the budget of other institutions, in order to obtain full efficiency on reforms.

LMs' senior officials should increase their attention to the budgeting process and the fulfillment of MTBP according to the MoF requirements. They should ensure that their staff and, above all, the programs' supervisors understand the importance of medium-term programming, give the right timing to budgeting, and do not overlooking any procedures.

LM staff should improve their knowledge of MTBP drafting, as well as how to include the structural costs of reforms in the annual budget. Even though templates have been prepared for each ministry, with concrete cases regarding respective areas that they cover, the submission of budget requests has not been at the appropriate level; on the contrary, it has aimed to be, from year to year, identical with the given instructions. Also, training, in particular for each ministry with a dedicated data set, should be more efficient and training sessions that instruct at the same time specialists or experts of different fields (e.g., transport and health care) should be preferred. This would make clear all the specific elements that an institution should keep in mind. A special training session may be prepared for programs that are considered of key

importance to the mission of the LM or that plan to implement important reforms in the future.

Despite the MoF's key role in this process, it is not involved directly in decision-making. It is mainly the coordinator in the budget organic law, unless the institutions do not submit the budget requirements within the deadline and are subject to administrative fines. Thus, we recommend the attribution of more decision-making competences to the MoF, so that the budgetary requests can be fulfilled at the desired level. At the same time, the ministries themselves should take penalizing measures by identifying the responsible people, but without turning these measures into a punishment system for budgetary institutions or its employees.

Albania needs to increase the sustainability of its public administration, to allow the consolidation of new procedures that it has begun to implement. It needs to invest in training and increasing the knowledge quality of key persons involved in the budgeting process. Exchange of experiences with other governments that have been successful in including the cost of structural reforms in the budget would be very valuable.

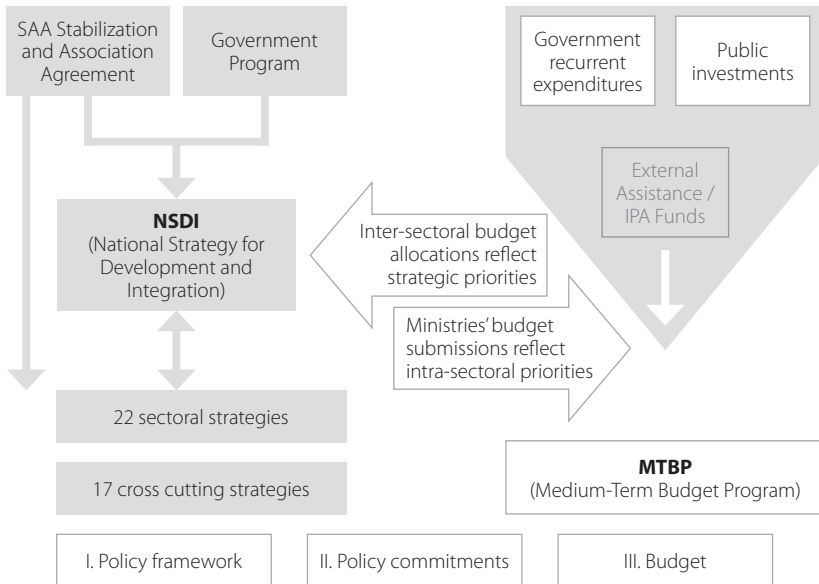
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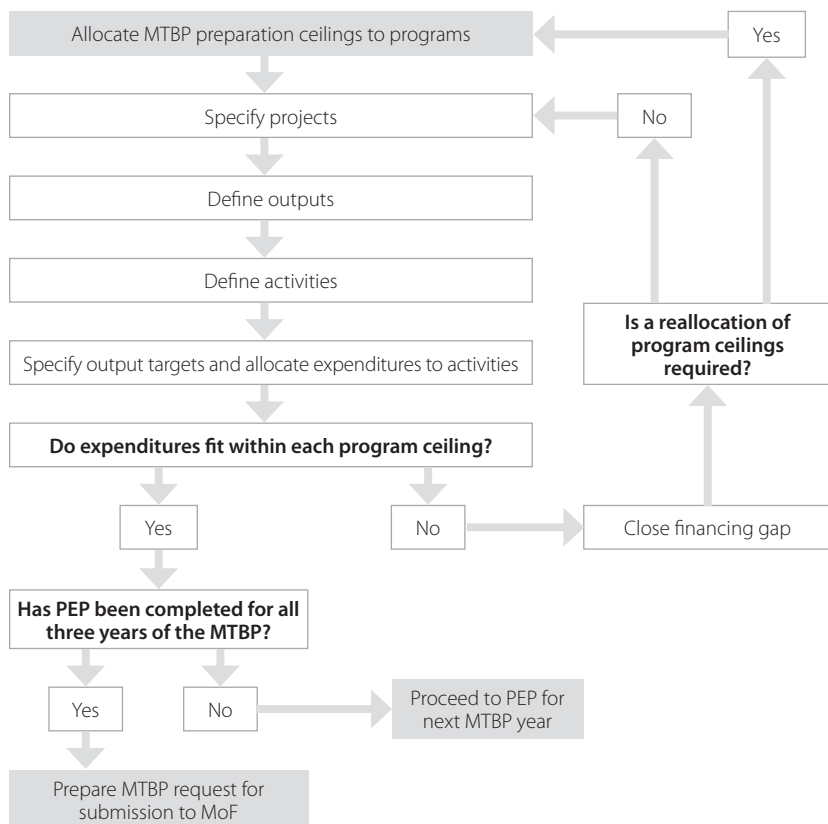
6. Appendix

Figure I-1: The linkage between the NSDI and the MTBP cycle



Source: DSDC presentation on the implementation of the Integrated Planning System (IPS) and the National Strategy for Development and Integration (NSDI), and the Regional Development Funds' (RDF) Evaluation & Aid Effectiveness, 2012.

Figure I-2: The programme expenditure process within a year in a budget institution



Source: Instruction No. 8, March 29, 2012, *Standard Procedures of the Preparation of the Medium-Term Budget Programming*, Annex 5, page 3.

Chapter 2

Case Study on BOSNIA & HERZEGOVINA

prepared by

Naida Čaršimamović Vukotić & Ognjen Đukić

Naida Čaršimamović Vukotić is a consultant with extensive experience in research, empirical analyses, capacity building, and providing policy advice in the fiscal and macroeconomic spheres. In her work on a number of BiH and regional projects financed by the European Commission, the World Bank and bilateral donors, she has gained comprehensive understanding of BiH and South East Europe's fiscal and economic systems. Since 2004, she has worked both directly with government officials and on independent analytical work for a number of reports and studies. She has five years of experience working with the State Ministry of Finance in BiH on DFID's Strengthening Public Expenditure Management Project, to address budgeting reforms.

She is currently a macroeconomic and fiscal expert on Horizontal Support to Coordination with International Financial Institutions in the Western Balkans and Turkey, a regional EC-funded project that operates within the Western Balkans Investment Framework (a joint initiative of the EU, IFIs, bilateral donors, and Western Balkans governments to support socio-economic development through financing and technical assistance for strategic investments). She is also working on the World Bank Institute's South East Europe Municipal Finance Review Project, and a resource expert for the Budget Community of Practice of PEMPAL (a multi-donor network of public finance officials from 21 countries of Europe and Central Asia).