

Final Consultancy Report

Functional Review and Organizational Analysis

Serbian Ministry of Education and Sports Management of School Finances

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(Funded by the United Nations Development Program)

October 31, 2003

Introduction:

This document is the final report of a 17 day consultancy contract between Bannock Consulting and the United Nations Development program conducted on behalf of the Serbian Ministry of Education and Sports (MoES). The consultant, Anthony Levitas of Development Alternatives Inc. carried out the work in parallel to a related (15 day) assignment for MoES funded by monies from a World Bank loan. This latter assignment is still ongoing.

The general purpose of both consultancies is to assess and improve the way primary and secondary school finances are managed by MoES, and to do so within the context of continuing efforts to decentralize the education system and to introduce a formula-based method of financing primary and secondary education.

The work conducted under this contract included extensive discussions with key actors at virtually all levels of the education system; review of the data collection instruments and available statistics on school finances, enrollment and employment; and the review of select consultant reports.

The work produced the following deliverables:

1. Initial Report on Serbian School Finances and Management (Appendix I)
2. Hands on Training Session for the Statistical Unit on checking the internal reliability and consistency of education data. (October 2 & 3, Appendix II)
3. Two day Policy Seminar on Select Issues on Education Finance for the Statistical Unit, Policy Unit, Financial Sectors, and Regional Officers of MOES as well as representatives of the Ministry of Finance (October 23 & 24, Appendix III)
4. One day Policy Seminar on School Accounting and Asset Management for the Statistical Unit, Policy Unit, Financial Sectors, and Regional Officers of MOES as well as representatives of the Ministry of Finance, school accountants and city education officers. (October 30, Appendix IV)
5. This report.

The report is structured in three parts. In the first, I address some of the more immediate issues related to improving MoES capacity to manage and analyze data on school finances. In the second part, I address what seem to me to be the most pressing current issues related to the role of local governments in Serbia's education system. In these sections I proceed by identifying relatively discreet questions and making – hopefully—concrete recommendations.

Finally, in the third section I highlight the interrelationship between three major dilemmas facing the Ministry: Who should determine, monitor and amend school budgets? How should formula financing work? And how should the Ministry think about the rationalization of school networks. In this session the discussion is more wide ranging, and the recommendations are of more general, strategic nature.

I. Education Finance Data

As stressed in the first report, the Republic of Serbia does not possess a reliable data base on school revenues and expenditures. This makes it impossible to analyze the allocation of resources to schools by different levels of government, or how much schools earn from the use of their own assets, and from charitable and parental contributions. By the same token, it is impossible to understand what schools are buying with these revenues, and hence to analyze variability across the system in terms of both educational and non-educational inputs (e.g. teaching time, other labor costs, materials of various sorts, utilities, repairs, investments). Most importantly, without such a data base it is impossible to simulate the consequences of any significant changes in the way resources are allocated in the system (by for instance, the introduction of formula funding), or indeed to assess how new programmatic requirements will effect the costs of schooling nationwide. **It is thus of critical importance that MOES take immediate steps to create such a data base.**

During the course of the consultancy substantial, if still initial progress was made in the construction of such a data base. The Statistics Unit succeeded in getting from the Ministry of Finance in electronic form the year-end revenue and expenditure reports of all schools for 2002. Some initial tests have been conducted on the reliability and internal consistency of the data and while there are undoubtedly problems, it is clear that this data should provide MoES with its first more or less comprehensive picture how education monies flow to, and are spent by schools. The Statistical Unit has also introduced the identifying numbers (*majchen broj*) of all schools into the data. This will allow the Unit to link the school finance data with employment and enrollment data for every school.

The Statistical Unit is currently waiting for the Financial Sectors to provide it with the enrollment and employment data collected through this year CENUS in *electronic form*. By linking (2002) data on school finances with (2003) data on enrollment and employment the Statistical Unit will be able to construct a reasonably comprehensive data base on the allocation and use of resources in primary and secondary

schools. And it is this data base which, among other things, will serve as the foundation for all future efforts to move towards formula financing.

Issue IA: Improving School Revenue and Expenditure Data

The primary source of data on school revenues and expenditures are the year end financial reports that schools submit to the MoF as indirect budget users of the national government. The form used by the MoF is new, and is based on the new chart of accounts. It is the same form used by all budgetary users and many of the line items it includes are not relevant for schools (e.g. net profits). At the same time it does not include important line items for education that are in the chart of accounts (e.g. it does not distinguish between expenditures on heat and on electricity).

Most importantly, the form is not accompanied by instructions to school accountants about how it should be filled in. As a result, the data it yields is less reliable than it should be (e.g. there are a number of different lines for transfers from other levels of government but it is not clear which lines should be used to describe which sorts of transfers).

The importance of these issues is now recognized by the Statistical Unit and the MoES representatives who took part the policy seminars conduct under this consultancy. There was wide consensus on the following recommendations.

Recommendations for Improving School Revenue and Expenditure Data

1. The MoES and MoF should create a small Task Force to improve the school financial reporting form required by Republic Government. The Task Force should redesign the financial reporting form and for write *instructions for its completion for school accountants*. The new form must be based on the chart of accounts and in line with budgetary law. But it should be focused on schools as particular types of budgetary users whose oversight requires particular types of information.

The new form and instructions should be prepared in the next two months so as to be used for the collection of 2003 year-end data. The Task Force should include school accountants. A competent Task Force could easily be assembled from the participants in the policy seminars. Line responsibility for the Task Force should be shared by MoF and MoES (probably, former ZoP and the Statistical Unit with clear support from higher up in both Ministries).

2. The redone form should be the primary source of raw data on school finances under the emerging Education Management Information System. No other data collection instrument is necessary under this system. Instead, this form should be made electronic and filled in by schools and integrated into the EMIS.

3. Schools should be legally required to submit the form to their local governments as well as to MoF so that local governments have the same information on school budgets as the national government.

4. MoES and the Republic Statistic office should compare the data on enrollment and employment collected by the Statistical Office and that collected by through the CENUS system. Overtime a single, improved reporting form should be developed to reduce the workload on schools and improve the quality of data. This form should make it possible to calculate the number of full-time teaching equivalents in the system. (Efforts in this direction are apparently being pushed forward under the EMIS Project.

Issue IB: Improving Data on Local Government Education Expenditures

Like schools, local governments are now being required to record their revenues and expenditures in accordance with the new chart of accounts. **Unlike for schools, however, MoF has yet to define a minimum set of line-item reporting categories for the presentation of local government budgets and the submission of their year-end financial reports.** As a result, local governments have been presenting their expenditures in both their budgets and year-end financial reports in different ways.

This makes it impossible to analyze the level or composition of local government expenditures on particular types of activities, including education. In fact, in education the problem is further compounded by the fact that many local governments are directly purchasing inputs for schools (e.g. heating fuel) As a result, these expenditures do not appear in the financial accounts of schools and may not even be listed as education expenditures in the budgets and financial reports of local governments¹.

MoF is currently developing a set of minimum budget presentation and financial reporting standards for local governments. The nature of these standards for education was discussed in the Policy Seminars and a consensus on the following recommendations was reached.

Recommendations for improving Data on Local Government Education Expenditures

1. **MoES should determine which local government education expenditures should be considered school and non-school expenditures.** In line with the practices of other countries, expenditures on investments, school transport and teacher training should probably be considered non-school expenditures, while financial support to schools for utilities, pedagogical and non-pedagogical materials and other operating costs should appear as (different sorts of) transfers to schools for school expenditures.

2. Once the basic conceptual categories have been decided upon, accounting rules that ensure that exceptions to the norm do not result in either expenditures being “lost” or recorded twice should be developed. (Exceptions include such practices as the central purchase of heating fuel and other inputs, or school payments for teacher training.)

¹ Because heating fuel is the single most costly operating cost that local governments are responsible for, this has led to a significant under-reporting and under accounting of municipal expenditures on schools.

3. MoES should send a small research team out to select local governments to examine how they are recording their education expenditures. This is because some local governments seem to be taking their education budgets very seriously and may have developed practices worth making mandatory (e.g. Nis, Zrenjanin)

4. Based on the examples of best practice (both at home and abroad) MoEs should recommend a standard set of education reporting categories to MoF for local government budgets and financial reports, as well as for accounting rules to deal with desirable exceptions. This should be done now because MoF is currently designing more general standards for local government budgets and financial reports and MoES should make sure that the categories for education are clear and transparent.

II. Clarifying Local Government Current Education Responsibilities

At the moment, the Laws on Primary and Secondary Education assign a number of very important responsibilities to local governments in the education sector. These include responsibility for:

- a. Payment for the maintenance and operation of school facilities
- b. Payment for pedagogical and non-pedagogical materials
- c. Payment for teacher training
- d. Investment in school facilities
- e. Some types of school inspection
- f. The improvement of school networks

Some of these responsibilities are governed by specific input norms defined in the Rulebooks on the Costs of Educational services, such as heating fuel by type of heating system and square meter of facility. Other responsibilities are more open ended, such as the provision of support for teacher training and investment in school facilities. Finally, certain responsibilities, such as the responsibility for improving school networks and for school inspections are new to local governments and exceedingly complex.

In this section we deal with uncertainties surrounding local governments responsibilities for the operating, investment and teacher training costs associated with primary and secondary education. In the next we address the more complex issues related to the improvement of school networks, school budgeting and formula finance.

All of these responsibilities were discussed in a fair amount of detail during the Policy Seminars as well as during interviews with educators and education officials at all levels of the system. In the following, I indicate where there was consensus, discord, and uncertainty about the nature of the particular problems associated with each issue.

Issue IIA Rulebook Norms on Local Government Education Expenditures

There is a general consensus that local governments do not following the Rulebook norms for providing schools with their basic non-wage operating costs. There is also uniform agreement that the practices of local governments differ both with respect to level of funding they provide to schools, and how they determine this level of funding.

But there is less agreement on whether it is a good or bad thing that local governments do not follow the rulebook norms, and what this lack of compliance implies for the system as whole. Some MoES officials seem to believe that local governments are spending significantly less (the figure 30% was mentioned) than the rulebook norms require. Most however felt that this is an unfair characterization for a number of reasons:

- First, as we have indicated data on local government education expenditures is very poor. As a result, it is extremely unclear how such an estimate could be arrived at².
- Second, adherence to the rule book norms would leave some schools under funded while providing “excessive funds” to others. For example, providing the rule book norm for heating fuel to an old village school with a run down boiler and no thermal insulation, might leave pupils very cold, while providing a more modern urban facility with the norm, might be unnecessary.
- Third, the norms themselves may simply be unaffordable for certain local governments given the overall state of their budgets.

Equally importantly, the norms themselves in some fairly profound way weaken or at least confuse the nature of local governments’ responsibilities in the sector by making it unclear whether local governments are primarily responsible for fulfilling the rulebook norms, or for ensuring that all schools operate under certain minimally acceptable conditions. In fact, the existence of the

Hypothetical Example of Rulebook Norm Problems

A number of local governments are providing all their schools with the rulebook norm for heating fuel. In some schools this is enough to reasonably heat the school and in other it is not. Then there is vicious cold spell and these local governments don’t provide additional monies for heating fuel. In many schools, not only are the children too cold to learn, but the pipes burst. Parents in these areas take their local governments to court for failing to reasonably heat the schools while the national government tells the local governments that they must fix the pipes. In the courts, the local governments maintain they are not legally responsible for either the children’s discomfort or the busted pipes because they have fulfilled their rule book obligations. Some courts rule in favor of local governments, some in favor of parents and the national government.

² On this score, it is worth noting that preliminary analysis of the data on school revenues shows that close to 9 percent of ALL school revenues –including earned incomes-- comes from local governments. This figure substantially exceeds what most MoES officials seem to think local governments contribute to the education system. Moreover, it does not included local government expenditures on centrally purchased inputs. This is very significant in some cities (e.g. Belgrade) which pay the heating bills of their schools directly.

norms themselves permits and indeed may encourage local government official to argue that education funding levels should not be based on what people think schools need to function reasonably, but on the normative prescriptions contained in the rulebooks. This can both depress local government spending on education, and create conflicts over who is really responsible for certain tasks when the rulebook norms can not be reasonably applied (see box).

Recommendations Concerning Rulebook Norms for Local Governments

1. It is clear that the Rulebook norms for local government support of schools do not have their desired effect in practice. They also weaken the nature of local governments' obligations in the sector and thus should be eliminated. This could be done simply by eliminating the relevant provisions in the Rulebooks. Ideally, however, this redrafting of the Rulebooks would be accompanied by amendments to both the Law on Local Government and the Laws on Primary and Secondary education that clearly identify local governments as being solely responsible for ensuring that the education process is carried out under reasonable physical conditions and that this is one of their most important “own” functions.

2. MoES should involve itself in the current debate over the reform of the intergovernmental finance system, and more particularly over how equalization funds are calculated for and allocated to local governments. Currently, all local governments receive some additional funds for education through the instrument of additional increments of shared sales tax. This system will change in the near future when the sales tax is replaced by a national value added tax³. From MoES point of view it is desirable that the way equalization funds are calculated be changed. Currently, the education component of this entitlement is calculated on the basis of the number of school buildings and classrooms located in each jurisdiction. This provides some additional funds to rural jurisdictions because they have more classrooms and building per pupil than more urban jurisdictions. But the system would be fairer, if all monies were allocated simply on the basis of the relative wealth of jurisdictions and without reference to educational infrastructure. In other words, MoES has a strong interest in seeing that additional revenues provided to local governments for their own functions be directed primarily to poorer jurisdictions, while richer ones pay for these functions –including school maintenance-- without additional support.

3. Overtime, the Republic Government in general, and MoES in particular needs to define which agencies of the national government are responsible for monitoring whether local governments are in fact fulfilling their obligation to provide minimally acceptable operating conditions in their schools. Some of these responsibilities might be assigned to health, sanitation, and building inspectorates. Some of them might be assigned to the Regional Offices of the Ministry.

³ For more on this see, Tony Levitas “Towards the Reform of Serbia’s Intergovernmental Finance System” SLGRP/USAID, May 2003 p 1-45)

Issue IIB Clarifying the Investment Responsibilities of Local Governments

At the moment, both the national government and local governments are expected to contribute investment monies to primary and secondary education. This is not unusual and in most countries both levels of government are involved in funding educational infrastructure. What is unusual however is that in Serbia, the Republic government expects local governments to shoulder the main burden of educational investments while it retains ownership of school facilities.

This policy weakens the link between local government officials, their electorates, and local schools and undoubtedly depresses local government investment spending on schools. Similarly, the MoES practice of providing individual schools with additional investment support, as opposed to providing this support through local governments, confuses the issue of who is really responsible for school infrastructure.

Among the participants in both policy seminars there was unanimous agreement that local governments should be made the legal owners of school facilities. Indeed, virtually all participants felt that if local government were made the owners of school facilities they would not only increase investment spending but would take more seriously their operating and maintenance (repair) obligations.

Recommendations for Clarifying Local Governments' Investment Responsibilities

- 1. In the current constitutional debate over property devolution, MoES should strongly support giving local governments ownership of the public property they manage.**
- 2. MoES should engage itself in the debate over the reform of the local government finance system so that in the future there is a legal category for earmarked grants to local governments.** This is important because currently the national government has no legal way to give local governments additional funds for particular projects or programs and be sure that these monies are spent on the purposes they are designed for. In fact, the intergovernmental finance system's lack of a category of earmarked grants will not only compromise the ability of the national government to help (poorer) local governments' improve their educational infrastructure, but will also make it difficult for MoES to direct resources to all or some local governments for special training or teaching programs.
- 3. Investment monies provided to schools by the national government should flow through local governments as earmarked (matching) grants and be designed to ensure significant local co-financing.** Such procedures will both reinforce the fact that local governments are primarily responsible for planning, executing and paying for investments in the sector, as well as help ensure that national monies for education investments are effectively used and spent in line with local needs and preferences.

Issue IIC Clarifying Local Governments' Responsibility for Teacher Training

Like investment in school facilities, investment in teacher training is an open ended commitment whose funding levels are ultimately dependent on how important local officials (and their electorates) consider the issue to be. In general, however, it is much more difficult to impress on local governments the importance of teacher training, than it is the importance of investment in school facilities⁴.

In part this is because investments in human capital are much less tangible to (public) investors and thus harder to win political support for. And in part, it is because there is no simple legal measure –such as making local governments the owners of school facilities—that signals to local officials and parents the seriousness of their responsibilities in this area.

In the last two years, MoES has taken important steps towards encouraging local governments and their citizens to feel responsible for what goes on inside of schools. Most notably, school boards have been strengthened and local government representation on them has been increased. Nonetheless, it often takes many years for new and hard pressed local governments to devote significant resources to intangible investments like training.

MoES has also sent somewhat ambiguous signals to local governments about just how involved they are supposed to be in the internal operations of schools. For example, they have been given no clear role in determining the types of optional program hours that schools will now be allowed to offer, nor do they have a clear role in determining the profiles of secondary schools.

Most importantly, and most immediately, MoES seems to be expecting that local governments simply pay the bill for whatever teacher training it decides is necessary and which it cannot fund on its own. Indeed, according to at least some local government officials, the MoES is mandating teacher training programs in the middle of the year and simple expecting local governments to find the cash to support them.

What this has meant in practice for the funding of teacher training is unclear. Some local governments seem to be contributing the expected support, while others are –understandably-- dragging their feet. Either way, the current rules of the game are too open ended and it is likely that many local governments will ultimately fail to support teacher training in line with MoES's ambitious expectations.

⁴ In other transitional societies the clear devolution of education responsibilities to local governments has generally been accompanied by a rapid increase in local government spending on educational infrastructure. For a variety of reasons, local governments have been slower to get involved in investing in the internal operations of their schools. See, Ken Davey, "School Management and Finance: an Overview" in, K. Davey, ed. Balancing National and Local Responsibilities: Education Management and Finance in Four Central European Countries (OSI/LGI: Budapest 2002)

Recommendations for Clarifying Local Governments' Responsibility for Teacher Training

1. It is unclear how teacher training is currently being funded and what exactly the national government expects local governments to fund in the future. **As a result, MoES should commission a study of present practice in light of the teacher training obligations it expects to impose on local governments in the immediate future.**
2. If MoES wants local governments to send specific numbers of teachers to specific types of nationally mandated training programs than at a minimum the costs of these programs should be presented to local governments before they finalize their budgets.
3. While most local governments will be able to support at least some teacher training programs, there will be others whose financial situation is so weak that even minimal contributions will be difficult or impossible. Thus MoES should figure out a way to provide them with additional targeted funds for teacher training. This however (and again) will require making it legal possible for the national government to give local governments earmarked grants.
4. If over the longer term MoES expects that most spending on teacher training will be the result of independent, local government decisions to “buy” as much training as they deem desirable, then the role of local governments role in pedagogical issues must be strengthened: Unless, local governments and their electorates feel truly responsible for the quality of their schools, they will typically “under-invest” in teacher training.

III Key Strategic Issues: Control Over School Budgets, School Rationalization and Formula Funding

As indicated in the first report prepared under this consultancy, there are currently two competing discourses in Serbia about education decentralization, a dominant one which focuses on increasing the autonomous decision making powers of schools, and a less prominent discourse about increasing the role of local governments in the sector.

These two discourses are not mutually exclusive. Nonetheless, it is important that MoES address the relationship between them in a more concrete way, and in direct reference to three absolutely central strategic issues:

- How do school budgets get determined and who monitors their execution?
- Who is responsible for the rationalization of school networks?
- And how should national government financial support for primary and secondary education flow to schools?

In the following we try to address each of these issues in a way that highlights their interrelationship and interdependency which will hopefully make some of the key issues facing the MoES clearer.

Currently schools receive financing from four distinct sources; the national government, local governments, earned income, and donations. The most important income comes from the national government for teachers' wages. Every fall, schools submit to the Regional Offices of MoES CENUS data on the number of classes they expect to teach and the teachers and pay grades of those who will teach them.

The Regional Offices verify the data on the number of classes and teachers and send this information to the Financial Sector of the Ministry in Belgrade⁵. The Financial Sector then uses this data to compute a wage budget for every school in the country. The final dimension of these wage budgets however, can only be determined after negotiations with the Teachers' Union and the passage of the national budget

At the same time that schools prepare the CENUS data --which in effect amounts to a budget request to the national government for their wage bills—most of them are also bargaining with their local governments about how much support they will receive for their other operating costs and investment needs. This bargaining usually results in schools being promised some combination (of often partial) rulebook norms and additional monies for repairs or investments.

As a result, it is fair to say that the transfers to schools from local governments is it is rarely governed by a formal procedure of budget requests, though certain cities seem to be trying to introduce such procedures(e.g. Nis, Zrenjanin)⁶. And because there is no formal system of budget requests, it is extremely unclear how most cities determine the level of funding they will provide to each school. What is clear, however, is that in many cases schools are simply informed of their transfers once the city passes its budget and then are expected to make up any shortfall in revenue from their own income.

Finally, and in parallel to all of this, schools are trying to create their own financial plans by estimating all of their anticipated income and balancing them against their anticipated expenditures. Obviously this is exceedingly difficult when the two most important sources of their revenue are uncertain or unknown until extremely late in the game.

Equally importantly, even after they are known, schools do not seem to submit a "final", legally binding financial plan or budget to either the national government or their local government for approval. And because there is no legally binding school budget, there is no way to monitor how schools actually execute their financial plans. Indeed, it is not clear who should be monitoring the execution of school financial plans, or what

⁵ There are 12 Regional officials responsible for vetting the CENUS data for all schools in the country. The process is done manually in about two weeks. Given the time frame and the workload it would not be surprising if many mistakes are made. Indeed, it is reasonable to suppose that in most cases Regional Officials approve this year's CENUS data if it does not differ significantly from last years. In other words, schools wage budgets are probably determined above all by last years budget.

⁶ The very existence of the Rulebook norms discourage the development of formalized budget requests by allowing all actors to pretend that the determination of local government transfers to schools should be automatic.

should happen if schools wish to shift money from one designated purpose to another during the course of the year.

In the immediate future all this should change as the new budget and treasury systems of the Republic (as mandated by the Law on the Budget System) are put into place. In short, as *indirect budget beneficiaries of the national government* schools will be expected to follow budget procedures like all other budget users. This means that:

- Schools should develop financial plans that specify their anticipated incomes and expenditures in accordance with the chart of accounts.
- That these financial plans should be approved by an agency of the national government and contained in the budget of that agency as well as in the Republic Budget as a whole.
- That this agent of the national government monitors the execution of these financial plans during the budget year, and accepts or rejects the school's year end financial reports.
- That this agent of the national government approve requests to shift money from one anticipated purpose (line item) to another during the course of the budget year.
- That all unspent funds return to the general budget of the national government at the end of the budget year.
- And that income earned from the use of assets owned by the national government are legally revenues of the national budget that can only be spent by schools in accordance to their approved financial plans.

Despite the relatively clear (and necessary) direction of change with respect to regularizing school budgeting procedures, certain aspects the future system remain extremely problematic.

First, and perhaps most importantly, it is unclear which agency of the national government should be responsible for approving school budgets, monitoring their execution, and accepting or rejecting proposals to spend money in ways different than those initially described in the school's budget or financial plan. One thing should be clear: Because approving and amending school budgets inevitably involves making policy decisions about how schools should be spending public money, and equally importantly, about what they should and should not be doing to raise more of it, the agent responsible for setting, monitoring and amending school budgets must be reasonably close to schools.

Second, if school budgets remain dependent on transfers from both the national government and local governments then it is unclear how the national government can approve school financial plans as legally binding budgets before local governments commit to specific levels of funding for individual schools. This, in turn, is difficult -- though not impossible-- because local government budgets are themselves dependent on the national budget.

And third, it is unclear whether schools should be included in the Treasury System of the national government or the local treasuries that the national government is currently in the process of requiring local governments to create. If schools, as indirect budget beneficiaries of the national government are included in the national treasury system, then not only will the national government be responsible for approving and processing all their transactions –a formidable task for 2000 odd schools—but local governments will have to transfer to the national government their contributions to schools.

Indeed, all of these issues seem to have produced some uncertainty within the Ministry of Finance about whether schools should continue to be budget beneficiaries of the national government, or whether they should be made budget beneficiaries of local governments⁷. Obviously, this is also a fundamental issue for MoES because **if schools are not made budget beneficiaries of local governments then it will probably fall to the Regional Offices of the MoES to approve, monitor, and amend school budgets. And this in turn will require a massive strengthening of their financial and analytical capacities⁸. In short, MoES must consider whether tasking the Regional Office with this responsibility is a good idea.**

With this question in mind, at how the question of budgetary responsibility for schools is related to both formula funding, and the question of the rationalization of school networks. As we have discussed earlier, national government money for education is currently allocated to schools on the basis of the number of classes they teach. As a result, the main determinant of how much money the national government gives to each school is the number of teachers they employ, and not the number of pupils attending them.

In general, this is not considered a good method of school finance since the most fundamental measure of the need for funds in education should be the receivers of the service –pupils- and not its providers –teachers. Indeed, per pupil financing of one sort or another is now the norm in most OECD countries. Moreover, allocating money on the basis of teachers and classes has become increasingly inefficient and problematic in Serbia over the last ten years for two reasons:

⁷ Deputy Ministers Bisic and Pavlovic mentioned this at a conference with local governments on October 15th, and the ZoP officials at the Policy Seminars repeated it.

⁸ On this note, it is worth mentioning another consultant engaged by MoES does not think that the Regional Offices of the Ministry are either equipped to perform this function now, or should perform this function in the future. Instead, he believes that the regional offices of the Ministry should be involved primarily in regional strategic planning for secondary education, with most of the day to day oversight of schools exercised by local governments. See Gábor Halász, “The reform of regional level educational administration in Serbia” February 2003.

- First, demographic decline has radically reduced enrollment levels, particularly in primary schools. This has left the national government financing ever greater numbers of ever smaller classes.
- Second, structural shifts in the economy have left the national government financing teachers and classes in many vocational schools whose programmatic structure was designed to serve the former economy and which are increasingly, inefficient, ineffective and unattractive to students

Thus MoES has correctly committed itself to moving towards some form of per pupil financing in the near future because per pupil financing will help direct resources in the system towards where there is greatest demand for them. **To date however, MoES has been thinking primarily in terms of developing a per pupil formula that will send money directly from the national government to schools.**

Such an idea, while sounding simple and attractive is almost impossible to realize practice. Indeed, no country that I know of has succeeded in really doing this. The reasons for this is that the existing disparities in the unit costs of schools tends to be so wide that any per pupil formula that sends money directly to schools either has to mimic these disparities –defeating the entire purpose of the exercise— or force those schools with higher than average per pupil costs into bankruptcy overnight⁹.

This is true even if the formula contains –as it should—weights that reflect the *average costs of educating different types of pupils in different types of schools* (e.g. normal pupils in primary schools in sparsely populated areas, handicapped pupils in urban primary schools, normal pupils in gymnasiums, normal pupils in vocational schools etc.) This is because the weights represent an *average* per pupil cost for different types of pupils in different types of schools, meaning that many schools –by definition-- will have per pupil costs significantly above the average. As a result, even a weighted formula per pupil formula that sends funding directly from the national government to schools will force the closure of many facilities.

Indeed, one does not need to go to school level per pupil financing to produce the same result: If MoES first defined and then enforced minimum class sizes exactly the same thing would happen. In short, both rigorously enforced minimum class sizes and school level per pupil financing will immediately draw MoES into the ugly politics of reducing teacher employment and restructuring school networks. Moreover, it is precisely

⁹ Until MOES can analyze the per pupil costs of all schools in the country, it is difficult to say how wide these disparities are, and where they are most problematic. But if Serbia is like other post communist countries –and there is little reason to suppose that it is not—these disparities are likely to be quite large. At the primary school level, these differences are being driven by the extremely small classes of many rural schools and their satellites. At the secondary school level, these differences are being driven by a combination of the programmatic norms for different types of vocational schools, and by the shift in enrollment that is probably taking place as students vote with their feet by abandoning vocational schools that seem to lead nowhere.

the fear of these ugly politics that is making it so hard for MoES to articulate either a clear strategy for school finance reform or a clear strategy for network rationalization¹⁰.

This can be seen both from the Laws on Primary and Secondary Education and the variety of opinions within MoES about how school rationalization should be carried out. On the one hand, many in the Ministry seem to believe that only the national government can be responsible for closing schools. Here some officials are expecting that the Ministry will define new minimum class standards, and that then the Regional Offices will then have clear and unambiguous reasons for closing schools. Meanwhile, others seem to be hoping that a per pupil formula will make school closures “automatic” thus taking the Ministry out of the direct decision making process.

On the other hand, the fact that the Laws on Primary and Secondary Education give local governments responsibility for network rationalization seem to suggest that at least some officials within the Ministry are hoping that local governments will take the lead in this painful process. Indeed, many participants at the policy seminar argue that local government will do this either because they will realize that tiny rural schools and/or archaic vocational school damage the life chances of their children or because they want to save money on the operating costs of inefficient or ineffective facilities.

Unfortunately, this is unlikely to be the case for at least two reasons. The first reason is that the political price local governments will have to pay for initiating and approving school closures is much higher than the meager financial gains that will come from closing small facilities: After all they are now responsible for only a small fraction of the operating costs of schools.

The second reason is that local governments will understand that while they will pay the political price of school consolidation the real savings (in teacher wages) will not only accrue to the national government, but will probably be spent elsewhere in the system. Indeed, experience in other countries suggests that parents accept school closures—and then only reluctantly—when the money saved by closures is clearly dedicated to improving the quality of the schools their children will now attend. In short, so long as local governments do not control the bulk of monies for school finance they cannot make this promise and thus are unlikely to pursue network rationalization.

Thus MoES is between a rock and a hard spot. On the one hand, the inefficiencies of the current system are driving it towards school rationalization, either through formula funding or the imposition new minimum class size rules. On the other hand, the political costs of reducing these inefficiencies are so terrifying—school closures, the firing of teachers, mass protests—that MoES is shying away pursuing finance reform while hoping that local governments will do most of the dirty for it.

¹⁰ This is also true outside of MoES. The Educational Forum’s UNICEF-funded study on the “Optimization of School Networks” clearly discusses the nature and severity of the problem facing Serbia today. It also contains a lot of interesting ideas about how optimization might be carried out at the local level. It says very little however, about who should be responsible for implementing these ideas.

Given these dilemmas is there any thing that can be done both to move towards formula funding and encourage school rationalization? And if so, what should local government's role in the process be. Here there are no easy answers. But an outline of one is perhaps best drawn from the experience of Poland during the 1990s. In short, and at least partially lieu of a formal set of specific recommendations I present a very brief (and oversimplified) version of the Polish story because I believe that the Polish case presents the clearest possible model of how Serbia might deal with the structural difficulties it is facing¹¹.

First, Polish reformers immediately transferred ownership of primary school facilities to local governments in 1990. Moreover, they made local governments responsible for paying all the non-wage operating costs out of their general revenues. At the same time however, they created an equalization system that gave poorer local governments more general revenues through an equalization grant. Almost immediately, local governments begin to make significant investments in the sorely neglected infrastructure they were given.

Shortly thereafter, reformers declared that all local governments would have to assume full control over their schools –including responsibility for teachers' wages-- by 1993. Local governments that wanted to take on these responsibilities earlier however were free to do so. In practice, all of Poland's larger cities made this decision almost immediately while the picture was mixed for smaller jurisdictions. Indeed, resistance from the teachers union and the Peasant Party forced the government to extend the mandatory deadline until 1996. Nonetheless by 1993 more than 65 percent of all primary school pupils attended local government run schools.

To make possible the local government assumption of the wage bills of school, the national government provided them with the money for teachers' wages through an education subsidy. Initially, local governments were simply given the amount of money the national spent on the schools in their jurisdictions prior to the transfer of responsibility. Eventually however, the Ministry of Education introduced a weighted per pupil funding formula that gave each local government an education grant based on the number of (different types of) pupils attending the (different types of) schools located in their jurisdictions.

With the transfer of responsibility for teachers wages to local governments, schools were made budget beneficiaries of local governments and local governments became fully responsible for determining, monitoring and amending their budgets. In short, local governments received education funds from the national government on a

¹¹ In the interests of full disclosure I should add that not only is the Polish case the one I know best but it is one whose evolution I was intimately involved with during the late 1990s. See Levitas and Herczynski, "Decentralization, Local Governments and Education Reform and Finance in Poland: 1990-1999," in K. Davey, ed. *op. cit.* I should also add that this brief account does not do justice to the serious and continuing problems of the Polish reform effort. All it is meant to suggest is that the Poles managed to resolve a number of the same problems that are currently haunting Serbia.

weighted per pupil basis, but were free to allocate these monies between their schools as they saw fit.

Because most local government had a reasonable number of schools --high and low cost schools of different types—there was relatively little difference between the amount of money local governments received from the national government through the formula and the amount of money that the national government had previously spent on the same schools when it was allocating funds on the basis of input rulebooks¹². This meant that local governments could basically afford to mimic the historical allocation of resources in their schools during the early years of reform and there was no “automatic” forcing of school closures.

Over time however, local governments did begin to close small primary schools and eventually when the process was repeated for secondary schools in the late 1990s, restructure vocational schools. In part this was simply because once they were responsible for setting entire school budgets it became painfully obvious to them how irrational some of the historical spending patterns were. And in part it was because demographic pressure continued to increase the per pupil costs of small facilities. In any case, over the course of the decade Polish local governments have been able to significantly rationalization primary school networks and equally importantly introduce radical changes in the structure and content of secondary schools.

Of course, none of this was easy, and both parent and teacher protests have haunted Polish local governments from the start. Nonetheless, local governments have proved more adept at negotiating these protests than the national government is likely to have been for at least two reasons. First, reducing teacher employment has remained a local matter, and not produced mass marches on Warsaw. And second, local governments have been able to promise parents –and keep the promise-- that money saved by closing a school will be used to improve the education of their children in their new place of learning..

Equally importantly, many local governments have chosen to keep small schools open –and indeed to more generally raise the quality of their schools-- by contributing increasing shares of their general revenues to their school. In fact, many have also significantly raised teachers pay through the provision of year end bonuses. At the same time, the are exercising more and more financial oversight over their schools and becoming increasingly concerned with, and involved in, pedagogical decisions.

Summary of Strategic Recommendations

1. MoES is facing a set of critical decision. In the immediate future policy makers will have to decide whether Ministry should take responsibility for setting, monitoring and amending school budgets, and for shouldering the heavy burden of network

¹² Here it should be noted that Serbian local governments are significantly larger than their Polish counterparts and contain more schools. This means that it would actually be easier to allocate money fairly to Serbian local governments for schools without producing adjustment shocks than it was in Poland.

rationalization, or whether these responsibilities are best transferred to local governments along with the ownership of school facilities and a per pupil education grant.

2. If the Ministry chooses the first option, very serious investments must be made to strengthen the capacity of its regional offices because these are the only agents of the national government close enough to schools to either effectively exercise financial control over them or to rationalize school networks. Even with serious and sustained investment, however, there are good reasons to believe that these offices will remain too far away from schools to effectively oversee them. Equally importantly, so long as responsibility for school budgets is divided between the national government and local governments any serious effort to rationalize school networks will be difficult extremely to coordinate locally, while also immediately provoking teacher protests against the nationally.

3. For these and other reasons I believe that it would be much better to make local governments responsible for school financial oversight, provide them with a weighted per pupil education grant, and let them slowly move to rationalize schools (which they should own.) If MoES choose this route, however then its policy makers should be arguing for this vision of the systems evolution in the current constitutional debate and taking a more active role in the reform of Serbia's intergovernmental finance system. With respect to the former, they should be supporting property devolution, and perhaps the definition of education as an inherent right and responsibility of local governments. With respect to the latter, they should be demanding that equalization monies be allocated on the basis of relative wealth; that the system contain possibilities for earmarked grants; and that local schools be made budget beneficiaries of local governments.

4. While it is unlikely that Serbia new and hard pressed local governments will be clamoring to increase their education responsibilities, there are good reasons to believe that they are reasonable well equipped to manage schools. As we have noted they are relatively large and there is little commutation of students across jurisdictional boundaries. This substantially simplifies the movement to a weighted per pupil education formula. Serbian local governments have also been endowed with reasonably robust revenues and seem poised to win greater tax powers, so their ability to contribute additional resources in the sector could be quite substantial. They also appear to be politically more powerful than the MoES itself, and may in fact be better able to defend the national education budget than the Ministry. Finally, some jurisdictions seem to be rather aggressively trying to improve their oversight over schools. In any case, and under all scenarios, MoES officials should be seeking out greater input from the Standing Conference concerning the problems confronting the sector, and the local government role in its evolution.

5. Under all rationalization scenarios the need to transport pupils to schools will increase. At the moment, extremely little is known by MoES about how many pupils are being transported to schools, how local governments are paying for this, and what it costs. As a result MoES should begin to investigate these issues. Similarly, it is extremely important that MoES get access to the data base on school networks developed by Educational

Forum under its contract with UNICEF. It would also be extremely desirable for MoES to analyze the data it has on the pupils preferences for certain types of secondary schools to determine which schools –in the eyes of pupils—least desirable and in need of restructuring (or conversion) and which schools are most attractive.