



## CROATIAN PARLIAMENT

Fiscal Policy Commission

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### **10<sup>th</sup> position paper of the Fiscal Policy Commission on the application of the fiscal rule for the first semester of the year 2016**

At its 15<sup>th</sup> meeting held on 11 November 2016, the Fiscal Policy Commission discussed the Draft Semi-annual Report on the Execution of the State Budget of the Republic of Croatia for the First Semester of the Year 2016 and the Draft Semi-annual Report on the Application of the Fiscal Rules for the First Semester of the Year 2016, submitted to the Speaker of the Croatian Parliament by the Government of the Republic of Croatia on 3 November 2016.

The Fiscal Responsibility Act (official gazette *Narodne novine* No. 139/10 and 19/14) sets the fiscal rules, whereas the Decision on the Establishment of the Fiscal Policy Commission, adopted by the Croatian Parliament at its session of 18 December 2013, defines, among other things, the task of the Commission to consider and assess the compliance with the fiscal rules, as defined in the Fiscal Responsibility Act, in the draft semi-annual and annual report on the execution of the state budget and financial plans of extra-budgetary users of the state budget.

Budget execution in the first half of the year 2016 indicates a decrease in the budget deficit. This is a direct consequence of funding the budget more strongly than expected, primarily as a result of accelerated economic activity and a slow execution of expenditures due to holding early parliamentary elections. The report of the Ministry of Finance shows that in the first six months the execution of expenditures by individual ministries was above 50%, which puts at risk the execution of certain budget items by the end of the year, such as expenditures for employees. This shows that there are still weaknesses in the planning of the budget although in comparison with previous years great progress has been made in the quality of budget planning.

The Fiscal Policy Commission has a positive opinion of the fiscal consolidation that took place in the first half of 2016, and judging from current indicators, believes that the general government deficit can be expected to be lower than originally planned for the whole year 2016. Fiscal consolidation is the result of an increase in tax and excise revenues due to the enhanced economic activity, an increase in private consumption and a successful tourist season. In the first half of 2016, budget investments grew significantly, primarily due to the successful absorption of EU funds, which is a positive indicator considering the decline in budget investments of almost 50% since the beginning of the financial crisis in 2008.

Based on the presented results for the first semester, and the development of the fiscal situation over the subsequent months, the Fiscal Policy Commission expects that the fiscal rule for the year 2016 will be met and that the general government budget deficit will be lower than planned in the Excessive Deficit Procedure. It is expected that the growth of expenditures relevant for the calculation of the fiscal rule (total expenditure minus interest expenses, expenses for the implementation of EU programs and annual changes in expenditures due to changes in the institutional coverage of the general government) will be lower than the growth of GDP at current prices. Thus the fiscal rule for this year should be met. However, the Fiscal Policy Commission warns that because of the lingering weaknesses in budget planning in certain ministries, it will probably be necessary to reallocate some individual budget items by the end of the year. We also warn of the significant arrears in the health sector, for which there are no funds provided in the state budget for 2016.

Due to the expected reduction of the general government deficit in 2016 in line with the recommendations of the Council of the European Union, it is possible that the excessive deficit procedure (EDP) for Croatia will be abrogated. However, it should be mentioned that the pace of reducing the structural deficit is weaker than recommended by the Council of the European Union. In addition, we have to underline that the criterion of public debt is also key to bringing the excessive deficit situation to an end. This requires that the relevant European Commission's projections indicate a reduction of public debt at a satisfactory pace in two years after reducing the budget deficit. The projections of public debt prepared by the Croatian Government are very ambitious because they forecast a reduction of the public debt to 80% of GDP by 2019. Although the projections of the European Commission are somewhat more conservative, Croatia might eventually only meet the requirements from the recommendations of the Council of the EU needed to close the excessive deficit procedure. But even if EDP vis-a-vis Croatia is abrogated, fiscal rules at EU level require a gradual reduction of public debt to 60% of GDP in order to avoid that excessive public debt becomes an obstacle to economic recovery of the country.