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Fiscal Policy Commission

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6th Position paper of the Fiscal Policy Commission on the Proposed Budget Amendments to the State Budget of the Republic of Croatia and Financial Plans of Extra-Budgetary Users for the Budget Year 2015

In line with item IV subparagraph 2 and item V paragraph 5 of Decision on the Establishment of the Fiscal Policy Commission, at its 11th meeting held on 17 September 2015 the Croatian Parliament Fiscal Policy Commission (hereinafter: the Commission) adopted the following position:

The Fiscal Policy Commission examined the Proposed Amendments to the State Budget of the Republic of Croatia and the financial plans of extra-budgetary users for the budget year 2015 as adopted by the Government of the Republic of Croatia on 15 September 2015 and forwarded it for debate in the Croatian Parliament. In line with the Decision on the Establishment of the Fiscal Policy Commission of the Croatian Parliament of 18 December 2013, one of the tasks of the Commission is to examine and assess the application of the fiscal rule as established by the Fiscal Responsibility Act in the draft amendments to the state budget of the Republic of Croatia and financial plans of extra-budgetary users, and to report to the Finance and Central Budget Committee of the Croatian Parliament and inform the public. The Decision stipulates that the Commission is obligated to report to the Finance and Central Budget Committee of the Croatian Parliament before the debate in Parliament.

1. The Government of the Republic of Croatia substantiates the Proposed Amendments with the fact that more favourable economic trends generated more revenue and by the need for allocating additional funds on the expenditure side of the budget; additional fiscal consolidation measures of April 2015 have been included.

The Commission holds that the higher revenues generated from general sources should have been used to reduce the budget deficit and not to increase the expenditures. Instead, the deficit remained at the same level as initially planned, thus making the effects of additional fiscal consolidation measures null and void.

2. The Proposed Amendments have been submitted in the run-up to the parliamentary elections and show that the budget plan for 2015 for individual ministries has not been made realistically. The Commission warned of such a scenario in its previous meetings. Particular attention must be given to the expenditures in the sector of education and science, in which an insufficient amount for salaries is being continuously planned. This is not in line with good budget planning practices;

therefore the Commission recommends that the State Treasury should ensure accurate and realistic planning of the expenditures for education and science.

In a period of low interest rates it would be more realistic to expect that the expenditures for interests are over-planned and not, as it is now the case, under-planned by about 1.6%. The Commission also recommends the establishment of a system that will enable a more realistic planning of interest expenditure.

According to the Proposed Amendments to the State Budget, expenditure for the healthcare sector would increase by 4.5%, which is not in line with the promises that by taking the Croatian Health Insurance Fund out of the State Treasury the problem of the expenditures for the health care sector would be solved. The expenditures have not been adjusted to the Decision on the measures for a temporary suspension of the execution of the State Budget of the Republic of Croatia for 2015; for instance, the Ministry of Health was supposed to reduce the total expenditures of the Croatian Health Insurance Fund by 100 million HRK. According to the Proposed Amendments to the State Budget, the expenditures for the Croatian Health Insurance Fund have increased.

Hereby the Commission proposes to the Ministry of Health and the Croatian Health Insurance Fund to publicly announce the data on overdue liabilities of the entire healthcare sector in order to enable a proper assessment of the consolidation progress in the healthcare system.

3. According to the Croatian Government's Explanatory Statement, the Proposed Amendments to the State Budget provide for a revenue increase by 1.8 bn HRK and an expenditure increase by 1.7 bn HRK. The Commission warns of a high deficit and accelerated growth of the general government public debt, which will reach approx. 89% of the GDP by the end of this year. The Proposed Amendments to the State Budget will only provide a passive response to the existing situation and merely confirm it. The deficit to GDP ratio could have been reduced by about 0.3%, which would have contributed to a slower growth of the public debt than expected; this would be probably assessed positively by rating agencies.

The Commission recognises the fact that one part of the earmarked revenues must be spent for the earmarked purpose (EU funds); however, one part of the increased general budget revenues should have remained saved as recommended by the European Council, which is Croatia's obligation under the excessive deficit procedure, while by making reallocations in other budgetary items the missing part of the expenditure could have been offset.

4. In these Proposed Amendments to the State Budget the estimate was not made according to the ESA 2010, which is indicative of weaknesses in the statistical capacity of the Ministry of Finance. Such weaknesses hamper quality long-term planning of the budget and transparency of public finances.

5. The Commission's estimate is that the 2015 general government deficit according to ESA 2010 will be lower than in 2014, but in the part relating to the reduction of capital investments. According to the Commission's expectations, the general government budget deficit in 2015 should be around 5% of GDP, which represents a reduction by 0.7 percentage points compared to 2014. This is still above the level of comparable countries where the deficit in 2015 is below 3% of GDP.
6. In the Explanatory Statement to the Proposed Amendments to the State Budget the Ministry of Finance did not refer to the compliance with the fiscal rule. The Commission holds that the compliance with the fiscal rule as defined in the Fiscal Responsibility Act should be explained and assessed in all budget documents.
7. According to the existing Fiscal Responsibility Act, currently in force is a fiscal rule according to which the year-over-year growth rate of the general budget expenditure should not exceed the growth rates of the projected or estimated GDP in current prices. According to the Commission's estimate, the general budget expenditure in the previous year, less expenditure for interests and implementation of EU programmes, amounted to 43.9 % of GDP, while an equal or slightly smaller expenditure/GDP ratio is estimates for 2015. As in 2015 the expenditure/GDP ratio remains almost unchanged, the Commission holds that the provisional fiscal rule for 2015 will probably be fulfilled.