

CROATIAN PARLIAMENT

Fiscal Policy Commission

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Position Paper of the Fiscal Policy Commission on Proposed Budget Amendments and Financial Plans of Extra-Budgetary Users for the Budget Year 2014

Fiscal Policy Commission discussed the Proposed Budget Amendments and financial plans of extra-budgetary users for the budget year 2014 adopted by the Government of the Republic of Croatia at its meeting held on 5 March 2014 and referred to Parliament for discussion. In line with the Decision on Establishing the Fiscal Policy Commission in the Croatian Parliament reached on 18 December 2013, one of the Commission's tasks is to examine and assess the implementation of the fiscal rule enacted by the Fiscal Responsibility Act incorporated in the Proposed Budget Amendments and financial plans of extra-budgetary users, where the Commission informs the Finance and State Budget Committee of the Croatian Parliament as well as the public about the positions taken. The Decision stipulates that the Commission shall inform the Finance and State Budget Committee about the positions taken before the plenary meeting of the Croatian Parliament.

Budget amendments for the budget year 2014 have been proposed with reference to the circumstances of the so called EU excessive deficit procedure which includes recommendations by the EU Council with a view to bringing an end to the situation of excessive deficit. Besides, Croatia has witnessed unfavourable economic conditions compared to the expectations in December 2013 when the State Budget was adopted for the budget year 2014. Furthermore, at the end of 2013 Croatian public debt increased at more than 60% of GDP as well as the budgetary deficit. Such situation obliged us to adopt proposed budget amendments and financial plans of extra-budgetary users.

Although macroeconomic projections of the economic growth for 2014 in the Proposed Budget Amendments to the State Budget of the Republic of Croatia for the year 2014 are lower than projected in the original budgetary plan, the Commission believes that they are more realistic now than at the moment of adopting the original Budget. However, the Commission emphasizes the existence of potential risks of not fulfilling the expectations of economic growth. Those risks are related to unfavourable trends at the end of the last year and to the planned fiscal consolidation and structural issues in economy impeding faster growth recovery. Thus the Commission accents the existence of considerable risks of not fulfilling expectations of economic growth and economic growth of budgetary revenue.

Proposed Budget Amendments to the State Budget of the Republic of Croatia for the budget year 2014 includes nominally significant fiscal consolidation of about 2.7% of GDP until the end of the year 2014 that is about 3.7% at the annual level. Among measures proposed for increased revenue there are significant measures related to transferring assets of the insured with beneficiary seniority from the compulsory pension insurance into the pay-as-you-go (PAYG) system in the overall amount of 5 billion Kuna where about 2.8 billion Kuna of one-time revenue is expected in 2014 and the constant revenue in the amount of 400 million Kuna. Overall increase of the State Budget revenue for the year 2014 has been planned for 3 billion Kuna that is 0.75% of GDP by introducing other revenue measures such as increase of excise duties and increase of health insurance rate from 13% to 15%. On the expenditure side a 0.15% reduction of GDP has been projected by abolishing the salary supplement for loyalty to service of 4.8 and 10% for state and public officials. Furthermore, it has been planned to reduce expenditures by an additional 3.4 billion Kuna, or about 1% share of the GDP, by cutting down material costs, investments and subsidies. It should be noted that it has also been planned to make savings on interests, and that the net effect of increasing the contributions on salaries should be taken into consideration because contributions increase the expenditures of budget users in terms of their gross salaries.

According to the proposed amendments to the state budget, the general government deficit has been projected to decrease from 5.8 percent of GDP in the original budget to 4.5 percent. The Commission finds that the proposed state budget revision is a good step in the direction of reducing fiscal imbalances in the context of a high level public debt and the existing needs for financing, which reduce fiscal capacity because of the increasing interest on public debt. However, the risks to the achievement of the budgetary targets have been assessed as significant. The Fiscal Policy Commission expresses its concerns due to the fact that the structural measures for reducing the budget deficit have been proposed mainly on the revenue side (0.7% of GDP), while on the expenditure side of the budget, the impact of the new measures aimed at reducing the structural deficit totals a modest 0.2% of GDP. Therefore, the Commission expects the Government to release a medium-term fiscal plan that will make the future Croatian fiscal position much clearer.

The Commission has also evaluated the compliance with the fiscal rules in 2014 against the background of the proposed amendments to the state budget. The Fiscal Responsibility Act (Official Gazette *Narodne novine* 139/10, 19/14) defines the fiscal rule in line with EU legislation according to the adjustment plan with the view of achieving the medium-term budgetary objective. Since an adjustment plan under the Fiscal Responsibility Act has not been established, a temporary fiscal rule is applied. According to the temporary fiscal rule, the inter-annual growth rate of the general budget expenditures must not exceed the inter-annual growth rates of the projected or estimated GDP at current prices, while interest expenditures, expenditures for the implementation of EU programs without national co-financing and the annual change in expenditures due to the changes in the general government are excluded from the total expenditure. The Commission estimates that budget implementation in line with the proposed amendments should lead to the fulfillment of the temporary fiscal rule.

The Commission, however, sees some risks on the expenditure side including the risks to the economic growth, which could affect the fulfillment of the fiscal rule. Therefore the Commission urges the Croatian Government to increase their monitoring of the key indicators relevant to the fiscal rule so that in the case of increased risks to the fulfilment of the fiscal rule, further measures to adjust the budget could be prepared on time.

One of the objectives of the proposed amendments to the state budget is the alignment with the recommendation of the Council of the EU for exiting the situation of excessive deficit. On this occasion the Commission has not assessed the compliance of the proposed measures therewith, but nonetheless recognizes that there is a risk that the measures of structural character might not be strong enough to stabilize public finances for a longer period of time. As the process of fiscal consolidation should rather be viewed as a longer process, a better estimate will be given once we are presented with all the fiscal measures that the Croatian Government is planning to take up by 2016.