**CROATIAN PARLIAMENT**
**Fiscal Policy Commission**
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**Position paper of the Fiscal Policy Commission of the Croatian Parliament on the proposal for a second revision of the State Budget of the Republic of Croatia for the Year 2014 and on the plan of the Ministry of Finance for meeting the Fiscal Rule for 2014 (November 7th 2014)**

At its 5th session held on 6 November 2014, the Fiscal Policy Commission of the Croatian Parliament discussed the Draft Amending State Budget of the Republic of Croatia for the year 2014 and the projections for 2015 and 2016, submitted to the Speaker of Parliament by the Government of the Republic of Croatia in its act of 30 October 2014. The Commission adopted the following position:

1. The Draft Amending Budget was submitted too late since now there is not enough time to influence the detected adverse trends of deficit increase and of accelerated growth of public debt, which is going to reach 80% of GDP by the end of this year. The proposed amendments will only passively react to the current situation and will do nothing more but confirm it. All the circumstances stated as the reasons for revising the Budget had been known much earlier (except for the floods, but their financial impact on the budget is still relatively small in relation to all the proposed changes), and were discussed by the Committee.

2. The Draft Amending Budget increases the deficit as compared to the previous plan, which sends a bad message. It can be estimated that this year’s general government deficit according to ESA 2010 methodology will be higher than last year (for example, forecasts of the European Commission), which indicates that the fiscal consolidation that is enshrined in the EDP has not been achieved as planned.

3. The Draft Amending Budget indicates a great weakness in the use of EU funds that have been reduced in this proposal, and the Commission assumes that this reduced allocation will not be utilized fully either. Croatian administration has been preparing for the use of EU funds for a long time and it is unacceptable that after more than a decade of using pre-accession funds there is still talk about our not being quite prepared to use EU funds.

4. The Draft Amending Budget shows that there is a very high risk that the fiscal rule for 2014 will not be met, which would then mean that the fiscal rule as defined by the Fiscal Responsibility Act has been breached for the second consecutive year.
    - Under the Fiscal Responsibility Act (OG 139/10, 19/14), a provisional fiscal rule shall apply for the year 2014 according to which the growth rate of the general budget expenditures shall not be higher than the growth rate of the projected or estimated GDP at current prices. The general budget expenditures do not include interest expense, expenditures for the implementation of EU programs without national co-financing and the annual change in expenditures due to changes in the institutional coverage of the general budget. Although the Draft Amending Budget does not contain any numerical data on revenues and expenditures at the level of the general government, either by reference to budget methodology or according to the ESA methodology, based on the data on the expenditures of the consolidated central government in accordance with the budget methodology, which are planned at the level of about 4.4 billion HRK higher than the actual expenditures incurred in 2013, it can be estimated that these expenditures will be higher than last year after consideration at the general government level, after the application of the ESA methodology and after adjustments for certain expenses in the manner prescribed by the Fiscal Responsibility Act. As estimates indicate that the GDP at current prices will decrease this year, it means that the fiscal rule for 2014 is highly unlikely to be fulfilled.
5. The very high risk of failure to meet the fiscal rule seriously undermines the credibility of the Government in the conduct of fiscal policy. It also weakens the confidence in the sincere commitment to fiscal consolidation. The question in these circumstances is how to convince the public that the expected legislative changes (Budget Act, Fiscal Responsibility Act) were in truth motivated by a sincere desire to improve the fiscal framework?
6. The explanation accompanying the second Draft Amending Budget for 2014 does not say a word about the situation in connection with the fiscal rule. The Fiscal Policy Commission takes the view and recommends that the Government should present, explain and give an assessment of the fulfilment of the fiscal rules defined in the Fiscal Responsibility Act in all budgetary documents, which would support a greater transparency of the process.
7. The Fiscal Policy Commission is also of the opinion that, in any future proposals for changes in fiscal rules, the Government should provide clear and unambiguous fiscal rules whose execution can be well monitored during the year, and provide the best possible estimates and projections of measurable corrective measures in the event that in the course of the year deviations occur compromising the fulfilment of the fiscal

rule. Finally, the Commission believes that the Government should base the whole process of achieving fiscal responsibility on realistic premises that would precisely define the responsibilities of the different levels of the Government in the execution of the budget and in the possible implementation of corrective measures, as well as clearly define the consequences of non-compliance with fiscal rules.

8. The Fiscal Policy Commission urges the Government to take a serious and responsible approach to strengthening the framework for the conduct of fiscal policy through legislative changes and genuine commitment to strengthening fiscal responsibility, and to accelerate the process of fiscal consolidation, regardless of political cycles because fiscal consolidation does not tolerate delay. If a vigorous fiscal consolidation is postponed, the vulnerability to domestic and external shocks significantly increases, and so does the possibility of uncontrolled developments in the fiscal and macroeconomic sphere.