Press Release

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Cautiously with the Croatian Budget Deficit in 2010

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The international financial crisis is still affecting the economies of EU candidate and pre-accession countries, but according to the most recent figures, there are some signs of the bottoming out of the crisis. Thus in Turkey, Croatia and Serbia the fall of GDP slowed down in the third quarter of 2009 as compared with the same period the previous year. However, this improvement could be short-lived. It is partially the consequence of the resolution of the crisis by increased public spending in 2009, which led to a considerable rise in budget deficits.[1] But budget deficits will have to be cut in the future.

On January 6, the Directorate General of the EC for Economic and Financial Issues (DG ECFIN) published a quarterly report for EU candidate and pre-accession countries.[2] Candidate countries are Croatia, Macedonia and Turkey, while pre-accession countries are Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo.

The report follows the figures most recently available for each given country, related to output and demand, the labour market, international transactions, prices, monetary and financial indicators and general government finances. In this commentary of the DG ECFIN report, we shall focus on trends in gross domestic product (GDP), the basic measure of overall economic activity in a country, and the deficit and debt of general government.[3]

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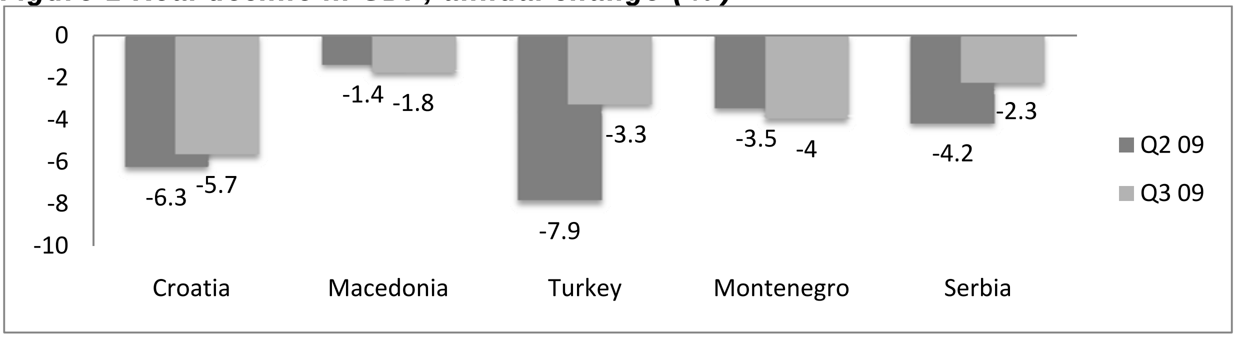
[1] The deficit of consolidated general government is meant; in Croatia this consists of: the consolidated central government budget, the financial plans of the extra-budgetary spending agencies and the budgets of local units.
[2] *European Commission, 2010. EU Candidate and Pre-Accession Countries Economic Quarterly. Directorate General for Economic and Financial Affairs*, published on January 6, 2010. Available at: [http://ec.europa.eu/economy_finance/db_indicators/cpaceq/documents/cceq_2009_q4_en.pdf].
[3] It is important to mention that the accessibility of figures for the countries differs in the report. Thus for example, with respect to Croatia, most of the figures for the third and fourth quarters of 2009 are available, while there are far fewer available figures for Albania and Kosovo.

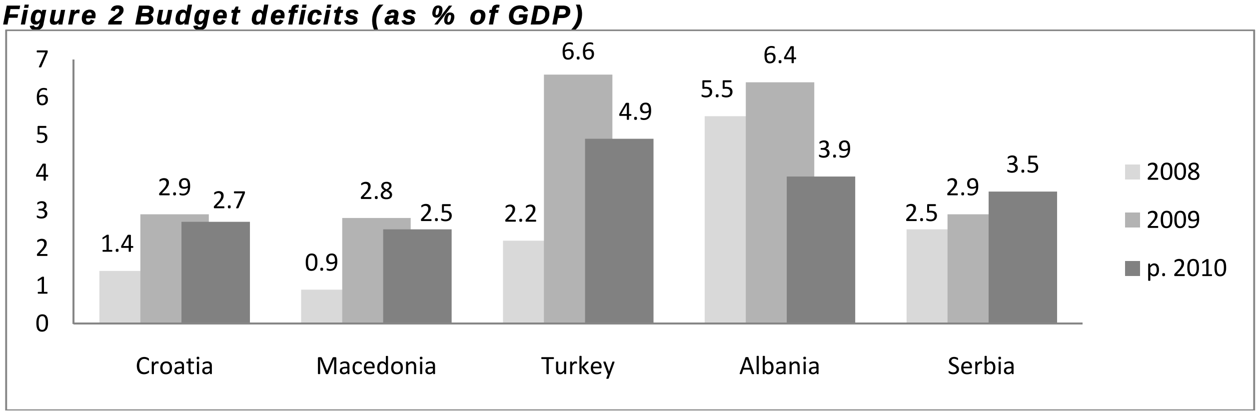
Figure 1 Real decline in GDP, annual change (%)



Q2 – second quarter; Q3 – third quarter
Figures for Albania, Bosnia and Herzegovina and Kosovo are unavailable
Source: European Commission, 2010. EU Candidate and Pre-Accession Countries Economic Quarterly. Directorate General for Economic and Financial Affairs

The most important conclusion of the report is that the international financial crisis is still affecting the economies of the countries observed, but according to the most recent figures some indications of the beginnings of a way out of the crisis are appearing. Thus in Turkey, Croatia and Serbia the third quarter of 2009 recorded a slow-down the fall of GDP (Fig. 1). However, the report does mention that this improvement might be short-lived as it is partially the result of increased public spending, which in 2009 resulted in considerable rise in budget deficits (Fig. 2). There are, that is, two ways in which the countries of CEE cope with the crisis: by increasing the budget deficit and/or borrowing at the IMF and/or the European Commission (Serbia, for example).

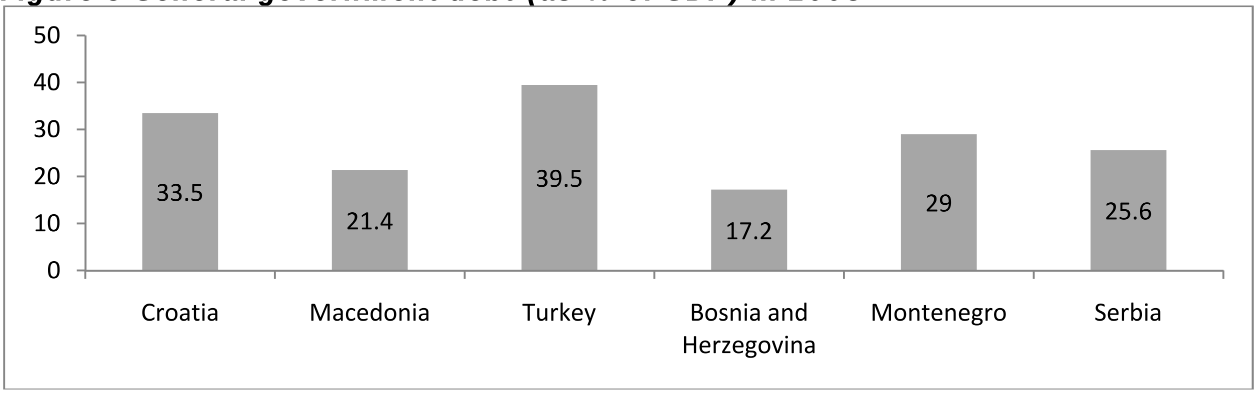
Figure 2 Budget deficits (as % of GDP)



** Data of the Ministry of Finance of the Republic of Croatia for 2008 are somewhat different. At the end of 2008 the deficit of consolidated general government came to 0.9% of GDP (Source: Annual Report of the Ministry of Finance for 2008, Ministry of Finance, Republic of Croatia).*
Data for Montenegro, Bosnia and Herzegovina and Kosovo are not available.
Source: as in Figure 1

Excessive growth in the budget deficit in times of crisis is particularly dangerous for it is dubious how and under what conditions the deficit will be financed. Apart from that, the rise in the budget deficit tends to lead to the further enlargement of the public debt (Fig. 3). Hence the report too concludes that the general government deficits must be lower in 2010 than in 2009. In their budget proposals for 2010, the governments of most of the countries observed have planned a reduction in budget deficits; the only question is whether they will be able to effectuate this (Fig. 2).

Figure 3 General government debt (as % of GDP) in 2008



** Data from the Ministry of Finance of the Republic of Croatia are somewhat different. At the end of 2008 general government debt as percentage of GDP was 29.1%. When to this percentage one adds Republic of Croatia guarantees and the debt of the Croatian Bank for Reconstruction and Development (CBRD), then the debt as percentage of GDP at the end of 2008 rose an additional 12.9 percentage points (9.7 + 3.2). Considered in this way, the overall debt of general government comes to as much as 42% of GDP. (Source: Annual Report of the Ministry of Finance for 2008, Ministry of Finance, Republic of Croatia).*
Figures for Albania and Kosovo are not available.
Source: the same as in Figure 1

In 2010 the Croatian government must try to keep to the planned level of budget deficit. Hence the government must be extremely cautious with all measures that it undertakes, including measures for economic recovery and development proposed at a session of the government on January 14, 2010.[4] The first measure is giving credits to firms through collaboration among the Croatian National Bank (CNB), the Croatian Bank for Reconstruction and Development (CBRD), the government and commercial banks; the second is the direct entry of open-ended investment funds into the equity structure of firms. Details of the measures are not yet published, but it is certain that the CBRD will have to assume part of the risk connected with the newly granted loans. It is important that there should be high quality criteria for the allocation of money, so that the guarantees are not activated, for this would have a negative effect on the long-term sustainability of public finances, especially because of the already high public debt in the country (Fig. 3). Further, since it is dubious if the planned level of government revenue will really be reached, the government should focus on a reduction of government spending (particularly on a reform of retirement and healthcare insurance and the state administration, for these are the expenditures that most burden the central government budget).

[4] A Proposal of the Decision on Measures for Economic Recovery and Development and A Proposal of a Decision on Intent to Take Part in the Participation in the Founding of Funds for Economic Collaboration. Available at: [http://www.vlada.hr/hr/naslovnica/sjednice_i_odluke_vlade_rh/2010/36_sjednica_vlade_republike_hrvatske].