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PRESS RELEASES

Fiscal Compact - the first decisive step towards euro adoption in Croatia

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The Government - in an expedited procedure - adopted a Draft Proposal for an Act on the Ratification of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union between the EU Member States, thereby taking the first decisive step towards joining the euro area an announcing stronger commitment to structural reform implementation. The Government accepted part of the Treaty provisions relating to the euro-area members (i.e. Title V, participation of the Heads of Government in the euro-area members' meetings). As concerns provisions arising from Title III (Fiscal Compact) and Title IV (Economic Policy Coordination and Convergence), Croatia will, like other Member States whose currency is not the euro, exercise its right of exemption (pending its accession to the euro area).

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was concluded in January 2013, with the aim of safeguarding the stability of the euro area and strengthening budgetary discipline within the EU. Under the Treaty, the Member States agreed to observe additional rules to tighten budgetary discipline and strengthen the coordination of their respective economic policies, with a special emphasis on the governance of the euro area. Through such coordination, the EU supports the achievement of its objectives for sustainable growth, employment, competitiveness and social cohesion. The Treaty applies to the euro-area and non-euro area Member States which have ratified it.

The Treaty has been signed and ratified by all the EU Member States except the Czech Republic, Croatia and the United Kingdom, and it entered into force in January 2013, after having been ratified by twelve euro-area Member States (the remaining signatory states ratified the Treaty subsequently).

The fiscal provisions of the Treaty (Title III) are binding on all euro-area signatories. Other signatory states will apply those provisions once they have acceded to the euro area, unless a country concerned declares its wish to be bound at an earlier date.

* The views expressed by Davor Galinec in this article are exclusively his own personal and professional opinions and do not necessarily represent the official views of his employing institution, nor are they in any way binding on it.

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The restrictive provisions of the fiscal part of the Treaty, set out in Articles 3, 4, 6 and 8 are as follows:

- The budgetary positions of national general governments must be balanced or in surplus.
- Structural deficit[1] must not exceed 0.5% of GDP.
- In countries where the ratio of general government debt-to-GDP is significantly below 60% of GDP and where risks in terms of long-term sustainability of public finances are low, a higher level of structural deficit is allowed, but it may not exceed 1% of GDP.
- In case of excessive general government debt (over 60% of GDP), it has to be reduced at an average rate of one twentieth per year.
- The signatory states are obliged to report ex-ante on their public debt issuance plans to the European Commission and to the EU Council.

Fiscal discipline can also be imposed by signatory states. Specifically, where a signatory state considers that another signatory state has violated, or improperly applied the fiscal provisions of the Treaty, it can bring the matter before the Court of Justice of the EU and request the imposition of financial sanctions on the signatory state concerned in accordance with the criteria established by the European Commission in Article 260 of the Treaty on the Functioning of the EU. Should the Court find that the violating party has not complied with its judgment, it may impose on it a lump sum or a penalty payment that is appropriate in the circumstances and that shall not exceed 0.1 % of its gross domestic product. The amounts imposed on a euro-area Member State shall be payable to the European Stability Mechanism. In the case of a country that has not exercised its right of exemption, payments shall be made to the general budget of the EU.

Signatory states are obliged to transpose the fiscal provisions of the Treaty into their national legal systems through binding and permanent provisions, preferably constitutional, or otherwise guarantee that they will be fully respected and adhered to throughout the national budgetary processes. **The EU Member States whose currency is not the euro may be exempt from the application of certain titles of the Treaty,** notably the obligations set out in Title III (Fiscal Compact) and Title IV (Economic Policy Coordination and Convergence).

Croatia accedes to the Treaty while exercising its right of exemption from Titles III and IV. This implies that, for now, it accepts the obligations laid down in Title V (participation of Heads of State in Euro Summit meetings which take place at least twice a year, to discuss issues of competitiveness, changes to the existing and introducing new rules to be applied in the euro area, as well as some specific issues regarding the implementation of the Treaty).

By adopting the aforementioned Act by Parliament, the first legal prerequisite for Croatia's convergence to the euro area and the EMU will be met. Given the fiscal part of the Treaty providing that the structural deficit of a Member State with a government debt-to-GDP ratio exceeding 60% may not exceed 0.5% of GDP, Croatia must, pending its accession to the euro area (when the exemption ceases to apply) intensify fiscal consolidation and speed up the announced structural reforms.

[1] The term „annual structural balance of the general government“ refers to the annual cyclically adjusted balance net of one-off and temporary measures.