Institute of Public Finance | No. 60 | Zagreb November 27, 2013
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PRESS RELEASES

A commentary on the Croatian 2013 Budget Revision and the 2014 Budget Proposal with Projections for 2015-16

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The Government on 14 November simultaneously presented two documents: A proposal for Amendments to the 2013 State Budget and A Proposal for a 2014 State Budget and Financial Plans of Extra-budgetary Users for 2014 with Projections for 2015-16. Unfortunately, however, this year's budget revision again came too late and was even not used as a basis for reasonable and realistic budget planning in the years to come.

In addition, some ten days ago, the European Commission and the International Monetary Fund released their respective opinions on the economic and fiscal situation in Croatia, followed by a Commission's Report on a need to open an Excessive Deficit and Debt Procedure for Croatia (EDP). Although the Commission's opinions should matter very much to this country because, after all, it has joined the EU voluntarily, no less important should be the opinion of the IMF, as it is very likely that Croatia will have to apply to it for assistance. Nevertheless, in this country, things have been going on independently of anyone's opinions, of the legally prescribed procedures and of the legal patterns and logic of the budgeting and macroeconomic processes.

This year's budget revision was again delayed too long, so that, unlike in 2012, when a few days passed between a revision of the current year's budget and the next year' budget proposal (which is also a too short period to achieve the real purpose of the revision), both the 2013 budget revision and budget proposal for 2014 with projections for 2015-16 were presented on the same day.

Despite last year's warnings that acting like that was both irresponsible and unserious, the same procedure was, unfortunately, repeated this year. Adopting a budget revision late in the year hardly leaves any time for improvements within the same year, and, if its adoption coincides with that of the next year's budget proposal, there is no possibility to recap the situation, draw some lessons from the current year's outturns and propose an as realistic as possible budget for next year.

And, to make the bad situation worse, although the two documents were presented on the same day, the Budget Proposal seems "to have nothing to do" with the Budget Revision! The proposed budget and projections are based on the data before the budget revision, which means lower revenue and higher expenditure in 2013, and a deficit increase of almost 60%! This prevents any comparison between the 2013 data and those for 2014-16. However, there is little consistency even in such contradictory data. While the bulk of the proposed budget relies on pre-revision data, some parts of the Proposal and projections still recognise the Budget Revision. Consequently, there is a detailed table in the statement of reasons showing a budget deficit of 4.8%, while only a few pages below in the text, the same deficit amounts to 3%. Does it make any sense to analyse such a budget proposal or discuss which ministries will be given more (or less) than the planned amounts and what the amounts of these changes will be?

And how will members of Parliament, who have to discuss and vote both documents, find their way through them?

Especially worrying is that there is no end to optimism. The 2013 Budget voted in December 2012 was based on a GDP growth rate of 1.8%. However, while it was clear from the outset that this growth rate was unrealistic, it was only in the April budget revision that the Government revised its growth expectations downwards to 0.7% and further to 0.2% in November. Unfortunately, this was again overly optimistic, as the Commission and IMF forecast falls in GDP of 0.7% and 0.75% respectively.

GDP growth rates planned for the coming years are also overly optimistic and unrealistic: for 2014, 1.3% (Gov't) and 0.5% (Commission); for 2015, 2.2% (Gov't) and 1.2% (Commission). The IMF does not even dare to offer any concrete figures, but rather forecasts a "modest recovery" in 2014, subject to a perceptible economic upturn in the euro area and a markedly stronger investment activity, emphasizing considerable risks to even such a slight recovery. According to the Commission, there is strong likelihood that even its forecast growth rates will not be realised, mainly due to low competitiveness of the Croatian economy, contraction in credit, especially to small and medium-sized enterprises, and lower capacity to absorb EU funds than forecast by the Government.

The main generator of economic growth in 2014, according to the Proposal, will be stronger investment consumption by public companies and general government. Despite the questionable effectiveness of public investments in an environment of "weak economic governance" (as the Commission cautiously puts it), the fact is that the share of public investments in GDP in Croatia is among the lowest among EU Member States with similar levels of income. The share of government's investment consumption in the budget is best shown in line item 'expenditures for non-financial assets'. Indeed, according to Government's projections, expenditures for non-financial assets will go up by almost 70% in 2014. But is this projection feasible? Even if we ignore the Commission's concern that Croatia's EU fund absorption capacity is lower than anticipated, which can have a major impact on investment realisation, the analysis shows that, year in, year out, expenditures for non-financial assets have been planned unrealistically and executed in lower-than-planned amounts. Thus, for example, the gap between planned and executed expenditures was 30% in 2011, and 15% and 20% in 2012 and 2013 respectively. Given such experience, is it reasonable to believe that expenditures for non-financial assets will grow by as much as 70% next year?

There are also differences in the general government deficit projections between the Government and Commission (5.5% vs. 6.5% in 2014 and 4.6% vs. 6.2% in 2015). Apart from higher deficit projections, the Commission also fears that the figures could even exceed those projected, given a strong likelihood of a continued economic downturn, a possibility of additional calls on government guarantees to state-owned companies and higher-than-expected interest rate costs, which would deepen insolvency.

At the end of the year, we are facing another unrealistic and overly optimistic budget proposal for the next year. However, unlike in the previous years, when we were left to our own resources, all eyes are now on Brussels and EDP. Given that it has long been known that imposing an EDP on the country is inevitable, that the Commission has already issued several instructive documents, that both the Budget Revision and Economic and Fiscal Policy Guidelines have been delayed and that the Croatian Bureau of Statistics has harmonised its government finance statistics for the period 2009-12 with the EU methodology, why was it not waited till the 2013 statistics were harmonised as well, in order to produce a feasible 2014 Budget Proposal with projections for 2015, based on realistic assumptions? The Government could have opted for interim financing in the first quarter of 2014, and, in the meantime, prepared a well-designed and realistic budget proposal in compliance with the already known requirements to be imposed under the EDP.

While much is expected from an EDP in Croatia, this measure is by no means a magic wand. Seventeen Member States are currently undergoing the procedure (some of them have languished there for years), while only two (Estonia and Sweden) have never been put in an EDP. However, the benefits of an EDP can only be reaped by countries with creditworthy policies and documents in which these policies are made public.