



PRESS RELEASES

Everything is like last year - we do not have the public debt management strategy?

ANTO BAJO, PHD, Institute of Public Finance, Zagreb

MARKO PRIMORAC, PHD, Faculty of Economic and Business, Zagreb

In the last quarter of 2014 the government has created HRK 17.5bn new direct and contingent liabilities both on the domestic and international financial market. Unfortunately, the borrowing was done without the clear borrowing plan and public debt management strategy. Such borrowing practices constantly increase the exposure of public finance to financial risks.

New borrowings in the last quarter of 2014. Government borrowing tends to intensify at the end of the year. Reasons for this include weaknesses in the budget planning, frequent revisions of the budget and the lack of insight into the actual extent of direct and contingent liabilities. In the last quarter of 2014 the government issued **bonds on the domestic market** in the amount of HRK 3.25bn and announced the release of **bonds on the international market** at the beginning of 2015 in the amount of EUR 1bn (about HRK 7.65bn). In addition, the Government issued guarantees and approved borrowing of public enterprises and local government units in the total amount of over HRK 6.5bn (Table 1). Over HRK 4bn is the debt of Croatian Motorways, and nearly HRK 1.3bn the debt of Croatian Railways. In other words, in late 2014 the government created a total of HRK 17.5bn direct and contingent liabilities.

The growth of the public debt. The part of the borrowing made in 2014 will be used to repay the existing debt. Therefore an increase in the public debt caused by new borrowing will be lower than the amount of borrowing. However, the total amount of debt has been growing rapidly despite the claims of the government that new borrowings are used mostly to refinance the existing debts. Due to the absence of the borrowing plan, public debt management strategy and annual debt report it is difficult to predict which part of the new borrowing is intended for refinancing of the existing obligations. In line with the growth of debt, the interest expenses have grown in 2013 amounting to almost HRK 10bn (Table 2). That is one third of the annual amount of compensation of employees at the general government level. Just like last year, borrowing in December is not a part of the prudent long-term public debt management strategy. On the contrary, it seems more like a desperate attempt of firefighting by adding oil to the fire.

Traditional festive borrowing. Government borrowing in the holiday season (due to the traditional preoccupation of the public with other activities) usually pass "under the radar". The **Institute of Public Finance** has already warned against that practice in January 2014. Today, one year later, nothing has changed. Croatia still has no public debt management strategy, whereas fiscal risks threatening the sustainability of public finances are even greater. The last Public Debt Management Strategy was issued in 2011 (for the period from 2011 until 2013). It was the first serious strategy released after the "Annual Report and Public Debt Management Strategy in 2006".

Who manages maturity risks of contingent liabilities? The management of contingent implicit and explicit liabilities arising from guarantees issued and other less obvious fiscal risks (such as debts of

public enterprises) does not exist. The contingent liabilities of the shipbuilding sector turned into a direct government debt in 2012 just as the contingent liabilities of the Croatian Roads and Croatian Motorways in 2011 and 2013. Bearing this in mind, it is only a matter of time when the contingent liabilities of the Croatian Railways (companies Croatian Railways Cargo and Croatian Railways Infrastructure) and other companies owned by the central government and local government units will turn into a direct debt as well.

There is neither plan nor calendar. In addition to the lack of the clear borrowing strategy, the Government and the Ministry of Finance do not publish government securities issuance calendars. The last **government bonds issuance calendar** was published in 2007 and is available on the Ministry of Finance's webpage. Due to the fact that it is more than outdated, the calendar should have been removed from the website long ago because it creates a negative image about the "timeliness" of the state administration and sends a bad signal to investors, professionals and general public concerned. Even the last **treasury bills issuance calendar** was published three years ago – in 2011. However, the Ministry of Finance regularly sends and publishes the **Call for participation in the auction of treasury bills**.

Borrowing transparency – bond prospectuses and borrowing conditions data are missing. Data on government bonds issued are only occasionally publicly available, vague and incomplete. An **overview of international bonds issued by the Republic of Croatia** is published on the Ministry of Finance's webpage. The range of information on particular bond issues seems quite comprehensive and clear (it even includes data related to lead managers), however, some most important details are omitted. For example, there is no information about the bonds' selling prices but only about the coupon interest rates (as if the borrowing cost relates only to the coupon interest rate). It is well known that bonds can be issued without coupons (zero coupon bonds) and sold as discounted securities, which does not mean that the borrowing cost for such securities does not exist. An **overview of domestic bonds issued by the Republic of Croatia** faces similar problems. In addition to the initial issue price, the Ministry of Finance should finally publish all other costs associated with borrowing. These include the agent/arranger fees and other dependent costs such as the cost of protection against currency risk (for international issues) and cost of marketing activities related to the issuance (roadshow expenses).

The government should adopt a separate Public Debt Act which will stipulate the obligation of a more comprehensive and timely reporting and drawing up the annual strategy and publication of government securities issuing calendar. Such a law would ensure flexibility and provide the necessary legal infrastructure for the debt management. In conditions when Croatia has accumulated more than HRK 250bn of debt and nearly HRK 30bn of guarantees (which together accounts for more than 80% of GDP), establishing an agency that will professionally manage both direct and contingent liabilities seems to be more than justified. Due to small number of employees, the existing Department within the Ministry of Finance is not able to perform this task. Without a clear legal and institutional framework, the effective public debt management in Croatia is currently not possible.

Table 1. Government guarantees and consents for borrowing issued in the last quarter of 2014

User	Source of risk	Amount (million)	Currency	HRK (million)
3. MAJ Shipyard	Guarantee	12.9	USD	79.6
Centre for Restructuring and Sale	Consent	50.0	EUR	383.7
City of Belišće	Consent	3.7	HRK	3.7
City of Split	Consent	30.0	HRK	30.0
City of Zagreb	Consent	190.0	HRK	190.0
Croatian Motorways	Consent	400.0	EUR	3,069.3
Croatian Motorways	Consent	150.0	EUR	1,151.0
Croatian Shipbuilding Trogir	Guarantee	60.2	USD	371.1
Croatian Railways Cargo	Consent	15.4	HRK	15.4
Croatian Railways Infrastructure	Consent	12.0	HRK	12.0
Croatian Railways Infrastructure	Consent and guarantee	250.0	HRK	250.0
Croatian Railways Infrastructure	Consent and guarantee	1,000.0	HRK	1,000.0
Port Authority Slavonski Brod	Consent and guarantee	38.0	HRK	38.0
TOTAL				6,593.7

Note: Currencies are converted according to the CNB's average foreign exchange rates for November 2014 (end of period): 1 USD = 6.16365 HRK and 1 EUR = 7.673128 HRK.

Sources: Croatian Government's decisions on issuing guarantees and consents for borrowing

Table 2. Public debt and interest expenses from 2010 until 2014 (in million HRK)

	2010	2011	2012	2013	2014
General government debt	173,087	199,311	212,998	250,061	256,357
Central government guarantees	29,432	22,468	24,950	23,911	22,553
Local government guarantees	3,013	2,621	2,291	2,199	*2,199
Total	205,533	224,400	240,239	276,171	281,109
Interest expenses	6,654	7,571	8,849	9,798	**8,651

Note: The data on general government debt and central government guarantees for 2014 refer to August 2014

* Guarantees issued by the local government units in 2014 are, due to the lack of data, approximated by data for 2013

** Interest expenses in 2014 refer only to the first three quarters of 2014

Sources: Croatian Nation Bank and Ministry of Finance