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PRESS RELEASES

Fiscal Effects of Reducing Public Service Employees' Rights

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A parliamentary procedure is currently underway for the adoption of proposals for an Act on Amendments to the Act on Denial of the Right to Increase Salaries Based on Seniority, and Act on Denial of the Payment of Certain Material Rights to Public Service Employees. Both proposals relate to Government measures to reduce huge budget deficit.

In December 2013, the European Commission delivered an opinion that an excessive budget deficit existed in Croatia. As early as end-January 2014, the EU Council adopted a recommendation, urging Croatia to implement structural reforms with a view to correcting the excessive budget deficit by 2016. In the Convergence Programme for the Period 2014-17, the Government outlined measures to cut budget deficit and quantified their fiscal effects (Table 1). One of the deficit reduction measures involves the abolition of certain rights (benefits) of employees financed from the national budget.

Expenditures for employees. Central budget expenditures for employees declined steadily from HRK 22.4bn in 2012 to HRK 21.5, planned for 2014. According to the 2015 plan, expenditures for employees will decrease further, to HRK 21.1bn. Funds to finance salaries will be provided from general revenues and receipts, contributions and receipts from borrowing. Expenditures for employees decreased in the reference period, but only in the part relating to bonuses (such as the allowances for: special working conditions, work on holidays and non- working days, shift work, seniority, etc.). The Government has so far not revised or required any reductions in the basic salary (through corrections of salary coefficients), but has obviously left this task to a future Government to be formed after the next parliamentary elections.

Legal basis for reducing employees' rights. Under the Act on Denial of the Right to Increase Salaries Based on Seniority (Official Gazette 41/14), civil and public service employees were denied the right to salary increases based on seniority in the period from 1 April to 31 December 2014. However, the Government's negotiations with trade unions were not finalised for all branch collective agreements by end- 2014. In order to continue the measures already underway, aimed at cutting spending on employees, the Government has, pursuant to the Act on the Powers of the Government of the Republic of Croatia to Regulate by Regulations Certain Matters within the Scope of Competence of the Croatian Parliament (Official Gazette 115/14), adopted a Regulation on an Amendment to the Act on Denial of the Right to Increase Salaries Based on Seniority (Official Gazette 157/14). By virtue of this Regulation, the application of the Act reducing employees' rights has been extended until 31 March 2015. Under the Act on Denial of the Payment of Certain Material Rights to Public Service Employees (Official Gazette 143/12 and 159/13), and a new such Act proposed in 2015, the Government has abolished the paid annual leave and Christmas bonuses for the period from 2012 to 2014 and for 2015.

Fiscal effects of the application of the Act on Reducing Compensation of Employees. As from 1 April 2014, the right to increased salaries based on seniority was abolished and civil servants' salaries were reduced by 6%. Also reduced were salary bonuses paid to active military personnel in the defence sector, as well as passive on-call duty allowances in the judiciary. The salary calculation method in the science sector was changed. These measures resulted in fiscal savings in the amount of about HRK 359m (0.11% of GDP) in 2014. However, the increase in the health insurance contribution rate (from 13% to 15%), with an effect of HRK 251m (0.08% of GDP), partly offset the fiscal effect of reduced compensation of employees, which is why the (net) fiscal savings on compensation of employees were envisaged to amount to HRK 108m (0,03% of GDP). Fiscal effects of the abolition of salary bonuses due to the abolition of the seniority bonus are not known for 2015. However, savings in the amount of HRK 350m are expected in 2015, thanks to the abolition of the annual leave and Christmas bonuses. Total savings might even exceed those planned in the Convergence Programme.

More emphasis should be put on structural measures on the revenue side. The Parliament should adopt amendments to the two acts in emergency procedure, in order to put them into effect as of 1 April 2015. Within its National Reform Programme, the Government will present to the European Commission measures aimed at correcting fiscal and macroeconomic imbalances. Since the opening of the excessive deficit procedure, the Government has paid more attention to increasing revenue through numerous tax regulation changes. Given that its revenue collection potential has already been exhausted, from 2016 on, the Government will generally have no option but to introduce relatively unpopular measures ranging from imposing property tax to cutting salaries in the public sector and further reducing social rights and subsidies. The total fiscal adjustment has slowed down from 2014. Reductions in the fiscal impact of adjustments are more noticeable on the expenditure side than on the revenue side. The Government has planned no detailed fiscal adjustment measures for 2016. Such measures might either be defined under a new National Reform Programme, or left to the competence of a newly-elected Government.

Table 1. *Excessive deficit correction measures under the Convergence Programme of the Republic of Croatia, 2014-16 (in HRK million and % of GDP)*

		2014		2015		2016	
		HRK million	% of GDP	HRK million	% of GDP	HRK million	% of GDP
	REVENUE STRUCTURAL MEASURES						
1	Increase in revenues from tax on gains from games of chance	300	0.09	200	0.06		
2	Changes in pension insurance contributions under the accelerated retirement plan	400	0.12				
3	Increase in concession fees	200	0.06				
4	Withdrawal of revenues from the state-owned companies' profits	500	0.15				
5	Increase in the health contribution rate from 13% to 15%	1,600	0.48	800	0.20		
6	Increase in corporate income tax revenues due to tax exemption for reinvested profits			500	0.15		
7	Introduction of tax on savings interest			300	0.09		
8	Increase in revenues from telecommunication service fees	350	0.10				
9	Introduction of real property tax						
10	Increase in excise taxes on energy	350	0.10	130	0.04	1,500	0.40
	I. Total revenue measures	**3,700**	**1.10**	**1,930**	**0.50**	**1,500**	**0.40**
	EXPENDITURE STRUCTURAL MEASURES						
1	Reduction of compensation of employees	108	0.03	230	0.07	101	0.08
2	Reduction of intermediate consumption expenditures	657	0.20	469	0.14	499	0.14
3	Reduction of subsidies	1,101	0.33	300	0.09	300	0.09
4	Reduction of social benefits and transfers	640	0.20	385	0.10	588	0.16
5	Reduction of other current and capital transfers	466	0.14	300	0.09	460	0.14
6	Reduction of gross capital formation expenditures	335	0.10				
	II. Total expenditure measures	**3,307**	**1.00**	**1,684**	**0.50**	**1,947**	**0.60**
	III. Reduction of extra-budgetary users' expenditures	**530**	**0.20**	**100**	**0.03**		
	TOTAL FISCAL ADJUSTMENT (I+II+III)	**7,537**	**2.30**	**3,714**	**1.00**	**3,447**	**1.00**

Source: Convergence Programme of the Republic of Croatia for the Period 2014-2016.