Institute of Public Finance | No. 78 | Zagreb May 11, 2015

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PRESS RELEASES

Public Sector Finance Management in Croatia

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Croatia is far from achieving fiscal consolidation. Its main focus should be on the finance management for the entire public sector, rather than on budget management. This is corroborated by the Central Bureau of Statistics' data on the amounts and scopes of budget deficit and general government debt for the period 2011-2014 released on 20 April 2015 in accordance with the European System of National and Regional Accounts (ESA 2010) methodology and Manual of General Government Deficit and Debt.

The 2014 general government deficit stood at 5.7% of GDP, i.e. HRK 18.84bn. The deficit level closely corresponded with the Ministry of Finance's projections included in the EDP notification tables from October 2014. This was expected, given that the general government deficit was 10.9% of GDP (HRK 8.2bn) in the first quarter, 7.3% of GDP (HRK 6bn) in the second quarter and 1% of GDP (HRK 900m) in the third quarter of 2014. Under the new convergence programme, the Government will be required to make much larger savings.

Interest expenses and terms of borrowing. As in 2013, interest on general government debt repayment amounted to HRK 11.5bn (3.4% of GDP) in 2014. Interest expenses were high and could even go up considerably in the next period. Despite the ECB's quantitative easing measures, in the first quarter of 2015 Croatia remained one of the countries with the highest yields on government bonds (3%). Only Cyprus and Greece recorded higher yields than Croatia (6% and 9.7% respectively). This suggests that that country risk and the risk of doing business with the government are still high, which reveals a lack of confidence of the financial market in the Government's policies.

Public debt exceeds 90% of GDP. According to the CBS and Eurostat, general government debt stood at 85% of GDP (HRK 279.6bn) in 2014, with a tendency to grow further. The increase in public debt of HRK 13.4bn over 2013 (80.6% of GDP or HRK 266.1bn) was due to the inclusion of the liabilities of the HBOR (4.4% of GDP) and HŽ Cargo in the general government debt. The general government debt will have to be further increased by about HRK 22.8bn in guarantees granted to public companies and about HRK 5.8bn in the liabilities of the Zagreb Holding. It is only by their inclusion in the scope of public debt that a more realistic picture of the government's financial position can be obtained.

Record-high repayments of government bond principal and coupons until 2025. After 2015, Croatia will enter a phase of high repayments of most of its bond principal and coupons as they fall due. Until 2025, an average amount of over HRK 18.8bn (HRK 14.2bn in bond principal and HRK 4.6bn in bond coupons) will fall due annually. From 2017 on, borrowing will increase due to the need to refinance these liabilities. Regrettably, there is no publicly available information on the maturities (of the principals and interest) of loans which account for about 35% of general government debt. Croatia has not experienced such a great need for borrowing to repay its due liabilities ever since its independence.

Revenues from financial assets used for the repayment of public debt principal and interest. As a result of high budget deficit financing needs, Croatia will have to increase the use of revenues from assets, primarily the profits of public companies (notably HEP and JANAF). Revenues from general government assets amounted to HRK 2.6bn in the first nine months of 2014, of which public company revenues accounted for HRK 1.1bn, revenue from rents and concessions HRK 1.3bn and interest revenue HRK 0.2m. According to a decision of the State Office for State Property Management, HRK 870m in public company profits was required to be paid into the state budget during 2014. An amount of HRK 1.1bn has been paid in so far (mainly due to withdrawal of a portion of the profits realised by HEP Group). Also noteworthy is the amount of HRK 900m paid into the budget on account of the privatisation of the insurance company Croatia osiguranje (these revenues are recorded in the state budget financing account).

Budgetary and public sector finances. Neither the state budget nor the general government budget is a sufficient source of information for a successful government finance management. The Institute of Public Finance has warned about that fact for years, but now it has been formally confirmed by the European Commission as well. According to the Commission, the general government deficit and general government debt also include the liabilities of public companies, such as Hrvatske ceste (Croatian Roads Ltd), HŽ Infrastruktura (Croatian Railway Infrastructure Ltd), HRT (Croatian Radio Television), Hrvatske autoceste (Croatian Motorways Ltd), Rijeka-Zagreb Motorway, CBRD, State Agency for Deposit Insurance and Bank Rehabilitation, and Croatian Energy Market Operator Ltd. What is more, the general government deficit and debt will increasingly include the financial transactions of local government-owned companies.

Public sector borrowing requirements. The government will have to revise its financial reporting system, by correcting submission deadlines for reports to government-owned companies (so far the deadline was end-April) and including them in the current budget reporting scheme. This will provide a much sounder basis for establishing the real needs for borrowing of not only the general government budget but also the public sector. Changing the scope of management also includes *a new management philosophy*: instead of on the general government budget management (consolidated national budget and budgets of local units and extra-budgetary users), the focus is on the finance management of the entire public sector (general government and companies owned by government and local units). Parliamentary debates on the national budget will now have to include documents on the financial operations of public companies owned by government and local units. The financial management of public companies will have to be equally efficient and transparent as that of the national budget.

Management is the key issue. Croatia has neither a public debt management strategy nor is its public debt efficiently managed. Having this in mind, the Government should pass a Public Debt Act, formulate a public debt management strategy for the next two or three years and present public debt repayment projections for the period until 2025. In this context, the actual level of general government deficit and the amount and dynamics of general government debt are less of a problem than the lack of a strategic plan, operational measures and competent professionals for public debt management.