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PRESS RELEASES

A Commentary on the Croatian Economic and Fiscal Policy Guidelines 2018 – 2020

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The Croatian Government on July 27 adopted the [Economic and Fiscal Policy Guidelines 2018 – 2020](#) which show no significant difference from numerous previous guidelines, as concerns approach and content, except that they were adopted on time and planned to reduce budget deficit and debt. The format requirements, laid down by the current Budget Act, have more or less been satisfied. However, successful fiscal consolidation and the implementation of reforms necessary for economic growth call for a more prudent, comprehensive and transparent, as well as longer-term approach to the entire fiscal process which should include not only the central budget but also local budgets, extra-budgetary users and public companies.

How can the Guidelines really serve their purpose?

The purpose of any economic and fiscal policy guidelines for a three-year period is to enable the drafting of budget proposals, projections and financial plans of the central and local governments, extra-budgetary users and public companies within the government sector. As suggested by the very names of these documents, the *guidelines* should determine the orientation of public finance, whereas specific and detailed figures should be provided in *budget proposals, projections and financial plans*. It would therefore be expected that, once the guidelines have been published, also the public would first be focused on their contents, and only after publishing the budget proposal, on the actual figures as well. However, what with the long-standing bad shape of public finances and the relatively late publication of the guidelines, the discussion usually centers on figures (their rise or fall), without going into the overall long-term intentions and consequences of the increase or decrease in particular items relative to the overall government finances.

The Government deserves commendation for the timely issuance of the guidelines, which is a big thing in this country, because they are usually behind schedule. There were years when the guidelines were issued simultaneously with the budget proposal, which was naturally why they could not serve their intended purpose. But exactly this is the reason for changing the budget calendar and even the Budget Act, so that the guidelines would be issued much earlier in the year and submitted for parliamentary procedure and consultations with the interested public. For if the budget is the key financial document of a country, then the orientation of government finance is definitely important as well, and should therefore be a topic for public debate.

Indeed, as stated on the [Central Government Portal](#), „consultations with the interested public during the procedures of making laws and other regulations constitute an indispensable part of the modern democratic public policy management process, but also one of the key steps towards increasing the openness, accountability and efficiency of government bodies. The main purpose of such consultations and the inclusion of all participants in the process is to collect information on their attitudes, suggestions and interests regarding a particular public policy. This will improve the understanding and

acceptance of the policy goals, but also help detect hidden weaknesses and adverse effects of the public policy which need to be removed in time. The Government consults with the interested public in order to collect information on a wide range of experiences and attitudes relevant for policy formulation, taking into account the influence of suggestions on various groups of society.“

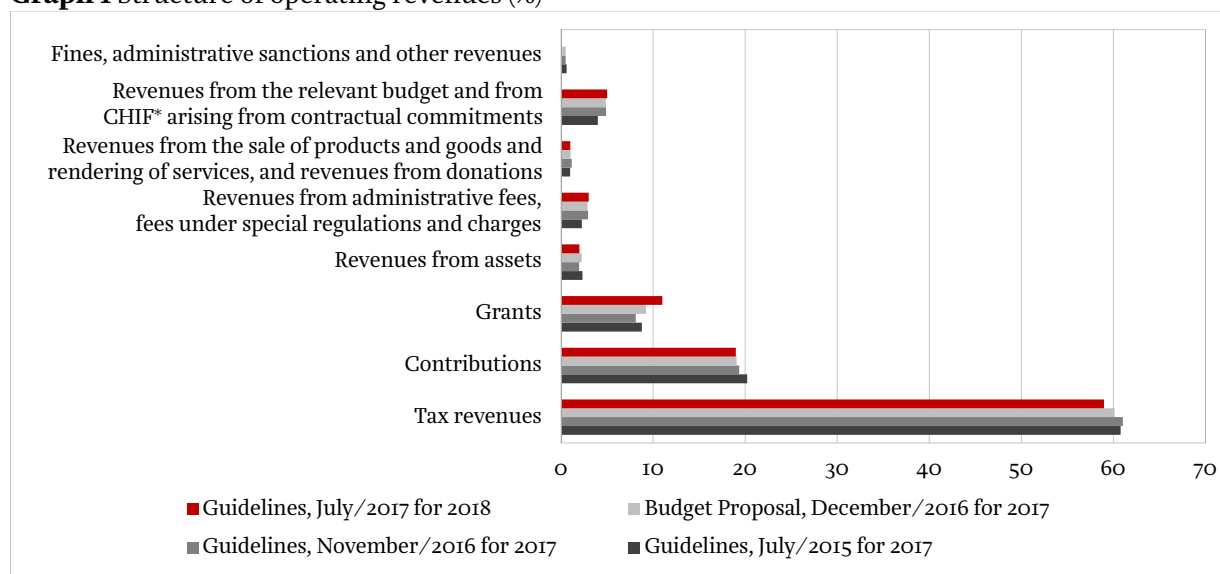
Just like the budget proposal, guidelines should be subject to consultations with the interested public, and this should have been regulated long ago. This would provide the Government with information on the views, suggestions and interests of the public and MPs regarding the Government’s intentions, for example, to procure fighter aircrafts, expand the rights of and intensify the care for Croatian homeland war veterans and their family members, repeal cuts in pension entitlements under special regulations or increase allocations for civil servants.

Are there any substantial differences between the new and most of the previous guidelines?

Looking only at key figures, the planned cuts in the deficit and debt are great news, but all the rest always seems to be more or less the same:

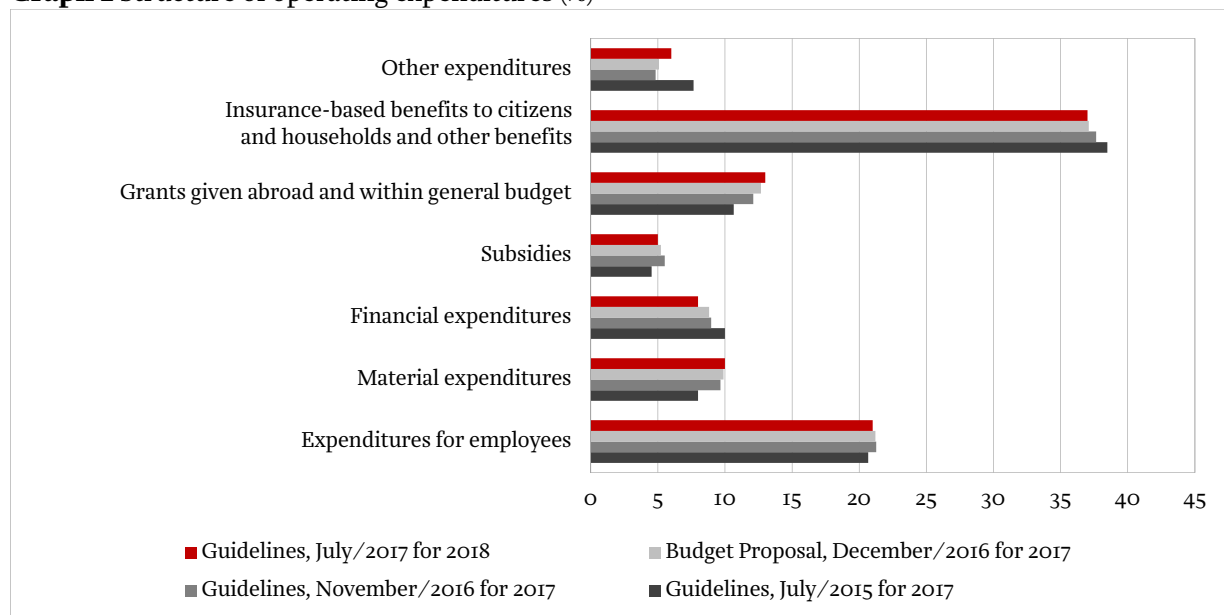
- Total central budget expenditures continue upwards in absolute terms; a major decline in their share in GDP (to below 34%) is not planned until 2020.
- While a reduction of tax burden is one of the main tax reform goals, the central budget's tax and contribution revenues, even without the personal income tax revenues transferred to local government units, are planned to grow steadily in absolute terms. Their share in GDP is planned to decline only slightly, exceeding 26% of GDP in all the observed years, even without the personal income tax revenues.
- Revenues from the sale of non-financial assets are planned to go up by 47% (from HRK 560m, planned in 2017 to HRK 823m in 2018). This increase is mainly expected from the „sale of flats and other construction facilities in state ownership, as well as plants and equipment“. Given the optimistic expectations of revenues from the sale of non-financial assets (nearly HRK 2.2bn in the period 2018-20), one cannot help remembering the figures from some of the previous guidelines, e.g. in 2016: HRK 629m (plan) vs. HRK 450m (outturn), or in 2015: over HRK 1bn (plan) vs. HRK 645m (outturn).
- Despite the announcements of reforms, the structure of revenues and expenditures seems to be predetermined. Governments change, reforms are announced, but the structure remains roughly the same. Graphs 1 and 2 show the projected structure of operating revenues and expenditures in 2018 according to the current Government's guidelines, as well as projections for 2017, made by previous Governments under the Guidelines from July 2015, Guidelines from November 2016 and the Budget Proposal from December 2016.

Graph 1 Structure of operating revenues (%)



* CHIF – Croatian Health Insurance Fund

Graph 2 Structure of operating expenditures (%)



- There are no major changes in the operating revenue structure. Due to the transfer of personal income tax revenues to local government units, the share of tax revenues is planned to decline a little, while the share of grants is planned to increase, thanks to the „significant increase in revenues from EU grants directly related to EU-funded projects, and direct payments in agriculture.“ It is only to be hoped that the expected 23.6% increase in grants (from HRK 11.2bn planned in 2017 to HRK 13.8bn 2018) will come true this time, which has rarely been the case so far. For example, the amount planned for 2016 was HRK 8.8bn and the outturn was HRK 7.8bn; for 2014, the plan was HRK 4.6bn and the outturn HRK 2.3bn; for 2013, the planned amount was HRK 2.2bn and the outturn HRK 1.8bn. The only exception was 2015, when the planned amount was HRK 3.98bn and the outturn HRK 4.96bn.
- As concerns operating expenditures, benefits to citizens and households and employee expenditures predominate, as usual, whereas all operating expenditures go up. The only exceptions are financial expenditures, due to more favourable terms of public debt servicing.
- As suggested by their very name, the Guidelines should relate to the overall economic and fiscal policy, and their purpose, according to the authors themselves, is „to define a framework for the financial plans of budget and extra-budgetary users, as well as companies owned by the RC“. Regrettably, however, the Guidelines only deal with the national budget in greater detail. Very little information is given about the orientation of the finance of extra-budgetary users, public companies and local government units, except for a few figures which indeed look scary (e.g. the 2018 deficit projection for the Croatian Roads company of as much as HRK 272.6m, or for Croatian Railway Infrastructure a high of HRK 739.9m. Fortunately, these deficits are planned to decline in the coming years).
- It is very encouraging, however, that the consolidated general government deficit is planned to decrease, according to the ESA methodology, from minus 1.3% of GDP in 2017 to plus 0.5% of GDP in 2020. Public debt is also planned to go down, from 81.8% of GDP in 2017 to 72.1% of GDP in 2020. It is exactly for this optimistic outlook that both the deficits and debt should have been elaborated in much more detail.

Is there a radically different approach to the fiscal process as a whole?

In order to be more successful in achieving the Government's economic and fiscal policy goals of „strengthening fiscal sustainability, promoting growth and development and providing adequate care to citizens“, and in order to be as efficient as possible in carrying out „comprehensive reform activities both on the revenue and expenditure sides of the budget“, much more should be done than just comply with the format laid down in the Budget Act. Although the Act has been amended several times, it dates

from 2008 and since then, there have been many changes in circumstances affecting the budget process. The EU membership involves certain obligations relating to documents, deadlines, coverage and methodologies. Moreover, experts from, for example, OECD or IMF promote new ideas of how to optimise budget management (by applying longer-term and programme planning, increasing transparency, fostering public participation in budgeting, enhancing government accountability, strengthening the role of independent institutions, etc.). It should be noted here that we are dealing with not only new administrative techniques, but completely new approaches and concepts of government finance management. As the Ministry of Finance has experts well acquainted with these concepts, the Government should introduce and support new ways of government finance management.

It is necessary to find a radically new - well-considered, comprehensive, longer-term and more transparent - approach not only to the national budget, but also, for example, to the health and pension insurance schemes, Croatian Roads and Croatian Railways. Otherwise, all that can be done is just plugging budget gaps and leading endless and futile discussions about insignificant percentage increases or decreases in certain budget items.