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PRESS RELEASES

Comments on the 2017 Croatian State Budget Proposal with Projections for 2018-19

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The Government of Croatia on December 8 adopted Proposals for the 2017 National Budget and Financial Plans of Extra-budgetary Users with Projections for 2018-19 and submitted them for parliamentary procedure. Although the documents definitely deserve endorsement, if only for the tight deadlines, it is a pity that the Government missed the opportunity to use its first term of office and its first budget, as well as the recent economic upturn and even slight growth of optimism in the economy for starting more aggressive fiscal consolidation.

As indicated in the explanation to the documents, „in order to address structural and fiscal vulnerabilities and strengthen favourable economic trends towards sustained and stable growth of economic activity and higher standard of living in Croatia...comprehensive and decisive reform measures are called for, both on the revenue and expenditure sides of the budget". As to the former, the proposal indeed reflects a tax system reform. However, when it comes to the expenditure side of the budget, the „comprehensive and decisive measures" are hard to identify, whereas total expenditures rise throughout the three-year period.

In the absence of any prevailing negative risks, especially the external ones, such as changes in the global economic growth and global trade dynamics, as well as movements in the world market prices of raw materials (primarily oil), which the Government is well aware of, the projected GDP growth of 3.2% in 2017 and 2018 and of 3.3% in 2019 is probably not overstated. What concerns us, however, is that the largest contribution to the growth is expected from domestic demand, the main generators of which are planned to be household consumption and gross fixed capital formation, while goods and services imports will continue to exceed the exports. Relying on domestic consumption in such a heavily indebted country like Croatia is hardly the best solution, and it is even questionable to what extent will the potential funds resulting from the tax reform be really poured into consumption. Moreover, some tax changes will lead to an increase in tax revenues, while others will cause their decline. Even the overall effect of the tax reform is uncertain. Similarly, it is hard to anticipate the effectiveness of the use of EU structural and investment funds (especially having in mind bad previous experiences) which are supposed to spur the growth of gross fixed capital formation.

All this leaves a lot of question marks about how to achieve the growth of budget revenues, (unfortunately) planned as a basis for continuous growth in expenditures. It is most regrettable that the Government failed to take a more aggressive approach to fiscal consolidation when planning its first budget in the first year of its term of office. So the question is whether this is all about a lack of political will or, perhaps, whether all parameters are fixed to such an extent that this would simply be impossible. To be more specific, a comparison between the Government's recent documents (the Guidelines from November and this budget proposal from December 2016) and, for example, the guidelines issued by the last Social Democratic Party (SDP) Government in July 2015 (not to go further into the past) shows no big differences in the structure of operating revenues, major tax revenues and operating expenditures (see graphs 1, 2 and 3). The same applies to the shares of revenues from the sale of non-financial assets which should average 0.4% of total revenues in all three documents. Differences are only seen in the shares of expenditures for the acquisition of non-financial assets that soared from 1.4% to 3.1% of total expenditures.

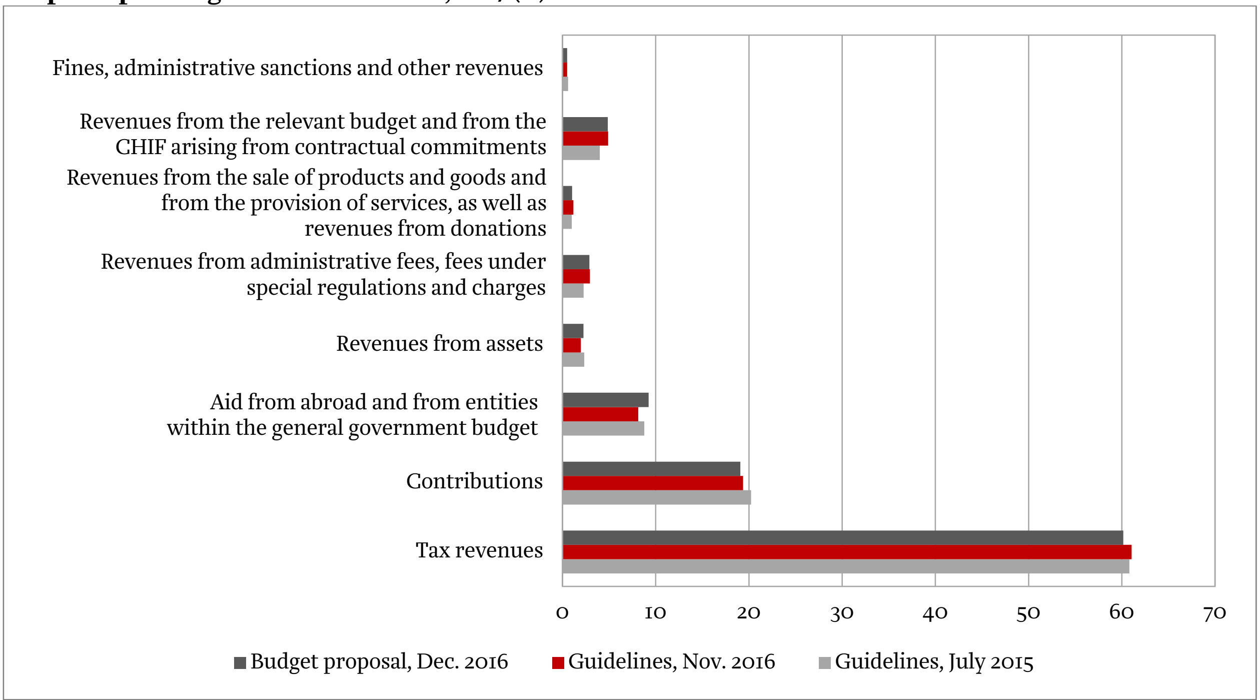
Despite the more or less constant national budget structure, there was a surprisingly sharp rise in total revenues and expenditures, by almost HRK 2bn in just a few days between the issuance of the guidelines and the adoption of the budget proposal. Over the couple of days, total revenues picked up by 2% and revenues from the sale of non-financial assets by as much as 36%. Total expenditures and operating expenditures also increased by 2% each. Among operating expenditures, the sharpest growth is seen in aid, material expenditures, expenditures for employees and other expenditures. Are such sharp changes (in only a few days) due to inadequately planned guidelines or strong (political) pressures coming from various budget users?

In any event, no „comprehensive and decisive measures“ to influence budget expenditures can be discerned in the budget proposal. However, the necessity for reform is best perceived in health care. The Ministry of Health's arrears are as high as 73% of the overall arrears of all ministries and other government bodies at the 'heading' level of the organisational classification; they jumped by 42% (from HRK 1.15bn to HRK 1.63bn in only nine months (January-September 2016). The Croatian Health Insurance Fund's (CHIF) arrears more than doubled over the same nine-month period (from HRK 500m to HRK 1.1bn). Hence, assuming that there are no mutual debts between the Ministry of Health and CHIF, health care alone reported arrears of HRK 2.75bn at the end of September.

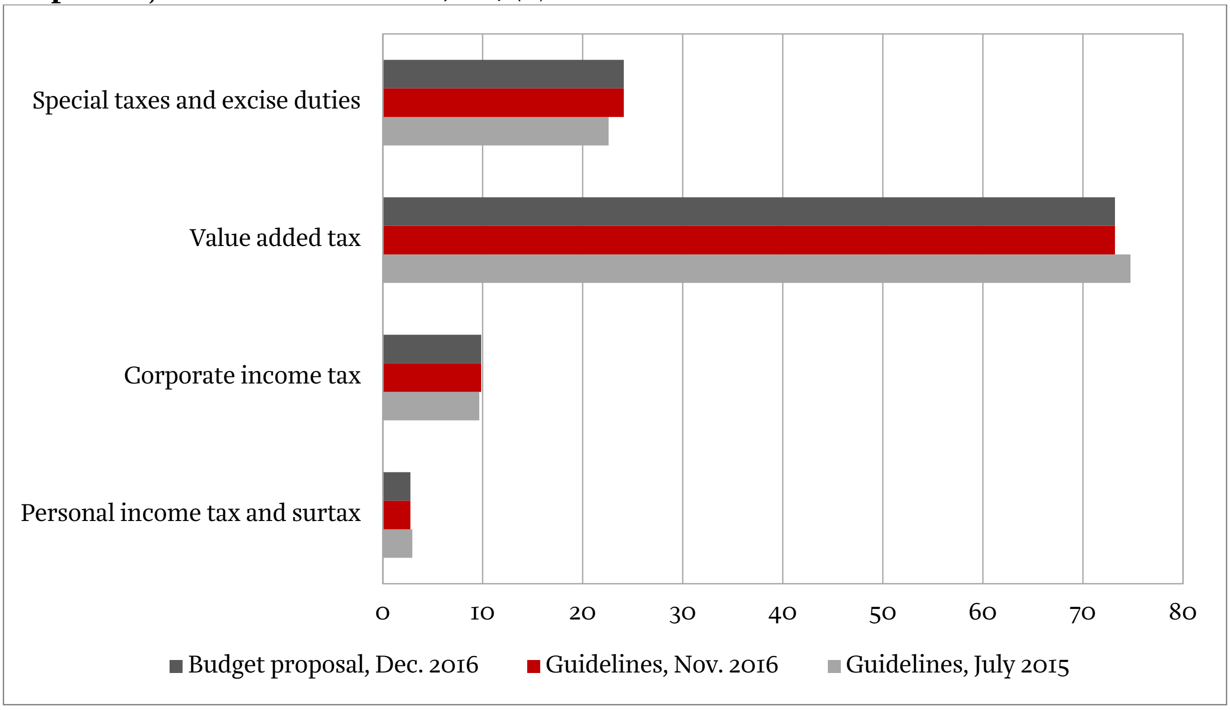
Regrettably, the proposal offers no ideas to resolve key issues, such as health care, for example, and what is surprising is the absence of two critical analyses. Firstly, despite the country's extremely high public debt, no analysis of its movement patterns has been carried out, neither has its amount ever been mentioned. Secondly, notwithstanding adverse global and domestic circumstances, no analysis of budget sensitivity to alternative macroeconomic scenarios has been made.

It is commendable, however, that the consolidated general government deficit ratio is planned to decline steadily (especially as compared with its much higher levels in previous years), i.e. from 1.6% of GDP in 2017 to 0.8% in 2019. That is, of course, assuming the projected GDP growth. Nevertheless, the structure of the consolidated general government deficit suggests a problem in the national budget, as both the extra-budgetary users and the consolidated local government are planned to run a slight surplus over the entire three year-period. This budget proposal shows that the Government missed the opportunity to make any major cuts in the consolidated general government deficit by reducing, instead of increasing, the expenditure side of the national budget. That is a pity, because the Government's first term of office and its first budget, the perceived economic upturn and even slight growth of optimism in the economy might have provided a good opportunity for more aggressive fiscal consolidation.

Graph 1 Operating revenue structure, 2017 (%)



Graph 2 Major tax revenue structure, 2017 (%)



Graph 3 Operating expenditure structure, 2017 (%)