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Croatian Central Government Debt: A New Angle

The recent financial crisis has led many governments to rescue their financial sectors through a combination of capital injections, toxic asset purchases and bank solvency guarantees. However, as the financial crisis developed into a full-blown global recession, governments are further providing the necessary fiscal stimulus to their economies. These measures have exerted huge pressure on government budgets, pushing them into large deficits. Britain is expected to run a deficit of 12% of GDP, while France's budget will come short 5.6% of GDP in 2009 (UK HM Treasury, 2009; Ministère du Budget, 2009). It is no wonder then that government debt is now being more closely scrutinized than before.

In Croatia, the media have often written about large government deficit and public debt. Indeed, for the past ten years the budget has been in deficit for every single year and, in absolute terms, our public debt has increased fourfold (CNB, 2009b). Although the government has initially remained unresponsive to the current recession, any prospect of a future fiscal stimulus or decreased tax revenues might further increase debt. However, as such debt accumulates it becomes increasingly important how it is financed and managed. Furthermore, to make meaningful conclusions we must also know how we compare to other countries.

In this respect, a comparison using OECD's standards on central government debt accounting can prove useful for two reasons. Firstly, it offers well-defined and more internationally comparable statistics in comparison to IMF's Special Data Dissemination Standard (2007). This will put Croatia's debt into perspective. Secondly, Croatian central government debt figures are not available in OECD format so this comparison could yield novel observations about its structure.

OECD standard on central government debt accounting

The OECD is an international organization that sets standards in many areas, and public finance is one of them. It publishes central government debt statistics on an annual basis in its Central Government Debt Statistical Yearbook. The OECD's definition of central government debt includes actual and potential liabilities borne by the central government, but excludes the debt created by local governments, municipalities and social security funds (OECD, 2006). For example, this means that when the Ministry of Finance issues bonds or borrows from banks, this is counted as central government debt. Government guarantees to shipyards are also counted. However, the liabilities accumulated by the City of Zagreb do not belong to the central government but to the local one. This is a standard that focuses on displaying debt for analytical and management purposes.

In the OECD's Central Government Debt Statistical Yearbook debt is accounted for in the model presented in the table 1.

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Table 1 OECD Central Government Debt

Marketable Debt	
Money market instruments	
Treasury Bills	
Commercial Paper	
Other	
Bonds	
Fixed Income Instruments	
Short-term	
Medium-term	
Long-term	
Index linked bonds	
Variable rate notes	
Other	
Memo items	
Marketable debt held by non-residents	
Marketable debt in foreign currency	
Weighted average maturity of marketable debt	
Weighted average yield of marketable debt	
Non-Marketable Debt	
Savings Bonds	
Other	
Memo item	
Non-marketable debt held by non-residents	

The model offers a different perspective on government debt than the IMF's guidelines. The division of debt into marketable and non-marketable components displays the financing methods of the government. Obtaining funds from markets is more transparent and usually cheaper than obtaining credit directly from banks. However, in less developed capital markets bank credit might sometimes prove a cheaper source of financing (Herring and Chatusripitak, 2000:42-43).

The classification of marketable debt by type of security gives an insight into the structure of financing instruments. For example, it displays how much debt has variable and how much fixed interest payments. It also breaks down the debt by maturity and the memo items provide important information such as the portion of marketable debt in foreign currency, weighted average maturity and weighted average yield, duration, etc. These statistics are important as they inform analysts, investors and researchers of the relative risks of interest rate changes, payment burden, cost of borrowing, etc., and they play an important role in government finance.

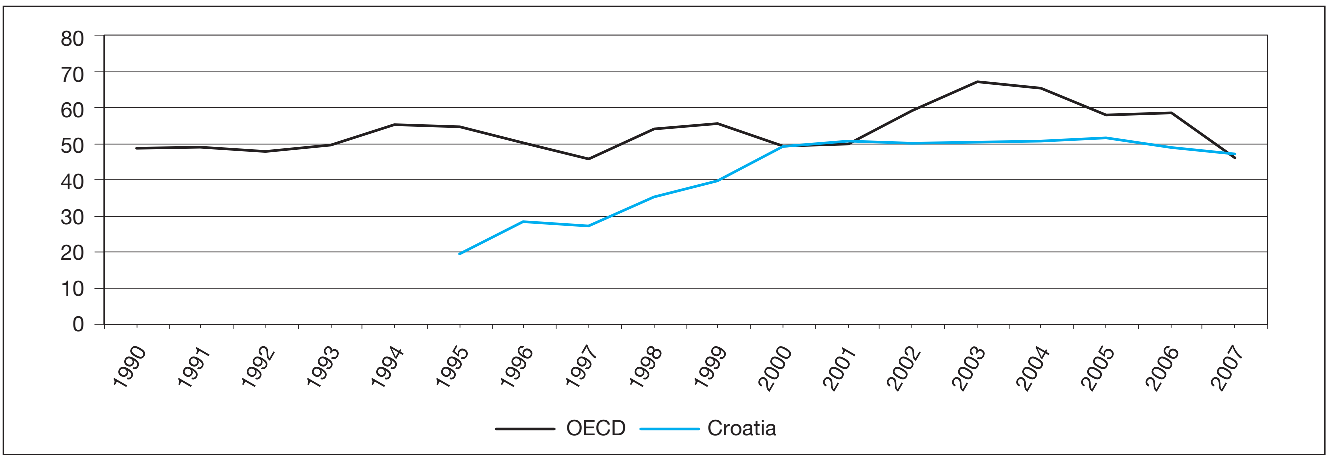
The non-marketable portion of debt is of a somewhat less defined category, as it includes bank loans, guarantees and sometimes the debt of governmental enterprises. This debt is more difficult to value and it is less transparent. Therefore, large amounts of non-marketable debt, especially compared to marketable debt, can be a reason for concern.

The OECD standard on central government debt accounting gives a direct and clear presentation of debt and its structure. This is useful, as the OECD also provides a dataset of its own members to which the Croatian debt can be compared.

Croatian debt in an international perspective

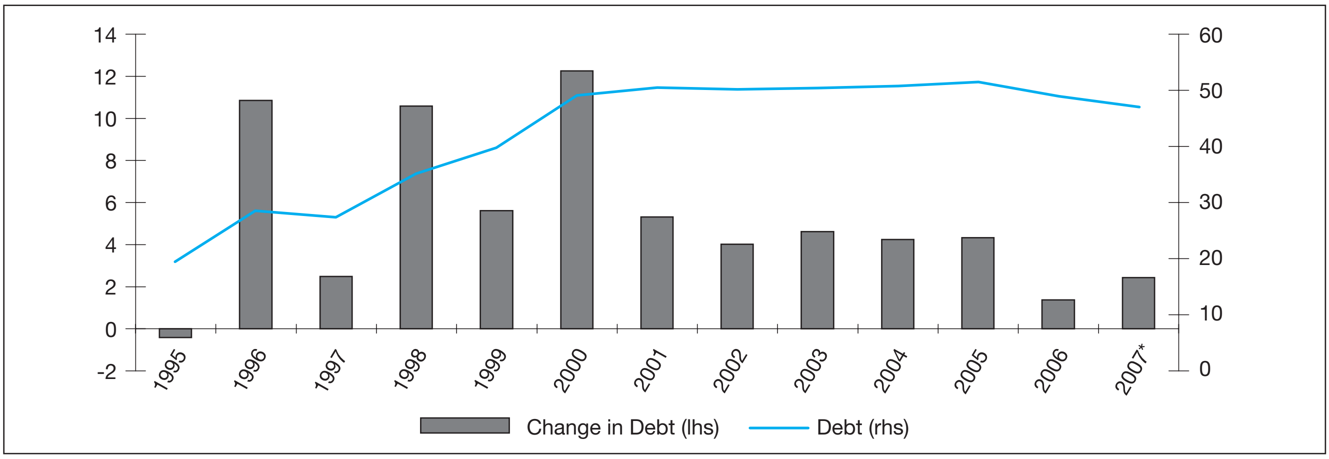
To construct an international comparison, the debt statistics reported by the Croatian National Bank were translated from the IMF format into the OECD standard. Due to the aggregation of reported data, some information, such as the amount of variable rate notes, the weighted average maturities and yield, is either unavail-

Graph 1 Central Government Debt: OECD vs Croatia (% of GDP)



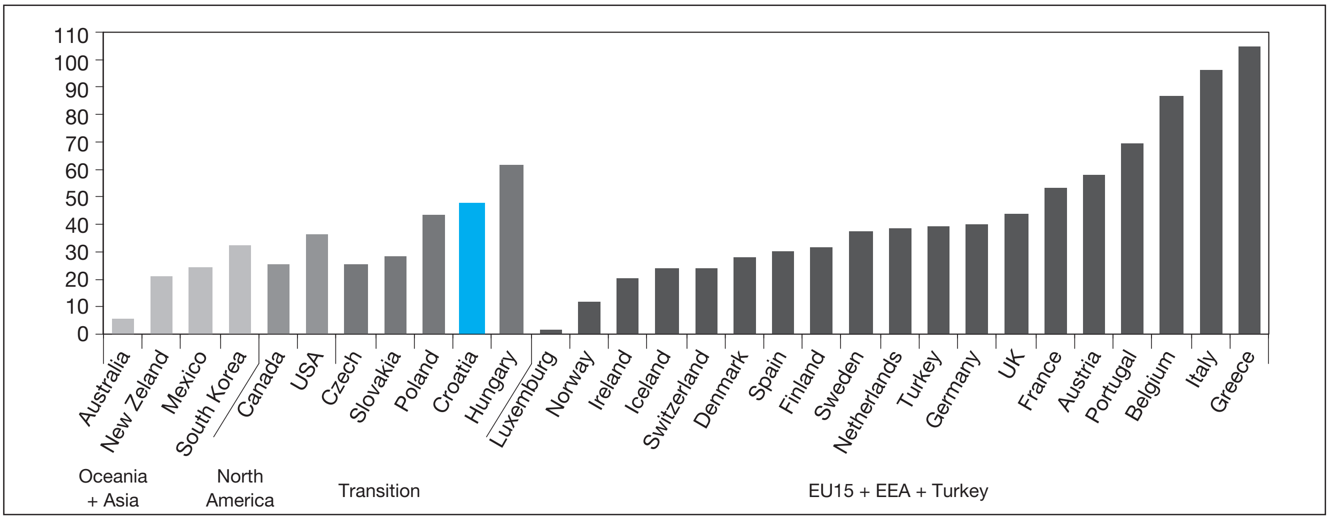
Source: Croatian National Bank

Graph 2 Croatian Central Government Debt (% of GDP)



Source: Croatian National Bank

Graph 3 Central Government Debt by Region in 2007 (% of GDP)



Source: OECD, Croatian National Bank

able or limited. Nonetheless, this does not impede the comparison.

So how does Croatia stand relative to other countries? The debt data on the OECD countries and Croatia is presented in Graphs 1 and 2. After the war, starting in 1996, the Croatian debt situation deteriorated markedly. In 1997, Croatia's debt-to-GDP ratio was 27.3% and it ranked 10th out of 30 OECD countries[1]. Debt reached a high of 51.6% of GDP in 2005, with a ratio higher than 73% of OECD members. It has receded since to 47.1%, but its ranking has slipped, and Croatia's debt-to-GDP ratio is currently higher than 75% of OECD members.

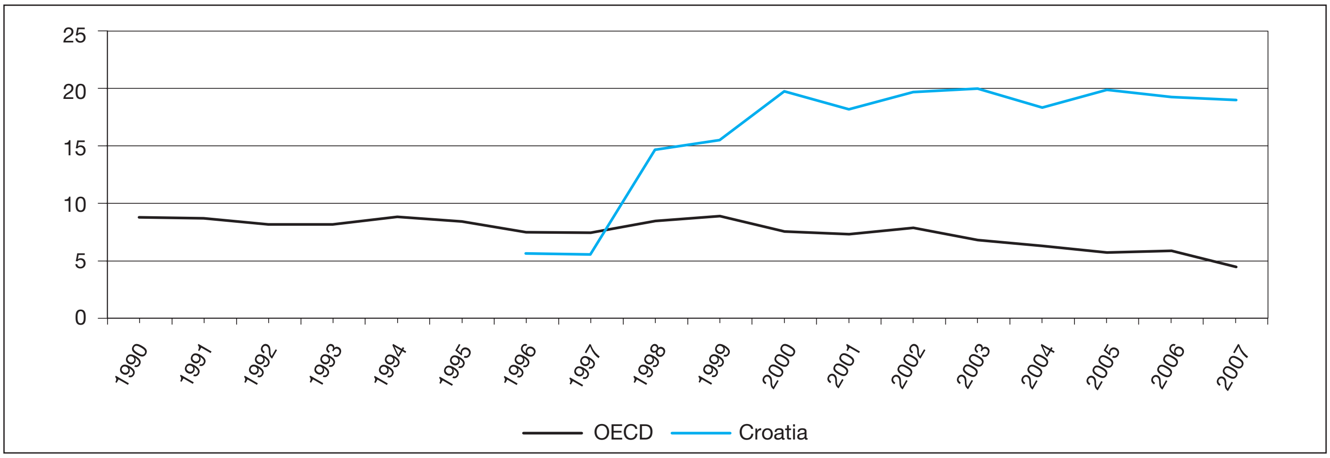
Countries with higher debt-to-GDP ratios than Croatia are France, Austria, Hungary, Portugal, Belgium, Italy and Greece[2]. Furthermore, if the OECD countries are grouped by region, as in Graph 3, among the transitional economies of Central and Eastern Europe Croatia ranks very high, second only to Hungary. In this respect, Croatia does have a huge debt.

Nonetheless, this may be slightly misleading for two reasons. Firstly, the highly indebted countries have a debt-to-GDP ratio ranging from 52.9% in France to 104.7% in Greece (refer to Graph 3). Indeed, the median of the OECD group is 34.1%, and the average debt is 39.4% of GDP. So, even if the Croatian debt exceeds 75% of OECD's members, it is not so large. Secondly, debt-to-GDP ratios are dynamic, and the recent financial crisis and coming global recession will result in higher absolute debt and higher debt-to-GDP ratios for many coun-

[1] Higher ranking indicates lower debt-to-GDP ratio.

[2] Excluding Japan due to data unavailability.

Graph 4 Non Marketable Debt: OECD vs Croatia (% of GDP)



Source: OECD, Croatian National Bank

tries. Governments across the world are spending unprecedented amounts to stimulate their economies. Combined with falling tax revenues, which is usual in recessions, some OECD governments' deficits are deteriorating. For example, the 2008 budget deficits for Great Britain and France were 2.7% and 3.2% respectively, and they are estimated to be 12% and 5.6% in 2009 (UK HM Treasury, 2009; Ministère du Budget, 2009). By contrast, Croatian budget deficit for 2008 was 1.7% and is estimated to be 3% according to the CNB's Financial Stability Report (2009a:17). Therefore, the OECD data will certainly show a different picture for 2008 and 2009, with Croatia improving its standing in the international comparison.

Thus, while the Croatian debt-to-GDP ratio rapidly increased in the period from 1995 to 2001, and ranked higher than those in most OECD countries in 2007, it is on the lower end of the spectrum of larger debtors. Furthermore, due to heavy recent spending and a shortfall in tax revenues in some OECD countries, Croatia's status in the international comparison is likely to improve.

Transparency: Marketable versus non-marketable debt

The level of debt, however, only gives a partial picture of a nation's public finances. What also matters is the composition of such debt, that is, how it is financed. The OECD standard on central government debt reporting uniquely divides debt into marketable and non-marketable parts. It further breaks down marketable debt by type of instrument. This is important because it generates transparency. Marketable debt is public by definition and provides information on its risks. Non-marketable debt is much less transparent, since the contract details of bank loans, for example, are not publicly available. It is also important because of the market discipline. Marketable debt is continuously valued and can provide strong signals to the government regarding fiscal balances. Non-marketable debt, on the other hand, is obscure and difficult to value.

When Croatia's debt is decomposed into its marketable and non-marketable constituents, a comparison with OECD offers an interesting insight. While non-marketable debt as a percentage of GDP has generally declined in the OECD countries, it has rapidly increased in Croatia. It reached a high of 20% of GDP in 2003, mildly receding to 19% in 2007. More interestingly, though, the ratio of marketable to non-marketable debt has been decreasing since 1995 and it has been by far the lowest than in any other OECD country since 2001.

Indeed, if one looks closely at the figures, non-marketable debt has grown at a faster pace than marketable debt.

Table 2 Structure of Debt in Period 1996-2007 (% of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
ΔDept/GDP	10.9	2.5	10.6	5.6	12.3	5.3	4.0	4.6	4.2	4.3	1.4	2.4
Marketable	72.8	74.4	8.4	77.3	56.1	100.4	23.5	56.1	103.0	34.0	33.9	40.5
Non-Marketable	27.2	25.6	91.6	22.7	43.9	-0.4	76.5	43.9	-3.0	66.0	66.1	59.5
Guarantees	0	0	62.3	0.2	24.5	18.8	13.4	-7.5	-34.9	1.6	48.8	47.7

Source: Croatian National Bank, author's calculations.

For example, in 2007 the former accounted for 59.5% of the increase in total debt, as shown by Table 1. This suggests that debt has been more financed and re-financed through non-market channels, such as bank credit, than through market channels, such as treasury bills and bonds. This is true, although the issued government guarantees for companies have occasionally contributed heavily to the increase in non-marketable debt. For example, in 1998 issued guarantees accounted for 62.3% of the debt increase and in 2006, they accounted for 48.8% of the increase in the Croatian central government debt.

Croatia compares unfavorably to the rest of OECD countries in this respect, because its public debt has actually been getting less transparent. Interest rates on bank credit and credit conditions are not readily available and guarantees, despite the availability of some relevant information on the Ministry of Finance's website, can be quite complex to understand.

The OECD comparison also suggests that the government could have done more to develop the domestic market. Indeed, in the Strategy for Debt Management in 2007 report, the Ministry of Finance (MF, 2007: 5) outlines this as one of its priorities. However, in 2007 non-marketable debt accounted for two thirds of the total increase in debt, while in the preceding years this portion was usually less than a half of the total. Thus, the domestic market development seems to have been a priority on paper rather than in reality.

Room for improvement

The comparison with the OECD central government debt also reveals several other non-transparent features of the Croatian public debt. The memo items that most OECD countries disclose indicate the important characteristics of public debt. Some of this information is disclosed in the Ministry of Finance's Strategy for Debt Management in 2007 report. For example, the Ministry reports (MF, 2006: 9-22) the percentage and composition of foreign currency debt, as well as the percentage of debt with variable interest. However, it is not clear if the latter refers to bonds or bank loans. The report also briefly mentions the debt portfolio duration, but it does not indicate the weighted average interest rate. The information is disclosed only in the report, and no tabulated historical data are available on demand. Moreover, this report is outdated as it has not been updated for over two years.

To be fair, the transparency of Croatian public finances has improved over the years. Bajo (2003) identified several areas for improvement, and some have already been improved. For example, information regarding government guarantees has been improved, a computerized debt tracking system and the accounting harmonization between the Ministry of Finance and the Croatian National Bank have been introduced, and access to data has been facilitated. However, there is still room for improvement.

The Croatian Ministry of Finance should provide better and timelier access to public debt data in order to improve transparency and accountability. This entails making detailed historical public debt data available online, as well as publishing related reports and announcements in a timely fashion. A good example to follow would be the United Kingdom's HM Treasury website. Indeed, Croatia is still classified in the group of countries disclosing 'some (budget) information', according to the latest Index on Budget Openness, despite a modest improvement (Bađun and Urban, 2009). By contrast, other ranked transition countries, such as Czech Republic and Poland, were classified as providing 'significant [budget] information' (OBS, 2008: 7).

Establishing an executive OECD-style debt management office would further improve debt management. Croatia has a Debt Management Office, but its objectives and operational responsibilities are unclear. Therefore, it is necessary to separate it from the Ministry of Finance and set well-defined objectives and responsibilities. This would allow for greater sophistication of financial and debt management and help recruit and retain debt specialists through market-based compensation (World Bank, 2007). Similar debt management offices in OECD countries, like Sweden, also manage cash and contingent liabilities such as government guarantees. This would particularly be useful for Croatia, as guarantees account for a large share of its debt. Consequently, a well-established debt management office would also increase transparency and accountability (Blommestein, 2002: 17).

In this regard, a comparison with the OECD standards points to further areas to work on.

Conclusion

Croatia's central government debt is an important issue, and especially more so in the context of the global recession and record budget deficits in some of the major world economies. A comparison with the OECD countries' debt sheds a new light on Croatian public debt and provides interesting insights.

The first insight is that Croatia's debt as a part of GDP is relatively high, although its debt levels differ greatly from some of the heavily indebted countries, such as Portugal or Greece. This standing is probably also set to improve if Croatia exercises fiscal discipline while other governments' increase their debt levels.

The second insight reveals a less favorable aspect of the Croatian public debt. A large portion of Croatia's debt consists in non-marketable debt due to reliance on bank credit and issuance of guarantees. As a result, the non-marketable debt is by far the highest among the OECD members, both as a percentage of GDP and as a ratio to marketable debt. This raises concerns about public debt transparency, as non-marketable debt is more obscure and information about it is less accessible.

The comparison also highlights the aspects of public debt transparency that could be improved. These include:

- The setting up of a separate Debt Management Office outside the Ministry of Finance, with clear objectives as regards to the government's financing needs;
- A more comprehensive and timelier disclosure of public debt data that includes information on weighted average interest rates, average yield and debt duration;
- Additional OECD-style reports that enable and facilitate international comparison.

The Croatian government has indeed enhanced debt transparency over the years, but it still has plenty of room for improvement in order to sustain this trend.

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