

Revising the budget in Croatia: yes, but ... for whom and why?

By [Sandrine Levasseur](#)

Under the [excessive deficit procedure that Croatia has been subject to since 28 January 2014](#), the country's government has been obliged to revise its projected budget for the forthcoming three years, which is the timeframe that has been set for putting its finances into "good order", with "good order" being understood to mean a public deficit that does not exceed 3% of GDP. This new budget is being fixed in adverse economic conditions, as the government's forecast of GDP growth for 2014 has been revised downward from 1.3% to a tiny 0.2%.

Paradoxically, the new budget could help prolong the recession in the country rather than help it recover, at least in 2014. This paradox is especially worth noting since this is also the opinion of those for whom the Croatian government is making this adjustment: first of all, the [rating agencies](#), and second, the international institutions (or at least [the IMF](#), as the European Commission has to keep quiet on the matter). In fact, a simple glance at the revised budget is enough to see that the fiscal adjustment being proposed by the Croatian government will not have an expansionary impact on GDP. For example, the budget provides for a hike in tax revenues, in particular through an increase in the rate of health insurance contributions from 13% to 15%. But this will also result in undermining the [international competitiveness of the country's businesses](#), which have already been hit hard.

The wages and bonuses of civil servants will fall (by about 6%) so as to give the public finances some breathing room. But

these cuts in civil servant salaries will not help perk up domestic demand, which has been anaemic due to the [adjustments consumers and businesses have made in their balance sheets](#). To take the latest example, to help bail out the state finances the profits of state enterprises will not be reinvested in the economy. However, the country is thereby depriving itself of a source of growth since, because of their weight in the economy, these enterprises account for a large [share of productive investment](#).

There is no doubt that Croatia's public finances need to be cleaned up. However, the horizon for the fiscal consolidation decided on by the Croatian government seems to us extremely "short-termist", as it doesn't call into question the existing model of growth or seek sources of sustainable growth. A few weeks ago, in an [OFCE note](#) we discussed the impact alternative fiscal adjustments would have on growth and the public finances. In the specific [case of Croatia](#), the government cannot avoid the need to consider doing the following: restructuring the productive apparatus (including through privatization and concessions); improving the system of tax collection; and, more broadly, implementing an anti-corruption policy to improve the country's "business climate". In the meantime, in large part due to the fiscal decisions being taken, 2014 is likely to wind up as the sixth year in a row Croatia has been in recession. The IMF forecasts, which anticipate that the recessionary impact of the fiscal consolidation will be greater than that projected by the Croatian government, [is expecting GDP to fall by about 0.5% to 1%](#) in 2014. In total, the decline in GDP since 2009 will therefore come to between 11.6% and 12.5%. It's not exactly the stuff of dreams....