EUROPEAN
COMMISSION

Brussels, 15.11.2013
COM(2013) 905 final

REPORT FROM THE COMMISSION

Croatia

Report prepared in accordance with Article 126(3) of the Treaty

REPORT FROM THE COMMISSION

Croatia

Report prepared in accordance with Article 126(3) of the Treaty

1. LEGAL BACKGROUND

Article 126 of the Treaty on the Functioning of the European Union (TFEU) lays down the excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1], which is part of the Stability and Growth Pact (SGP).

According to Article 126(2) TFEU, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) TFEU stipulates that, if a Member State does not fulfil the requirements under one or both of the above criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

This report, which represents the first step in the EDP, analyses whether Croatia is compliant with both the deficit and debt criteria of the Treaty, with due regard to the economic situation and other relevant factors.

Following the amendments to the SGP in 2011, the debt requirement has been put on an equal footing with the deficit requirement in order to ensure that, for countries with a debt-to-GDP ratio above the 60% reference value, the ratio is brought below (or sufficiently declining towards) that value.

Data notified by the authorities in autumn 2013[2] and subsequently validated by Eurostat[3], show that the general government deficit in Croatia reached 5% of GDP in 2012, while the debt ratio stood at 55.5% of GDP.

---

[1] OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 3 September 2012, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/legal_texts/index_en.htm .

[2] According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Croatia can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/excessive_deficit/edp_notification_tables.

[3] Eurostat news release No 152/2013 of 21 October 2013.

According to the 2013 Economic and Fiscal Policy Guidelines[4], a document produced on 26 September in preparation of the budget, which does not however apply the ESA 95 methodology[5], the general government deficit in Croatia is planned to remain above the 3% of GDP reference value in the years between 2013 and 2016. In the same Guidelines, the general government debt ratio is projected to breach the 60% reference value by the end of 2014. The Commission 2013 Autumn forecast projects the general deficit significantly above the 3% of GDP reference value in the period 2013-2015, while the debt ratio is forecast to breach the 60% reference value as of 2014. Even when adjusted for cyclical effects the general government debt ratio remains above the 60% reference value at the end of 2014.

Table 1. General government deficit and debt (% of GDP)[6]

		2010	2011	2012	2013		2014		2015	
					COM	National authorities	COM	National authorities	COM	National authorities
Deficit criterion	General government balance	-6.4	-7.8	-5.0	-5.4	-3.6	-6.5	-5.5	-6.2	-5.1
Debt criterion	General government gross debt	44.9	51.6	55.5	59.6	56.6	64.7	60.6	69.0	63.4
	General government gross debt adjusted for the effect of the cycle						62.8			

Source: Eurostat, COM 2013 Autumn Forecast, National authorities (EDP notification, 2013 Economic and Fiscal Policy Guidelines).

The draft budget for 2014 has not yet been presented. However, according to the projections in the 2013 Economic and Fiscal Policy Guidelines, the planned general government deficits for the years 2013, 2014 and 2015, which continue to be above 3% of GDP, together with the projected general government gross debt ratio in 2014 and in 2015 above 60%, provide *prima facie* evidence on the existence in Croatia of an excessive deficit based on the deficit criterion and of the risk of a breach of the debt criterion in the sense of the SGP. The Commission has therefore prepared the following report to comprehensively assess the excess over the reference values, in order to conclude whether this merits the launch of an EDP. Section 2 of the report examines the deficit criterion. Section 3 examines the debt criterion. Section 4 deals with public investment and other relevant factors. The report takes into account the Commission 2013 Autumn forecast, released on 5 November 2013.

---

4 The 'Economic and fiscal policy guidelines for 2013' can be accessed at http://www.mfin.hr/hr/smjernice-ekonomske-ifiskalne-politike.

5 Deficit estimates for 2009-2012 based on ESA95 are between 1.5 and 3.3 percentage points higher than those reported according to the national methodology. Differences stem mainly from the fact that deficit figures according to ESA95 include certain guarantees payments, debt assumptions and the repayment of the debt to pensioners. Note also that the Guidelines were published on 26 September 2013 and therefore do not take into account the higher deficit and debt figures for 2012 notified by the statistical office.

6 The cyclically-adjusted debt is computed as:

$$\left(\frac{B_t}{Y_t}\right)^{3-years\ -adjusted} = \left(\frac{B_t + \sum_{j=0}^{2}\left(C_{t-j}\right)}{Y_{t-3}\prod_{h=0}^{2}(1+y_{t-h}^{pot})(1+p_{t-h})}\right)$$

where Bt stands for debt, Yt for GDP at current price, ypot for potential growth, pt for the price deflator of GDP, Ct for the cyclical part of the budget balance. The cyclical components and potential growth are calculated according to commonly agreed methodologies.

2. DEFICIT CRITERION

The authorities currently plan a deficit of 3.6% of GDP for 2013, after 5% in 2012, and expect it to increase further in 2014 and 2015. According to the Commission 2013 Autumn forecast the deficit will be well above the 3% of GDP Treaty reference value in the period 2013-2015. Thus, planned and forecast deficits are above and not close to the Treaty reference value.

The excess of the deficit over the 3% of GDP reference value results in part from a severe economic downturn in the sense of the SGP. Croatia is in a protracted recession that started in 2009 with the onset of the global financial crisis, which led to a reversal of foreign capital flows that had supported economic activity during the pre-crisis years. Domestic demand also contracted severely as the crisis unfolded. This resulted in five years of falling economic activity, with a brief intermission in 2011, when the economy stagnated. The protracted recession was the combined result of a worsening external environment, a deteriorating labour market, on-going deleveraging from a significant private debt overhang, as well as fiscal consolidation measures that negatively impacted on capital expenditure and household spending.

Structural weaknesses exacerbated the contraction of domestic demand[7]. Net exports made a positive contribution to growth largely on account of a sharp fall in imports induced by weak demand from both households and businesses. Export performance remained fragile, also reflecting the low competitiveness of domestic producers and Croatia's narrow export base. Thus, in 2012 the negative output gap, which had opened up at the onset of the recession, widened again.

Table 2: Macroeconomic and budgetary developments [a, b]

	2010	2011	2012	2013		2014		2015	
	COM	COM	COM	COM	National authorities	COM	National authorities	COM	National authorities
Real GDP (% change)	-2.3	0.0	-2.0	-0.7	0.2	0.5	1.3	1.2	2.2
Potential GDP (% change)	-1.1	-1.6	-1.4	-1.0	n.a.	-0.3	n.a.	0.5	n.a.
Output gap (% of potential GDP)	-3.4	-1.9	-2.4	-2.1	n.a.	-1.3	n.a.	-0.7	n.a.
General government balance	-6.4	-7.8	-5.0	-5.4	-3.6	-6.5	-5.5	-6.2	-5.1
Primary balance	-4.2	-5.2	-1.9	-1.9	n.a.	-2.4	n.a.	-1.5	n.a.
One-off and other temporary measures	0.0	0.0	0.0	-0.4	n.a.	0.0	n.a.	0.0	n.a.
Government gross fixed capital formation	2.4	2.3	2.0	2.1	n.a.	2.4	n.a.	2.7	n.a.
Cyclically-adjusted balance	-4.9	-7.0	-3.9	-4.5	n.a.	-5.9	n.a.	-5.9	n.a.
Cyclically-adjusted primary balance	-2.7	-4.4	-0.9	-1.0	n.a.	-1.8	n.a.	-1.2	n.a.
Structural balance [c]	-4.9	-7.0	-3.9	-4.1	n.a.	-5.9	n.a.	-5.9	n.a.
Structural primary balance	-2.7	-4.4	-0.9	-0.6	n.a.	-1.8	n.a.	-1.2	n.a.

Notes:

[a] In percent of GDP unless specified otherwise.

[b] Cyclically adjusted and structural balance of the COM have been calculated using the updated elasticity endorsed by the EPC in November 2013.

[c] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Eurostat, COM 2013 Autumn Forecast, National authorities (EDP notification, 2013 Economic and Fiscal Policy Guidelines).

Altogether, the depth and length of the economic contraction can be considered a key factor driving the strong deterioration in public finances since 2009, even though other aspects of fiscal policy, including the take-over of debt from state-controlled enterprises and health care entities, also played a role. Moreover, discretionary policy measures, such as the reduction of social contributions to the health sector or changes in the system of corporate income taxation

7 See also the Commission services' Staff Working Document, assessing the Economic Programme of Croatia, in the context of the country's voluntary participation in the 2013 European semester: http://ec.europa.eu/europe2020/pdf/nd/swd2013_croatia_en.pdf.

have added to the deficit and partly account for the deterioration in the structural balance in 2013[8]. All in all, the rise in headline deficits can be considered to a substantial degree exceptional.

However, the excess over the 3% of GDP reference value is not temporary in the sense the Stability and Growth Pact. In particular, the budgetary forecasts as provided by the Commission indicate that the deficit will remain significantly above the reference value not only in 2013 (at 5.4% of GDP), but also in 2014 and 2015 (with a headline deficit projected to remain above 6% of GDP), when the economy is expected to expand again and economic growth is projected to move above its potential rate.

The budgetary projections of the Commission 2013 Autumn Forecast take into consideration the 2013 Economic and Fiscal Policy Guidelines leading up to the 2014 budget proposal, that were approved by the government on 26 September, before the 2013 fiscal notification was published. However, the Commission baseline projections do not take into account medium-term fiscal consolidation measures announced in late September 2013 along with the publication of the Guidelines, as they were not sufficiently specified. According to the authorities, the intended consolidation package will consist of measures on both the revenue and the expenditure side that are projected to produce savings of HRK 2 billion (approximately 0.6% of GDP) in 2014 and HRK 4 billion (some 1.2% of GDP) in 2015 compared to the baseline. Even if realised fully, the impact would still fall well short of what would be required to bring the headline deficit close to or below the 3% of GDP reference value in 2014 and 2015. Finally, the announced but not yet adopted revision of the 2013 budget is expected to have only an effect on the very last part of the year and would not substantially alter existing trends.

In sum, the deficit is not close to the 3% of GDP reference value, and although the excess over the reference value could be considered partly as exceptional in the sense of the SGP, it cannot be deemed temporary. The analysis suggests that the deficit criterion in the Treaty is not fulfilled.

3. DEBT CRITERION

According to the Eurostat notification, of 21 October 2013 from 2009 to 2012 the general government gross debt ratio in Croatia increased by almost 20 percentage points from 36.6% in 2009 to 55.5% in 2012. This increase was mainly driven by the accumulation of persistent deficits on the back of a protracted recession. The impact of a string of negative primary balances (except in 2012) was compounded by debt-increasing "snowball" effects on the back of rising interest expenditures. However, the debt ratio was also impacted by sizeable debt assumptions by the government, in particular the transfer of debt of some public and state-owned enterprises, such as several now privatised shipyards. Stock-flow adjustments had a debt-increasing impact of about 1.3 percentage point of GDP in 2010. On the other hand, in 2012, the contribution of stock-flow adjustments to the debt level equivalent was negative, due to decrease of government financial assets.

[8] The Commission services' Staff Working Document on the 2013 Economic Programme of Croatia noted that the changes introduced in corporate taxation "can decrease the effective corporate income tax but also narrow the tax base".

Table 3: Debt dynamics

	2010	2011	2012	2013	2014	2015
Government gross debt ratio	44.9	51.6	55.5	59.6	64.7	69.0
Change in debt ratio [b] (1 = 2+3+4)	8.2	6.7	3.9	4.1	5.1	4.2
Contributions:						
• Primary deficit (2)	4.2	5.2	1.9	1.9	2.4	1.5
• "Snowball" effect (3)	2.7	1.7	3.0	2.9	2.7	2.7
of which:						
Interest expenditure	*2.2*	*2.6*	*3.0*	*3.5*	*4.1*	*4.7*
Real GDP growth	*0.8*	*0.0*	*1.0*	*0.4*	*-0.3*	*-0.7*
Inflation (GDP deflator)	*-0.3*	*-0.9*	*-1.0*	*-0.9*	*-1.1*	*-1.2*
• Stock-flow adjustment (4)	1.3	-0.2	-1.1	-0.7	0.0	0.0

Notes:

[a] In percent of GDP.

[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.

Source: Eurostat, COM 2013 Autumn Forecast.

In the 2013 Economic and Fiscal Policy Guidelines, the government foresees an increase in the debt-to-GDP ratio from 56.6% of GDP in 2013 to 60.6% of GDP in 2014, thus above the reference value in the Treaty, and further to 63.4% of GDP in 2015 and 65.3% of GDP in 2016.

In the Commission Autumn 2013 forecast, the general government debt ratio is projected to increase to 59.7% of GDP in 2013. On unchanged policies, the debt ratio is expected to rise above 60% of GDP in 2014, thus exceeding the 60% of Treaty reference value.

Article 2(1a) of Regulation 1467/97 stipulates that the requirement under the debt criterion shall also be considered to be fulfilled if the budgetary forecasts of the Commission indicate that the required reduction in the differential with respect to the reference value will occur over the three-year period encompassing the two years following the final year for which the data is available. As the Commission forecasts as well as the plans and forecasts of the authorities show that debt is on a steep upward trend and is expected to remain so in the forecast horizon, without changes in policies the forward-looking debt benchmark is not fulfilled.

In view of these trends over the forecast horizon up to 2015 the debt-to-GDP ratio is not considered as "sufficiently diminishing and approaching the reference value at a satisfactory pace" in the sense of the SGP. This analysis suggests that the debt criterion in the Treaty is not fulfilled.

4. RELEVANT FACTORS

Article 126(3) of the TFEU provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors, including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration.

According to Article 2(4) of the Regulation, "when assessing compliance on the basis of the deficit criterion, if the ratio of the government debt to GDP exceeds the reference value, those factors shall be taken into account […] only if the double condition of the overarching principle – that, before these relevant factors are taken into account, the general government deficit remains close to the reference value and its excess over the reference value is temporary – is fully met. However, those factors shall be taken into account in the steps leading to the decision on the existence of an excessive deficit when assessing compliance on the basis of the debt criterion." Finally, Article 2(5) of the Regulation provides that the implementation of pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar should be considered in all assessments in the framework of the excessive deficit procedure.

In view of the above provisions, the following subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); (3) the developments in the medium-term government debt position, its dynamics and sustainability; (4) other factors put forward by the Member State; and (5) pension reforms as mentioned above.

4.1. Medium-term economic position

Cyclical conditions and potential growth. The growth rate of potential output in Croatia, as estimated by the Commission services according to the commonly agreed method has plunged sharply since the onset of the crisis. It averaged 3.2% in the 2004-08 period, stagnated in 2009, turned negative in 2010 and has been negative since then. The contraction of potential output is caused by declining contributions of labour inputs (due to a decreasing participation rate) and the estimated negative contribution of total factor productivity in the period 2007- 2013, which points to structural weaknesses compounding cyclical trends. Moreover, the positive contribution of capital also declined over the crisis period, due to the plunge in investment. Average real GDP growth in 2004-08 exceeded potential growth. However, economic activity is estimated to have contracted by close to 12% between 2009 and 2012 compared to the peak in 2008. Real GDP is even projected to contract further in 2013, with a slight recovery expected only in 2014. The rate of economic growth is expected to gradually pick up in 2015 on unchanged policies. As a result of these developments, the calculated output gap, which had been negative since 2009, is expected to gradually narrow over the forecast period yet remain negative through 2015, confirming the depth and the extension of the recession.

Recent structural reforms. Croatia participated in the 2013 European semester on an informal basis. To this end, in April 2013 the country voluntarily submitted an economic programme, providing information on the macroeconomic outlook and fiscal policy as well as on the future government reform plans in a broader range of fields. A qualitative assessment of this programme was provided by Commission services in a dedicated Staff

Working Document.[9] However, as Croatia had not yet acceded as an EU Member State, the Commission did not formulate any proposals for country specific recommendations.

Overall, welcome efforts to fight tax evasion, e.g. through the introduction of cash registers, seem to constitute the most tangible progress in the fiscal domain in 2013. With respect to structural measures aimed at addressing a wider range of challenges (including those identified in the Commission Staff Working Document prepared in the context of the 2013 European Semester), in June 2013 the first phase of a new labour market reform was adopted, with measures to relax the duration of a first fixed-term contract for an employee, to simplify the collective redundancy procedure, to extend the range of activities of temporary employment agencies and to abolish a monthly limit on overtime work. Further educational reforms are under way, with a Strategy of Teaching, Education, Science and Technology 2013-2020 presented for public consultations in September. In addition, a National Industrial Strategy for 2013-2020 is also under preparation, which should position 12 sectors as priority for economic growth.

4.2. Medium-term budgetary position

Fiscal policy and structural deficit. Cyclical factors interacting with entrenched weaknesses in economic structure account for an important part of the adverse trends in the headline public finance ratios for Croatia. However, with respect to the fiscal stance and fiscal governance, other factors also appear relevant. Recurrent assumptions of private debt by the government have been an additional factor pushing up the general government deficit and debt ratio. This suggests weaknesses in economic governance. Given the strong interaction between cyclical and structural factors and the additional impact of specific fiscal transactions, it is very difficult to infer the underlying fiscal stance in recent years. Discretionary policy measures, such as the reduction of social contributions to the health sector or changes in the system of corporate income taxation have added to the deficit. Furthermore, the deficit figures were impacted very heavily by assumptions of the debt of some public and state-owned enterprises, such as (now privatised) shipyards.[10] These measures, although exceptional, are not considered as one-off.

The general government budget balance in structural terms (cyclically-adjusted balance corrected for the impact of one-off measures) in the period 2009-2012 was high, above or close to 4% of GDP. However, from the changes in the structural primary balance one can infer a loosening tendency in fiscal policy in the early years of recession, followed by tightening in 2012 and slightly further in 2013. Thus generally loose fiscal policies, although to some extent countercyclical, appear to have contributed to the level and persistence of headline and structural deficits in recent years.

Regarding the cyclically adjusted debt developments, article 2(1a) of Regulation 1467/97 stipulates that the requirement under the debt criterion shall also take in account the influence of the cycle on the pace of debt reduction. Negative cyclical developments in recent years do not appear to have had a significant impact on the debt ratio. When adjusted for the cycle the 2014 general government debt ratio remains above the 60% of GDP reference value. The forward-looking benchmark shows that the debt ratio would remain above the Treaty reference value in 2014 and it is projected to keep rising.

---

9 Available at http://ec.europa.eu/europe2020/pdf/nd/swd2013_croatia_en.pdf.

10 In 2011 the debt assumptions alone increased the deficit by around 2% of GDP.

Public investment. Government investment in terms of GDP has been continuously decreasing, from 3.6% of GDP in 2009 to 2% in 2012. According to the Commission Autumn 2013 forecast, the public investment ratio is expected to recover marginally in 2013, and increase somewhat towards the end of the forecast period because of the expected implementation of large infrastructure projects. However, throughout the period, the general government deficit ratio in both headline and structural terms exceeds the government investment-to-GDP ratio. Overall, the share of public investment in GDP is among the lowest among EU Member States with similar levels of income.

Quality of public finances. The fiscal framework in Croatia has been significantly reformed in recent years. Three key legal acts have entered into force: i) the Budget Act (2009), which introduces a three-year time horizon for the general government budget planning; ii) the Fiscal Responsibility Act (2011), which specifies numerical fiscal rules applying to general government expenditures and deficit; and iii) the Government Decision on the establishment of the Fiscal Policy Committee (2011). Having joined the EU, Croatia has to transpose EU Directive 2011/85 on national budgetary requirements into a national law by the end of 2013. Currently, the draft act on the amendments to the Fiscal Responsibility Act, aiming to transpose necessary elements and introduce changes to the fiscal rule, has been adopted by the Government and sent to Parliament. An assessment of the implementation of the directive will be carried out by the Commission in 2014.

4.3. Medium-term government debt position

Long-term sustainability of public finances. In the absence of long-term projections of ageing related expenditure, based on the common macroeconomic assumptions as carried out by the Economic Policy Committee, it is not possible to assess the impact of population ageing in Croatia on a basis comparable with the other Member States. The country will be a part of the regular Ageing Report on long-term economic and budgetary projections from 2015 onwards. However, taking into account the age-structure of the population and low ratio of workers to pensioners, it can be expected that the long-term budgetary impact of ageing will be above the EU average. Improving the structural budgetary position over the medium-term would thus contribute to containing risks to the sustainability of public finances.

Total stock of the debt guaranteed by the government. The high level of contingent liabilities, which according to the Ministry of Finance amount to 11.7% of GDP in December 2012, represents an additional risk for Croatia's public finances. The guaranteed debt of the Croatian Bank for Reconstruction and Development, which is a public company classified outside the general government sector, amounts to 4.9% of GDP.

In the first 6 months of 2013, the government granted additional guarantees amounting to 9% of GDP, mostly to public infrastructure companies, such as Croatian motorways. The total amount of guarantees called in the same period has been relatively small, though, amounting to less than 0.1% of GDP. The successful restructuring of the shipbuilding industry led to outright debt assumptions by the government but helped reduce the implicit liabilities stemming from those activities. However, given the important stake the state has in public corporations, some of which appear to be structurally loss-making, there are non-negligible risks stemming from possible guarantee calls. On the basis of current information the extent of the risk is difficult to quantify.

4.4. Other factors put forward by the Member State

In a letter of 8 November 2013, the authorities of Croatia have listed what they consider relevant factors in accordance with Article 2(3) of Council Regulation (EC) No 1467/97. The analysis presented in the other sections of this report already covers the key factors put forward by the authorities, namely the severity and protracted nature of the recession, the deleveraging (balance sheet adjustments) as an impediment to growth and some fiscal costs associated with structural reforms.

In addition, the authorities refer to a negative short-term fiscal impact of EU accession. The costs of contribution to the EU budget are reported to add 1% of GDP to expenditure. Moreover, the authorities also add that changes in tax collection following Croatia's accession have caused a postponement in revenue which they estimate at 0.5% of GDP. The fiscal impact of EU accession is reflected in the baseline projections of the Commission used as a reference in this report.[11]

4.5. Systemic pension reforms

Systemic pension reforms. As regards “pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar”, Croatia introduced significant changes to the pension system in 2001 and 2002. With the reform, a mandatory second pillar was introduced alongside the pay-as-you go pillar. The combined contribution rate to the two mandatory pillars is 20 % of the gross wage, of which 15 pps are attributed to the first and 5 pps to the second pillar. A third voluntary pillar was also introduced to channel additional pensions savings. According to the data delivered by authorities to Eurostat, the cost of the fully funded pillar is on average close to 1.4% of GDP in the period 2009-2012, and can be expected to remain at around that level in the coming years. However, the planned budget deficit in Croatia significantly exceeds a level that can be considered close to the reference value and the budgetary implications of the pension reform cannot be taken into account in the assessment of the breach of the deficit criterion.

5. CONCLUSIONS

The planned and forecast general government deficit in Croatia is above 3% of GDP in 2013, after 5% of GDP in 2012. The excess over the reference value can be qualified partly as exceptional within the meaning of the SGP. However, it cannot be considered temporary, according to both the projections by the authorities in the Economic and Fiscal Policy Guidelines of 26 September and the Commission Autumn 2013 forecast. This suggests that the deficit criterion in the Treaty is not fulfilled.

The general government gross debt ratio is expected to remain below the 60% of GDP reference value in 2013. However, it is on a rising trend and is projected to exceed the reference value at the end of 2014, and continue rising thereafter according to both the projections presented by the authorities in the 2013 Economic and Fiscal Policy Guidelines and the Commission Autumn 2013 forecast. Furthermore, once corrected for negative cyclical developments the debt ratio in 2014 would remain above the Treaty reference value. This analysis suggests that the debt criterion in the Treaty is also not fulfilled.

In line with the Treaty, this report has also examined “relevant factors”. As specified in the SGP, for the deficit these factors can only be taken into account in the steps leading to the decision on the existence of an excessive deficit procedure if the general government deficit remains close to the reference value and its excess over the reference value is temporary,

[11] The Commission 2013 Autumn Forecast of the general government deficit also corrects for the time shift in VAT collection, which it assumes to entail a one-off revenue shortfall of around 0.5% of GDP in 2013.

which is not the case for Croatia. The relevant factors, in particular the deep and protracted recession, against the backdrop of unsupportive external conditions, have been taken into account in the assessment of compliance with the debt criterion. They do not modify the conclusion that the debt criterion in the Treaty is not fulfilled.