



**COUNCIL OF  
THE EUROPEAN UNION**

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**LEGISLATIVE ACTS AND OTHER INSTRUMENTS**

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Subject: **COUNCIL RECOMMENDATION with a view to bringing an end to the  
situation of an excessive government deficit in Croatia**

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**COUNCIL RECOMMENDATION**

**of**

**with a view to bringing an end to the situation  
of an excessive government deficit  
in Croatia**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission;

Whereas:

- (1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU) Member States are to avoid excessive government deficits.
- (2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.
- (3) On ... by means of Decision ...\*, the Council decided, in accordance with Article 126(6) TFEU, that an excessive deficit existed in Croatia.

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\* OJ: please insert the date of adoption and number of the decision in doc. 17908/13.

- (4) In accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97<sup>1</sup>, the Council is required to address recommendations to the Member State concerned with a view to bringing the situation of an excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0,5 % of GDP as a benchmark. In addition, in accordance with Article 2 of Regulation (EC) No 1467/97 specifying the requirement under the debt criterion, the budgetary target recommended for the final year of the correction period must ensure that the required reduction in the differential between the general government debt ratio and the 60 % of GDP Treaty reference value will occur over the two years following the correction of the excessive deficit, based on the Commission forecast.

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<sup>1</sup> Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

- (5) According to the Commission services' 2013 autumn forecast, the general government deficit is projected to remain above the 3 % of GDP reference value in the 2013-2015 period, and the structural balance is projected to continue to deteriorate throughout the forecast period, from around 4 % of GDP in 2013 to nearly 6 % of GDP in 2015. These developments result mainly from increases on the expenditure side, such as interest outlays, combined with revenue shortfalls. The Commission services' 2013 autumn forecast did not include Croatia's budgetary consolidation programme announced in September 2013 with the release of its Economic and Fiscal Policy Guidelines, as the information on measures underpinning this announced consolidation package was very limited. Measures presented in the second revision of the 2013 budget and the draft 2014 budget adopted by the Croatian Government and sent to the Croatian Parliament on 14 November 2013 do not have a substantial impact on budgetary trends. Indeed, the projections for government revenue and expenditure and general government debt in the Commission services' 2013 autumn forecast, which has been updated to reflect new information that became available after the forecast release, show only very modest changes. The revised projections constitute the Commission's new baseline.

- (6) In relation to general government debt developments, according to the second revision of the 2013 budget and the draft 2014 budget, the planned general government debt ratio at the end of 2014 is expected to reach 62 % and to increase further to about 64 % and 64,75 % in 2015 and 2016, respectively. The Commission services' 2013 autumn forecast projects the general government debt ratio to breach the Treaty reference value in 2014, reaching close to 65 %, and increasing further over the forecast. An update of the Commission services' 2013 autumn forecast to incorporate additional information that became available after the forecast release, most notably a new USD-denominated bond issuance in November 2013, brings the general government debt ratio above the 60 % of GDP threshold already in 2013.
- (7) Against the background of high uncertainties regarding economic and budgetary developments, the budgetary target recommended for the final year of the correction period should be set at a level clearly below the reference value, in order to ensure compliance with the debt reduction benchmark in the final year of the correction period.

- (8) According to Regulation (EC) No 1467/97, the correction of the excessive deficit should be completed in the year following its identification, unless there are special circumstances. In order to correct the excessive deficit by the 2015 deadline consistent with this approach and ensure the joint compliance with the debt reduction benchmark, the required structural effort would amount to at least 1,3 % of GDP both in 2014 and 2015. This would result in a significant output loss and aggravate an already protracted and deep recession. Longer deadlines can be set, in particular in the case of excessive deficit procedures based on the debt criterion, when the general government deficit requested to comply with the debt criterion is significantly lower than 3 % of GDP.

- (9) In light of this, setting the deadline for the correction of the excessive deficit by 2016 is warranted. In particular, a credible and sustainable adjustment path under this extended deadline would require Croatia to reach a headline general government deficit target of 4,6 % of GDP for 2014, 3,5 % of GDP in 2015 and 2,7 % of GDP in 2016, which is consistent with an annual improvement in the structural balance of 0,5 % of GDP in 2014, 0,9 % of GDP in 2015 and 0,7 % of GDP in 2016, based on the excessive deficit procedure scenario ('EDP scenario'). The scenario for the adjustment path is based on the Commission services' 2013 autumn forecast updated to reflect new information, including from the second revision of the 2013 budget and draft 2014 budget, and extended up to 2018 relying on standard assumptions about the closure of the output gap and the sensitivity of the budget to the cycle. This adjustment path would allow the headline general government deficit to be brought below the 3 % of GDP reference value by 2016 while at the same time ensuring that the general government debt ratio would approach the 60 % reference value at a satisfactory pace, thus complying with the debt criterion. Based on the EDP scenario, to reach the above-mentioned structural targets, Croatia would need to adopt consolidation measures of 2,3 % of GDP in 2014, and 1 % of GDP in 2015 and 2016. These targets take into account the need to compensate for the negative second-round effects of fiscal consolidation on public finances, through its impact on economic activity.



- (10) Budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of public finances. In particular, measures to prioritise growth-enhancing expenditure and investments including through the use of the Cohesion Fund and the Structural Funds, to enhance tax compliance and to strengthen the fiscal framework, would be supportive in this respect.
- (11) In order to ensure an outcome most conducive to economic prosperity in the medium to long term, the correction of the excessive deficit would benefit from accompanying macro-structural reforms. These measures should aim to reinforce the growth potential of the economy by creating a more flexible labour market, improving the quality of the business environment and increasing the efficiency of public administration,

HAS ADOPTED THIS RECOMMENDATION:

1. Croatia should put an end to the present excessive deficit situation by 2016.
2. Croatia should reach a headline general government deficit target of 4,6 % of GDP for 2014, 3,5 % of GDP in 2015 and 2,7 % of GDP in 2016, which is consistent with an annual improvement in the structural balance of 0,5 % of GDP in 2014, 0,9 % of GDP in 2015 and 0,7 % of GDP in 2016.
3. Croatia should specify and rigorously implement the measures that are necessary to achieve the correction of its excessive deficit by 2016, and use any windfall gains for deficit reduction.
4. The Council sets the deadline of 30 April 2014 for Croatia to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail on the consolidation strategy that it envisages in order to achieve the targets; thereafter the Croatian authorities should report on progress made in the implementation of these recommendations at least every six months until the excessive deficit has been fully corrected.

Furthermore, the Council invites the Croatian authorities to:

- (i) carry out a thorough expenditure review with the objective of rationalising wage, social security and subsidy outlays and to provide sufficient fiscal space for the implementation of growth-enhancing expenditure, including co-financing of projects funded by the Union;
- (ii) further improve tax compliance and increase the efficiency of its tax administration, and
- (iii) improve the institutional framework of public finances, including by enhancing multi-annual budgetary programming, by strengthening the role and independence of the Fiscal Policy Committee, and by ensuring compliance with fiscal rules.

In addition, the Council invites the Croatian authorities to implement structural reforms, in particular as regards addressing labour market rigidities and an unfavourable business environment and improving the quality of public administration, with a view to promoting potential GDP growth.

This Recommendation is addressed to the Republic of Croatia.

Done at Brussels,

*For the Council*

*The President*

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