

# NEWSLETTER

No. 50

August 2010

ISSN 1333-4417

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## A Short History of the Revisions of the Croatian Central Government Budget from 1999 to 2009

In the 1999 to 2009 period, Croatia did not pass a single year without a revision of the central government budget – in these 11 years, there were 14 revisions. Almost always, they involved augmented expenditures – both in years in which revenue rose and at times when it declined. An exception came in 2009, when both revenue and expenditure were cut, if expenditure to a much smaller extent than revenue. In every revision except in 2009, particularly in years in which there were general elections, expenditures for employees and welfare payments rose. The over-frequent revisions indicate the need to create mechanisms for the planning of a longer-term and more trustworthy fiscal policy.

In the budgetary process in all countries the phases of preparation, adoption and execution of the budget move along more or less the same well-trodden path. In exceptional circumstances, exceptional steps are also possible, such as the adoption of a decision on interim financing or a decision to revise the budget. While interim financing decisions are really rare in Croatia<sup>1</sup>, it

is quite a different matter with revisions: in 11 years as many as 14 budgetary revisions were adopted or, put in another way, in the period from 1999 to 2009 not a single year went by without a revision.

Something that ought to be an extraordinary event, because of which in well-managed countries finance ministers are forced to resign, even whole governments, is so normal in Croatia that it is factored in right at the beginning of the year, and the finance minister himself announces, as the budget is being passed, that problems will be resolved with a revision, and in the middle of the year both opposition and media will castigate the government for being late with the budgetary revision. It is true that Croatian governments regularly prepare and propose budgets that are known even from the beginning to be infeasible, and that experts regularly and promptly draw attention to this – for example Ott (2008) for the 2009 budget; Bronić (2009) and Bađun (2009) for the 2010 budget. Nevertheless, the governments did pass unrealistic budgets for these years too, and in 2009 there were three revisions, one after the other, while in 2010 the deficit envisaged for the whole of the year was already achieved in the first half. Since the Finance Ministry has experts who know all this just as well as the authors listed above and are capable of shaping a rea-

<sup>1</sup> For example, because of the general elections at the end of 2007, instead of a central government budget for 2008, a decision on interim financing was made, until the parliament should be convened to adopt the central government budget for 2008.

## Definition of revision

A revision is a change of the amounts in the budget, that is, their reduction from or enlargement over the budget plan adopted at the beginning of the calendar year. It occurs when, during the budgetary year, it is ascertained that budgetary revenue has been estimated unrealistically or when unforeseen expenditure arises. A revision can also be caused by unpredictable circumstances in the local or world economy, but can also be a result of the government's incapacity to plan its revenue and expenditure realistically.

listic and doable budget, these are clearly political decisions (concerning the motivation behind unrealistic budgetary planning, see Švaljek, 2009).

While we are waiting for one of the upcoming revisions, this paper provides a historical review of the revisions of the Croatian budget in the 1999-2009 period. This is a preliminary survey, without any very profound analyses, which will be given in some future paper, and yet a historical review itself might well be useful and instructive. Its object is to display the temporal dynamics of budgetary revisions, the changes that appeared on both revenue and expenditure sides during the revisions, the links between revisions and trends in GDP and the impact of general elections on revisions.

## Time dynamics of revisions

Table 1 shows the last 11 years in which there were as many as 14 revisions of the central government budget – one each year, in 2001 two and in 2009 three, including two in a single month (July). July is clearly the month for budget revisions, since most of them have been adopted in this very month. The fact that since 2004 revisions have not been adopted at the end of the year but at the latest in July and perhaps even earlier could suggest a deterioration in the planning of budgetary revenue and expenditure, or a better control of the execution of the budget. This year, however, 2010, will not fit into this pattern, for the exchequer will hold out until September at least.

## Trends and changes in overall revenue and expenditure

Table 2 shows the trends in overall revenue and expenditure that in the given period rose almost two and a half times. The reasons for the swelling of the central budget have been discussed several times, and this problem will not be made more of here, rather there will be

Table 1 Revisions from 1999 to 2009 according to months

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
1999												
2000												
2001												
2002												
2003												
2004												
2005												
2006												
2007												
2008												
2009 <sup>a</sup>												

<sup>a</sup> in July there were two revisions

Source: Official Gazette

an endeavour to show the changes of total revenue and expenditure after the revisions.

Table 2 Total revenue and expenditure of the central government budget from 1999 to 2009 (in billion kuna)

	Revenue			Expenditure		
	Plan	Revision	Execution	Plan	Revision	Execution
1999	49.0	47.9	46.4	49.0	49.3	48.9
2000	47.0	44.0	44.6	48.3	50.7	50.7
2001 <sup>a</sup>	49.7	54.2	53.5	49.7	58.1	57.8
2002	70.2	70.2	69.9	73.3	72.9	73.4
2003	75.3	75.3	74.9	77.9	77.9	79.1
2004	79.7	82.5	80.7	83.4	85.3	84.8
2005	86.6	85.9	85.9	89.8	89.8	89.7
2006	94.5	95.4	95.6	97.9	98.3	97.9
2007	103.8	109.0	108.8	107.1	111.9	111.1
2008	115.9	118.4	116.1	118.4	121.2	118.6
2009 <sup>b</sup>	124.6	111.2	110.6	127.0	120.5	120.2

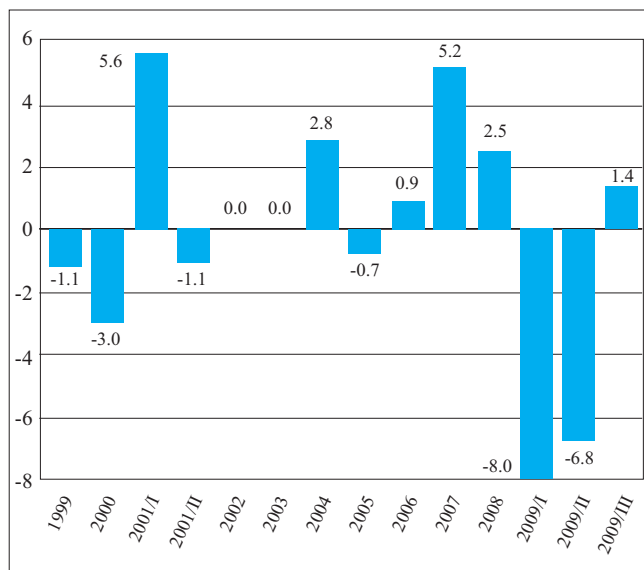
<sup>a</sup> amount of the second revision

<sup>b</sup> amount of the third revision

Source: Official Gazette

Changes to total revenue brought about by the revisions, shown in Graph 1, indicate fairly clearly the existence of three sub-periods: 1999-2001, with very large oscillations; then the heyday period of 2002-2008; and dramatic 2009. The Ministry should be praised for having in 2002 and 2003 correctly estimated total revenue and not having had to undertake a revision. As can be expected, changes in revenue can be fairly well correlated with trends in GDP, of which there will be more discussion below.

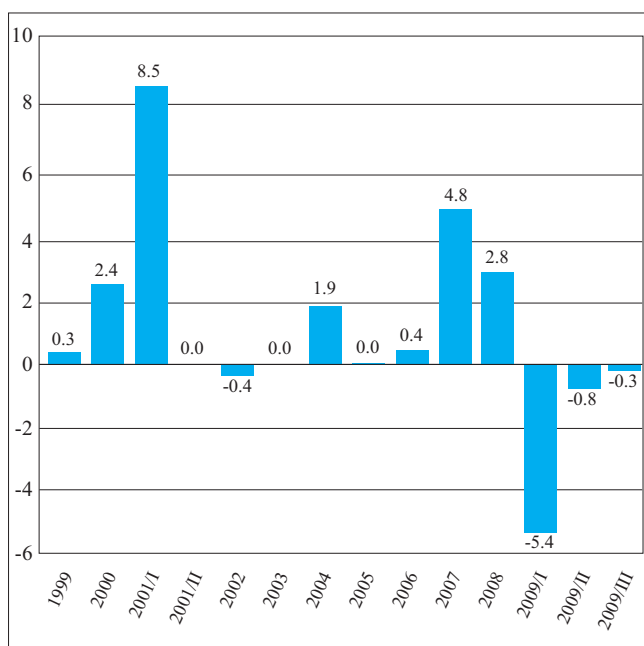
Graph 1 Changes in total revenue, revisions from 1999 to 2009 (in billion kuna)



Calculation from data published in Official Gazette

Changes in total expenditure brought about by revisions, shown in Graph 2, indicate the existence of only two different periods: 1999-2008, when expenditure was increased (except for 2001, when it was slightly reduced, and 2003, when it was correctly estimated) and 2009, when there was a sudden reduction in expenditure. Quite clearly, expenditure was not augmented only in years when revenue was larger, but also in

Graph 2 Changes in total expenditure, revisions from 1999 to 2009 (in billion kuna)



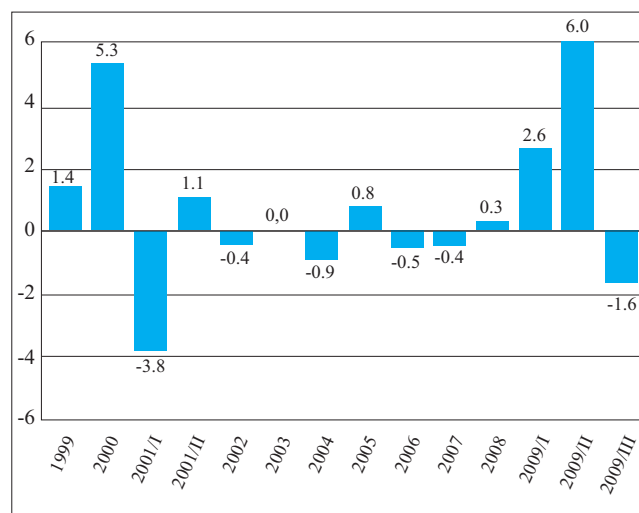
Calculation from data published in Official Gazette

years when it was diminished (for example, in 1999 and 2000), in other words, the increase in expenditure was greater than the increase in revenue in years when revenue did in fact rise (for example, 2001) and was reduced by a sum less than the reduction in revenue (for example, 2009).

Alterations to total revenue and expenditure resultant upon revisions were reflected, of course, in the budgetary balance. All these years, the Croatian central government budget was in deficit, and not a single revision changed that. In five out of eleven years, revisions led to a budgetary deficit – because of reduction of revenue and increase in expenditure, because expenditures were increased in excess of the extra revenue or because expenditures were reduced by a figure lower than that of the reduced revenue. Graph 3 again shows three sub-periods: great oscillations in 1999-2001, a relatively stable period from 2002 to 2008 and turbulent 2009.

## The structure of changes in revenue

Graph 3 Changes in the budgetary deficit, revisions from 1999 to 2009 (in billion kuna)

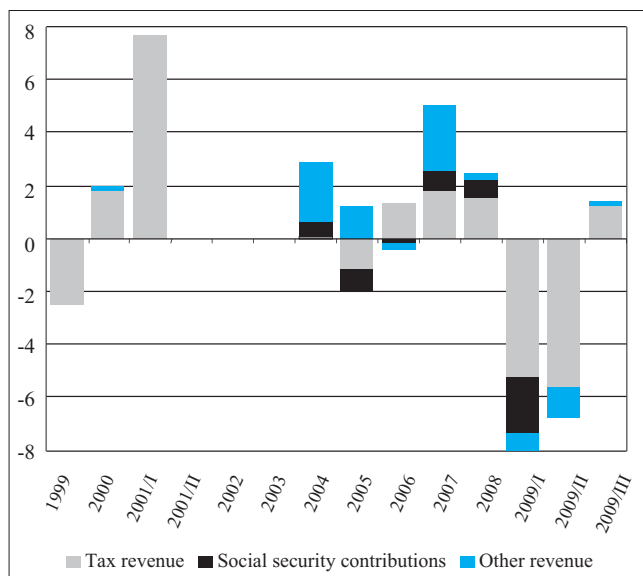


Calculation from data published in Official Gazette

Since operating revenue comprises more than 99% of total revenue, it is displayed first, after which come tax revenue and social security contributions.

Operating revenue, as is shown in Graph 4, was properly planned only in 2002 and 2003, when it did not need to be changed at all; however in the revision of 2001, it was drastically enlarged, and with the revisions of 2009 drastically reduced. In other years it deviated a good deal from the plans. And in all years, except 2004, tax revenue, which anyway constitutes about 60% of operating revenue, was most significantly modified. Except

Graph 4 Changes in operating revenue, revisions from 1999 to 2009 (in billion kuna)

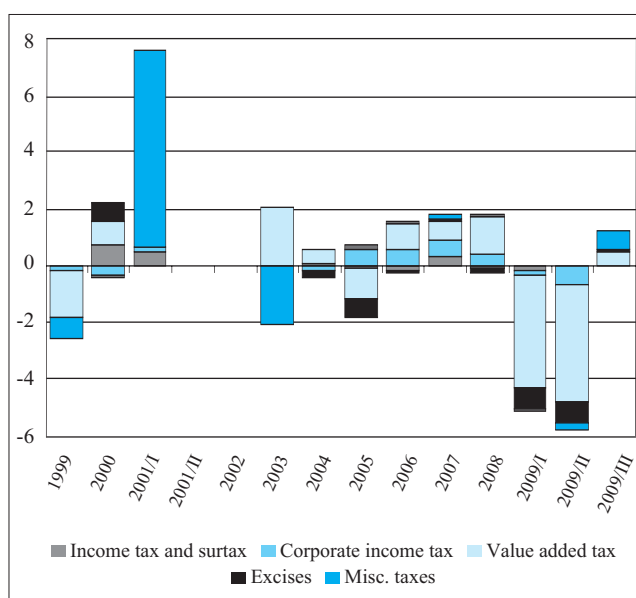


Calculation from data published in Official Gazette

for 2009, in which year they were reduced drastically in the revisions, social security contributions did not change very significantly. In an analysis of the structure of operating revenue, the item “other revenue” is particularly interesting. Although other revenue, on the whole from interest, dividends, various fees and the like, makes up only 5% of total operating revenue, it was changes to these items that had a considerable influence on the revisions from 2004 onwards. In that year, other revenue was increased over 80% by the budgetary revision, and it was also considerably modified in years that were to come – increased in 2004, 2005 and 2007, and cut in 2009. But to ascertain the reasons for such changes in the item “other revenue” deserves a more detailed and profound analysis that exceeds the scope of this paper.

Graph 5 displays the way that tax revenue altered by the revisions constituted the lion’s share (60%) of operating revenue. Only in 2002 was it well planned, and then it was in no need of modification. The most considerable deviation from the plan occurred in 2001, when revenue was much enlarged, and in 2009, when it was reduced by an even greater amount. What is particularly surprising is the considerable deviation of other taxes, which make up only 0.2% of total revenue from taxes and social security contributions. The increase in 2001 and reduction in 2003 constituted a very important part of the revision. Value added tax, the most important source of tax revenue, was markedly reduced in 1999, still more so in 2009, but did deviate in almost all the other

Graph 5 Changes in taxation revenue, revisions from 1999 to 2009 (in billion kuna)



Calculation from figures published in Official Gazette

years. Except in 2005, it was common for more revenue to be collected than had been planned.

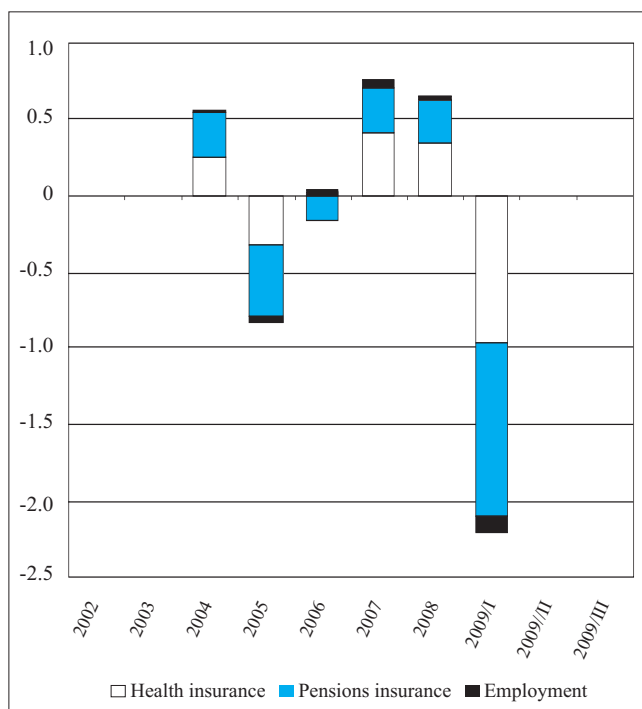
Social security contributions revenue is also a very important source for it makes up about 35% of overall operating revenue; Graph 6 shows how it was changed by the revisions in the 2002-2009 period. Contributions revenue was well judged in 2002 and 2003 and did not need revising. In the 2004-2008 period it did deviate from the plan, but not as drastically as in 2009. It was above all contributions for retirement and then for health insurance that led to adjustments to contributions revenue in all years, while changes in revenue from employment contributions were negligible, which is to be expected, since they make up no more than about 5% of all revenue from contributions.

## Structure of changes in expenditure

Since expenditure has always been a major stimulus to revisions, the structure of changes to expenditure brought about by revisions is now discussed. It is practically impossible to compare the structures of expenditure in the periods up to and then after 2002, and so it is the 2002-2009 period that is analysed here.

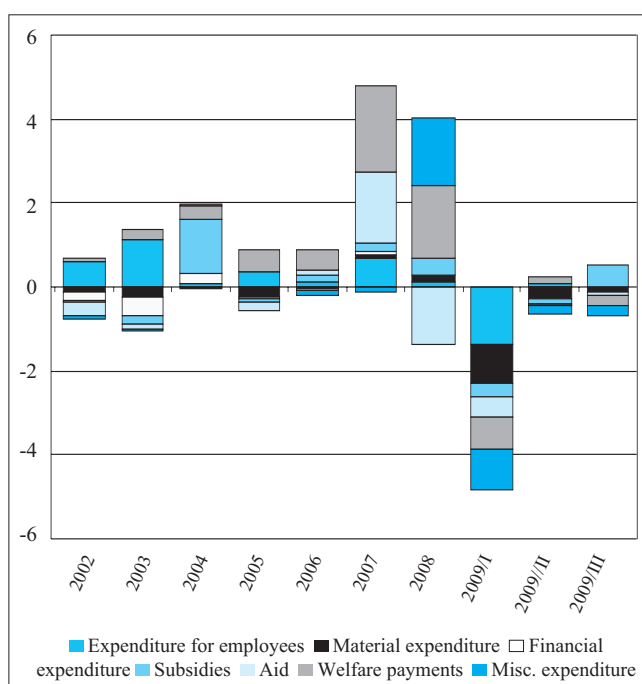
Interestingly, in this period, various transfers and aid to extra-budgetary spending agencies (see Graph 7) have a particularly important part to play in the changes, but the text below will concentrate on changes related to welfare payments and expenditure for employed per-

Graph 6 Changes in social security contributions revenue, revisions from 2002 to 2009 (in billion kuna)



Calculation from figures published in Official Gazette

Graph 7 Structure of changes in operating expenditure, revisions from 2002 to 2009 (in billion kuna)

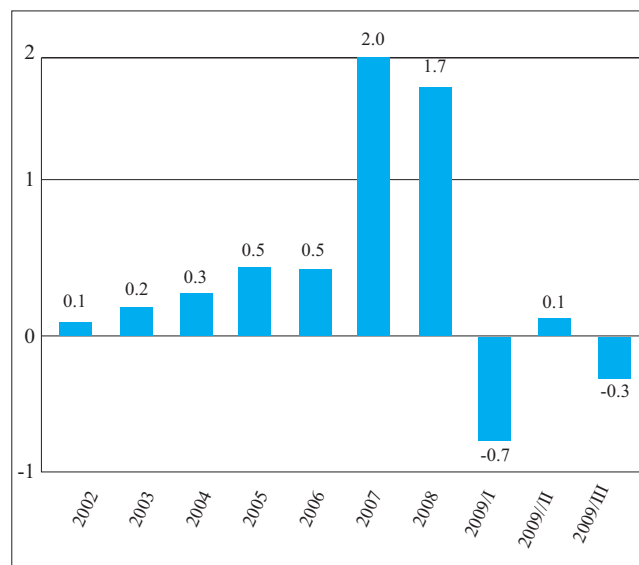


Calculation from figures published in Official Gazette

sons, for they make up about 70% of total operating expenditure.

Graph 8 shows that welfare payments changed in an increasingly upward trend in the 2002-2008 period, particularly in 2007 and 2008, but fell in 2009.

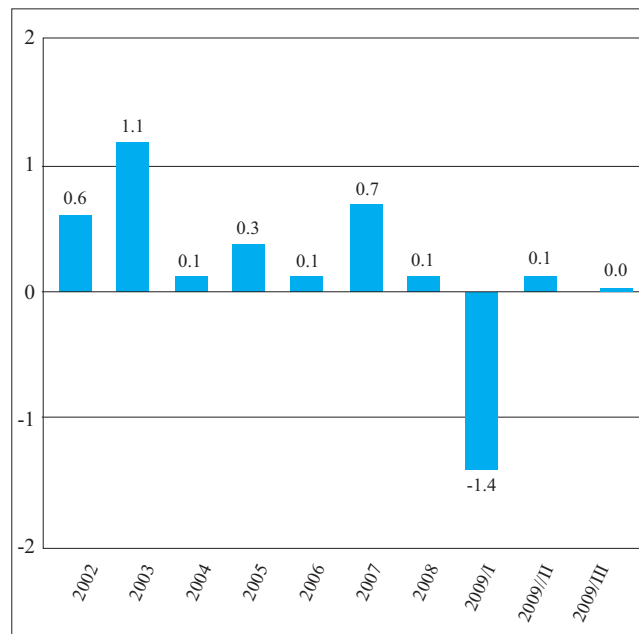
Graph 8 Changes in welfare payments, revisions from 2002 to 2009 (in billion kuna)



Calculation from figures published in Official Gazette

A similar trend is shown by expenditure for employees (Graph 9), increased in the revisions the whole of the 2002-2008 period and reduced only in 2009.

Graph 9 Changes in expenditure for employees, revisions from 2002 to 2009 (in billion kuna)



Calculation from figures published in Official Gazette.



## Trends in GDP and the revisions

At very first sight Graph 10 shows the impact of trends in economic activity as expressed by rise in the rate of GDP, particularly in 2009, when the sudden downturn in economic activity brought about as many as three revisions and a great rise in the central government budget deficit; there were on the other hand relatively small revisions with reductions in the deficit being more frequent than enlargements in the period of prosperity from 2002 to 2006. Still, the particularly unrealistic planning of the budget for 2007 gives reason for surprise, for in this period of continuous GDP growth, both revenue and expenditure were underestimated to such a large extent. Something similar occurred in 2008, albeit to a somewhat smaller extent. Also poorly planned were the budgets for 2000, when the economy had started to recover and yet revenue was reduced, expenditure increased and the deficit drastically increased in the revision, and for 2001, when increased revenue and drastically increased expenditure deviated very considerably from realistic economic trends. In subsequent research it would be worthwhile studying the precision of estimates of GDP and taking into consideration the quality of other macroeconomic indicators relevant to the drawing up of the budget.

## Impact of general elections on revisions

There have been frequent and often well supported claims that election campaigns have tended to result in increased government expenditure. Although in the period observed there were nine elections of different kinds - general, local and presidential – for the moment we

will here consider only the general elections (of 2000, 2003 and 2007) for it is assumed that they can have the most effect on the planning of and modifications to the government budget.

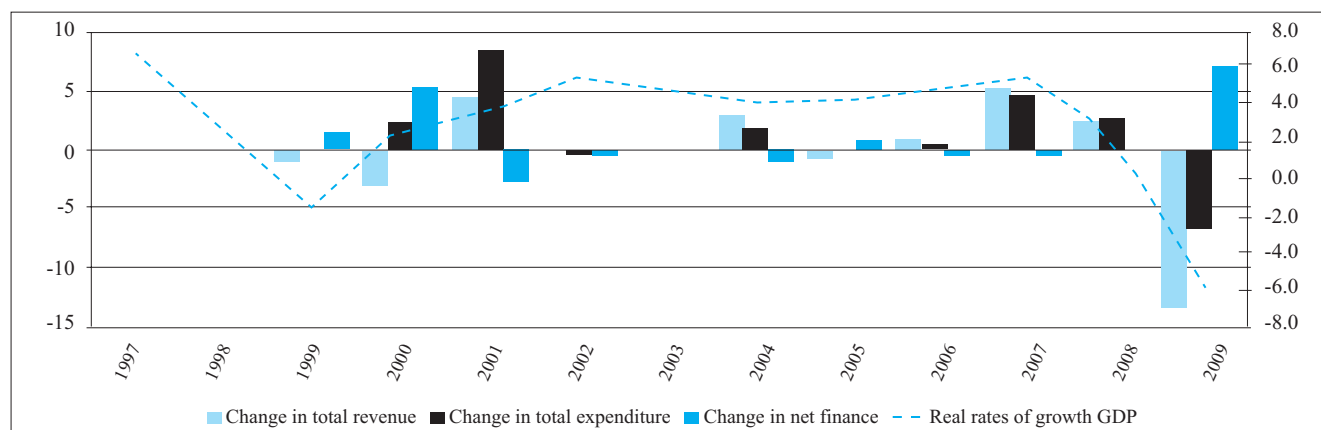
### Revisions in other countries

It is very hard to compare the frequency and size of revisions in different states, for budgetary decision making and the chances of a revision occurring depend on many factors. For example, it is impossible to compare the circumstances of countries with parliamentary, presidential or Westminster systems, and practices are very different in America and Europe, in Nordic and non-Nordic western European and east European states. Still, with even a superficial google it is possible to see that unlike Croatia, Ireland, for instance, in the 1996 to 2010 period had just a single budget revision – in the year 2009.

Googling budgetary revision 2010 will produce information about revisions in countries not perhaps renowned for the quality of their financial management: Nepal, Kenya, Zimbabwe, Uganda, Nigeria, Sudan, Haiti, Romania, Serbia, Bulgaria, FYR Macedonia and, of course, Croatia.

The first general election in the period under consideration was held at the beginning of January 2000 and could thus not have had any effect on the revision for that year, only perhaps on the 1999 revision. And indeed, in spite of the need to reduce revenue from the sum planned – and at the end revenue was even lower than that provided for in the revision – the expenditure was increased in the revision, but actually reduced in the ex-

Graph 10 Real rates of growth in GDP from 1997 to 2009 (right hand scale, in %) and revisions from 1999 to 2009 (left hand scale, in billion kuna)



Calculation from figures published in Official Gazette; for GDP, the source is the CBS

cution. The deficit too that year was considerably enlarged. Transfers to the extra-budgetary spending agencies were increased by as much as 2.2 billion kuna, while most of the other expenditure items were cut.

The 2003 general election was held at the end of November. The total amount of revenue and expenditure was not changed by the revision, but the revision did considerably enlarge expenditures for employees and for welfare payments, while all other operating expenditure was cut. At the end the execution showed changes – a somewhat lower revenue and a much higher expenditure than had been planned. Expenditure for employees was increased most of all by the revision in that very 2003 (see Graph 9).

In 2007 too, the general election was held at the end of November. The revision of that year led to a considerable enlargement of both revenue and expenditure (see Graphs 1 and 2). Although the executions were at the end a little lower than those envisaged by the revision, they were nevertheless much higher than originally planned. That year, because of the revision, expenditure for employees underwent the second biggest enlargement in the period under observation (the biggest was in 2003, also an election year), while welfare payments were boosted as never before or since (see Graphs 8 and 9). In subsequent research it would be worthwhile investigating in further detail why in that year aid was increased by as much as 1.7 billion kuna, while in most of the other years in the period it was regularly reduced or stayed just the same (see Graph 7).<sup>2</sup>

Only three years is too small a sample for all these changes in election years to be ascribed to the elections alone, but we are certainly concerned with suggestive figures that deserve additional analyses.

## Conclusion

This is primarily a review paper without any major or hard and fast conclusions, the drawing of which would require much deeper research and analysis. There are many obstacles and restrictions in the way of making any very concrete conclusions. The period under observation is fairly short, and at the same time fraught with various methodological and systemic changes that cannot always be properly compared. Extra-budgetary spending agencies were included into and excluded

from the central government budget, the sources of their revenue were changed, and in 2001 the contributions for retirement insurance were included into budgetary revenue, and payments of pensions into budgetary expenditure; then came transactions of the Croatian Health Insurance Institute and the Croatian Employment Agency; in 2008 Croatian Motorways left the budget; tax rates changed, as did tax bases and deductions, new taxes were introduced; the debt to the retired population was paid and so on. This paper – as far as was possible – attempts to offer only comparable figures. The changes mentioned did, of course, have an effect on the revisions, and yet this does not justify the revisions. Such major changes should not have been inaugurated overnight, and should rather have been planned in such a way as not to have brought about in the years to come such major disturbances in the revenue and expenditure sides of the budget as to have required the adoption of budgetary revisions.

The frequent revisions of the budget and the large increases and reductions of revenue, expenditure and deficit all indicate unrealistic planning and inadequate attention paid to real economic trends. The year 2009 was disastrous even for countries that manage their public finances exemplarily, and part of the bad planning might be forgiven, but the frequent and numerous revisions in relatively stable years give cause for concern. Of course, 2009 too might have been better planned, for when the budget was being planned it was already clear that because of the reduction in consumption brought about by the recession revenue from taxes and contributions would also be diminished. Further research should show whether this was just unrealistic planning, lack of time for detailed analyses, concealment of the real state of government finances or something else, at present unknown to the analysts.

Particularly surprising are the great changes in relatively minor items such as other operating revenue, other taxes and so on. It is not clear how there can be such imprecision in planning revenue from customs duties and dividends that it could to such a considerable extent lead to revisions of the government budget.

The ever-growing expenditure – that sorest point of the Croatian central government budget – is here looked at exclusively according to an economic classification: revenue in kinds (taxes, aid and so on) and expenditure according to economic purpose (payment for employees, welfare payments and so on). Further research should also take into consideration some other classifications, such as expenditure in terms of organisation (per ministry, government office, funds and so on),

<sup>2</sup> Aid or grants are non-repayable transfers of resources to international organisations, foreign governments, budgets, extra-budgetary beneficiaries, financial institutions and corporates. There are many grants from the central budget to local budgets. They can be current (for current expenditure) or capital (for the procurement of fixed assets) as well as for a defined purpose or without a defined purpose.

while the increase of welfare payments in every revision should make them the subject of special research.

Since the investigation has shown a correlation between budgetary revision and the general election cycle, that is, considerable increases in expenditure just before the elections, budgetary planners ought to factor in this consideration, when the politicians themselves cannot be reined in. Although it is the government that is to be blamed in general for unplanned pre-election increases in welfare payments, expenditure for employees and various kinds of aid (grants), the finance minister should be fiscally responsible and not give in to such pressures. In his hands he has the government treasury from which all payments are made, and he should defend the budget as adopted tooth and nail. If he is prevented from so doing in the government, he always has the option of resigning.

A short history of revisions of the Croatian central government budget shows the poor planning of public finances, which is clearly done in fits and starts, from today to tomorrow. This kind of practice has to be stopped by the creation of mechanisms for longer-term and more trustworthy fiscal policy, in which the following are recommended:

- avoidance of sudden and major changes in the budgetary system without due planning of their effects on budgetary revenue, expenditure and the ensuing balance;
- improvement of the quality of assessing the macro-economic indicators relevant to the drawing up of the budget;
- more precise planning of all revenue and expenditure, even the smallest amounts;

- concentration on a better quality planning of the expenditure side of the budget, which is a constant generator of revisions, particularly on the constantly growing welfare payments and expenditure for employees;
- passing a proper fiscal responsibility law and by implementing it preventing increases of expenditure in pre-election periods.

These recommendations are directed exclusively at the quality of planning the budget for the sake of avoiding the need for revisions and to enable a stable fiscal atmosphere and do not at all consider the essential fiscal problems of excessively high expenditure and taxation, deficit and public debt.

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