

**REPUBLIC OF CROATIA
MINISTRY OF FINANCE**

**FINAL ACT ON THE AMENDMENTS TO THE FISCAL RESPONSIBILITY
ACT**

Zagreb, December 2013

FINAL ACT ON THE AMENDMENTS TO THE FISCAL RESPONSIBILITY ACT

Article 1

In the Fiscal Responsibility Act (Official Gazette, no. 139/2010), after Article 1, the following Article 1a shall be added:

„Article 1.a

By this Act, the Council Directive 2011/85/EU of 8 November 2011, on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011.), shall be transferred into the legal system of the Republic of Croatia.“

Article 2

In Article 3, after paragraph 1, the following paragraph 2 shall be added:

„(2) Provisions of this Act shall also refer to companies owned by the Republic of Croatia, that is by one or more local and regional self-government units, and to other legal persons founded by the Republic of Croatia, that is by one or more local and regional self-government units.“

Article 3

In Article 4, items 1 and 2 shall be amended as follows:

„1. Deficit/surplus of the general budget shall be a difference between total revenues and total expenditures of the general budget expressed according to the methodology of the European System of Accounts (ESA).

2. The Fiscal Responsibility Statement shall be an annual statement whereby heads of budgetary and extra-budgetary users of the State Budget and budgets of local and regional self-government units, heads of local and regional self- government units and presidents of the management boards of the companies owned by the Republic of Croatia, that is, by one or more local and regional self-government units, heads of other legal persons founded by the Republic of Croatia, that is by one or more local and regional self-government units (hereinafter referred to as: the head) shall confirm that they have, while performing the work, ensured legal, earmarked and purposeful use of funds, as well as an efficient and effective functioning of the financial management and control system.“

Item 4 shall be deleted.

Former item 5 shall become item 4.

After item 4, the following items 5, 6, 7, 8, 9 and 10 shall be added:

„5. European Semester is a mechanism for coordination and supervision of economic policies of European Union member states, in line with the goals of fiscal stability and growth.

6. Structural balance is a deficit, that is, a surplus of the general budget, which does not include cyclical economic effects, and one-off and temporary measures having an impact on the revenues, that is, on the expenditures of the general budget. Structural balance is calculated according to the methodology of the European System of Accounts (ESA) and European Union rules.

7. Cyclical economic effects are a part of the change in the revenues, that is, in the expenditures of the general budget that follow automatically from the prevailing cyclical conditions of the economy.

8. Tax expenditure represents a loss of tax revenue due to allowing deductions, exemptions and the like from taxable base, deferral of tax liability and preferential tax rates.

9. Disaster is an event defined by the regulations from the field of protection and rescue, while having a significant effect on the financial condition of the general budget.

10. Major economic disturbance refers to the inter-annual real decline in gross domestic product or cumulative loss of output in a longer period characterized by inter-annual real rates of economic growth significantly lower than the potential ones, and in line with the provisions of the Stability and Growth Pact.“

Article 4

The title above Article 5 and Article 5 shall be amended as follows:

“FISCAL RULE

- (1) Structural balance expressed as a share in gross domestic product (hereinafter referred to as: GDP) shall be realized according to the adjustment plan in order to achieve medium-term budget target whereby the increase in the revenues of the general budget must not exceed the referential potential GDP growth rate, increased by the expected price rise.
- (2) The adjustment plan referred to in paragraph 1 of this Article shall be determined by the Government of the Republic of Croatia for the purpose of realizing the medium-term budget target, and on the recommendation of the Council of the European Union, whereby inter-annual reduction in structural balance has to amount to at least 0.5 percent of GDP.
- (3) Medium-term budget target referred to in paragraph 1 of this Article shall be determined as a structural balance that ensures that the general budget deficit is not higher than three percent of gross domestic product, that is, that the public debt is not higher than sixty percent of gross domestic product.

- (4) Referential potential GDP growth rate referred to in paragraph 1 of this Article shall be established by the European Commission.
- (5) As an exception to paragraph 1 of this Article, the expenditures of the general budget may be increased above the referential potential GDP growth rate by the amount of the increase in the revenues as a consequence of the change of legislative framework.
- (6) The reduction in the revenues of the general budget, due to change in the legislative framework, shall be in compliance with the reduction in the expenditures of the general budget and/or with the increase in other revenues, by changing the legislative framework.
- (7) Expenditures of the general budget referred to in paragraphs 1 and 5 of this Article shall not include:
 - expenditures for interest rates,
 - expenditures for the implementation of EU programmes without national co-financing,
 - annual change of expenditures as a consequence of changes in the institutional scope of the general budget, and
 - annual change in cyclically sensitive expenditures determined by the European Commission.
- (8) The application of the fiscal rule referred to in this Article shall be monitored by an expert and independent body the tasks of which shall be defined by a special regulation.“.

Article 5

After Article 5, the following title and Article 5a shall be added:

„MACROECONOMIC AND BUDGET PROJECTIONS

Article 5a

- (1) Fiscal planning shall be based on realistic macroeconomic and budget projections while using the latest available information.
- (2) Documents referring to the preparation of the State Budget and projections for medium-term budget period, adopted by the Government of the Republic of Croatia, that is, proposed by the Government of the Republic of Croatia to the Croatian Parliament for the adoption thereof, shall contain the assumptions based on which the macroeconomic projections referred to in paragraph 1 of this Article are prepared, along with the sources thereof being cited.“.
- (3) Macroeconomic and budget projections referred to in paragraph 1 of this Article shall be compared to the latest available projections by the European Commission, and significant differences shall be explained in the documents referred to in paragraph 2 of this Article.
- (4) Documents referred to in paragraph 2 of this Article referring to the medium-term budget period shall contain:

-multi-annual budget targets expressed by the indicators of deficit/surplus of the general budget, of the level of the public debt and of the expenditures of the general budget complied with the fiscal rule referred to in Article 4 of this Act,

-projections by types of revenues and expenditures of the general budget based on fiscal effects of unchanged acts, other regulations and acts of planning, and

-description of anticipated changes in acts, other regulations and acts of planning, which have a fiscal effect in the medium-term budget period, demonstrating the way in which the anticipated changes are reflected in the realization of the adjustment plan referred to in Article 4 of this Act in relation to the existing condition.

- (5) When preparing the State Budget and projections, the information on the effect of tax expenditures on revenues, information on potential liabilities and information on the investment in stocks and shares in the principal of credit and other financial institutions as well as of companies, within public sector and outside public sector, with significant impact on the budget, shall be published as well.“.

Article 6

In Article 6, paragraphs 1 and 2 shall be deleted.

Former paragraph 3 shall become paragraph 1.

In former paragraph 4, which shall become paragraph 2, number: „3“ shall be replaced by number: „1“.

In former paragraph 5, which shall become paragraph 3, number: „4“ shall be replaced by number: „2“.

Former paragraph 6 shall become paragraph 4.

Article 7

In Article 7, after paragraph 6, new paragraphs 7 and 8 shall be added and shall read as follows:

“(7) Head of a company owned by the Republic of Croatia, or head of other legal person founded by the Republic of Croatia shall submit the Statement to the competent ministry that shall review the contents thereof.

(8) Head of a company owned by one or more local and regional self-government units, or head of other legal person founded by one or more local and regional self-government units, shall submit the Statement, for the review of the contents thereof, to the local and regional self-government unit that has the majority ownership, and if two or more local and regional self-government units participate in the ownership with equal ratio, the

Statement, for the review of the contents thereof, shall be submitted to all these local and regional self-government units."

In former paragraph 7, which shall become paragraph 9, the words: „4 and 5“ shall be replaced with the words: „4, 5, 7, and 8“.

In former paragraph 8, which shall become paragraph 10, the words: „4 and 5,, shall be replaced with the words: „4, 5, 7 and 8“, and the words: „paragraph 5“ shall be replaced with the words: „paragraph 3“.

In former paragraph 9, which shall become paragraph 11, number: „7“ shall be replaced with number: „9“.

Article 8

Article 8 shall be amended as follows:

„Fiscal rule referred to in Article 4 of this Act shall not be applied in cases of a disaster and major economic disturbances provided that this does not jeopardize the sustainability in the medium-term period. The procedure of the determination of the occurrence, that is, of the existence of these circumstances, having a significant impact on financial condition of the general budget, shall be established by a special regulation defining the tasks of an expert and independent body for monitoring the application of the fiscal rule.“.

Article 9

In Article 9, paragraph 2, number: “9“ shall be replaced with number: “11“.

Article 10

In Article 11, paragraph 3 shall be deleted.

Article 11

After Article 11, the following title and Articles 11a and 11 b shall be added:

„PENALTY PROVISIONS

Article 11a

The fine in the amount of HRK 5,000.00 to HRK 250,000.00 shall be imposed for a misdemeanour on the head:

1. if he/she does not prepare and submit the Fiscal Responsibility Statement in line with Article 7, paragraphs 2, 3, 4, 5, 6, 7 and 8 of this Act,

2. if the Ministry of Finance, competent ministries and local and regional self-government units, when reviewing the contents of the Fiscal Responsibility Statement referred to in Article 7 of this Act, notice that the documentation, on the basis of which the Statement is provided, is not authentic.

Article 11.b

(1) Budget supervision inspector who has, within the supervision procedure, determined the actions by which a misdemeanour had been committed, shall prepare an information against the misdemeanour offender and shall submit it to the competent regional Tax Administration office.

(2) Misdemeanour proceedings for misdemeanours prescribed by this Act shall be led in the first instance by the competent regional Tax Administration office.

TRANSITIONAL AND FINAL PROVISIONS

Article 12

(1) Fiscal rule referred to in Article 4 of this Act shall be applied after the Government of the Republic of Croatia establishes the adjustment plan referred to in Article 4 paragraph 2 of this Act, for the purpose of realizing the medium-term budget target, and on the recommendation of the Council of the European Union.

(2) Until the establishment of the adjustment plan referred to in paragraph 1 of this Article, the temporary fiscal rule shall be applied.

(3) According to the temporary fiscal rule referred to in paragraph 2 of this Article, the inter-annual general budget expenditures growth rate shall not be higher than the inter-annual growth rate of the projected, that is, of the estimated GDP in current prices.

(4) General budget expenditures referred to in paragraph 3 of this Article shall not include:

- expenditures for interest rates,
- expenditures for the implementation of EU programmes without national co-financing, and
- annual change of expenditures as a consequence of changes in the institutional scope of the general budget.

Article 13

Companies owned by the Republic of Croatia, that is, by one or more local and regional self-government units, and other legal persons founded by the Republic of Croatia, that is, by one or more local and regional self-government units, shall prepare for the first time the Fiscal Responsibility Statement in line with the provisions of this Act, for the year 2014.

Article 14

The Government of the Republic of Croatia shall align the Regulation on preparation and submission of the Fiscal Responsibility Statement and reports on the application of fiscal rules (»Official Gazette«, no. 78/2011, 106/2012 and 130/2013) with the provisions of this Act not later than 90 days after the date of entry into force of this Act.

Article 15

This Act shall enter into force on the eighth day after the publication in the „Official Gazette“.

EXPLANATION OF THE FINAL ACT ON THE AMENDMENTS TO THE FISCAL RESPONSIBILITY ACT

I. REASONS FOR THE ADOPTION OF THE ACT

The Fiscal Responsibility Act (Official Gazette, no. 139/2010, hereinafter referred to as: the Act) was adopted by the Croatian Parliament at its session held on November 23, 2010. The objective of the Act is to ensure and maintain fiscal responsibility, transparency and medium-term and long-term sustainability of public finances. This objective may be achieved by establishing fiscal rules and by strengthening the rules for ensuring fiscal responsibility, based on which the Government of the Republic of Croatia determines and carries out the fiscal policy.

Article 5 of this Act defines the fiscal rule according to which total expenditures of the general budget expressed by the share in gross domestic product (hereinafter referred to as: GDP) have to be reduced annually by at least one percentage point until the moment when primary fiscal balance of the general budget in nominal amount is equal to zero or positive. The change in the rule has occurred since the existing rule does not take into consideration the existence of economic cycles, and, in the prevailing conditions of decreasing economic growth, such a rule additionally jeopardizes the prospects for growth. The additional reason for changing the rule is the compliance with the EU legislation referring to the new framework for coordination and supervision of economic policies of member states, which is directed towards the strengthening of the implementation of the Stability and Growth Pact. New rules, that is, the provisions of the „Six Pack“ and the „Two Pack“, which are to be followed within the framework of the European Semester, are determined by the package of regulations and directives of the European Union prescribing preventive and corrective measures. The rules prescribed by the Six Pack refer to all member states, and those prescribed by the Two Pack refer only to the members of the eurozone.

The Six Pack has been in force since December 2011, and it contains five regulations and one Directive (2011/85/EU). Along with the fiscal supervision, it also includes macroeconomic supervision within the framework of the macroeconomic imbalances

procedure. In the field of fiscal policy, the Six Pack strengthens the provisions of the Stability and Growth Pact according to which member states have the obligation to adhere to the medium-term budget target which, as a preventive measure, represents the value of structural balance determined in a way so that it ensures that the general budget deficit does not exceed three percent (3 %) of gross domestic product and that public debt does not cross the limit of 60% of GDP. In order to realize the medium-term budget target, an adjustment plan is prescribed for each member state and the provision that the annual growth of general budget expenditures must not exceed the referential potential GDP growth rate is introduced, whereby some exemptions for certain categories of expenditures are allowed. If a member state exceeds the top limits of deficit or public debt, the Excessive Deficit Procedure will be initiated as a corrective measure for achieving fiscal criteria from the Stability and Growth Pact.

Furthermore, the Council Directive 2011/85/EU, being a part of the „Six Pack“, prescribes the requirements for budgetary frameworks of member states and introduces detailed rules regarding macroeconomic and budget projections within multi-annual budgetary framework, by which the compliance with the budget discipline is achieved as requested by the Treaty on the Functioning of the European Union. Therefore, this Act partially transfers the Council Directive 2011/85/EU into the national legal system. However, the provisions of the Directive were also transferred by other legal regulations – Budget Act (Official Gazette, no. 87/2008 and 136/2012), Regulation on the preparation and submission of the Fiscal Responsibility Statement and reports on the application of fiscal rules (Official Gazette, no. 78/2011, 106/2012 and 130/2013) and Act on the Internal Financial Control System in Public Sector (Official Gazette, no. 141/2006).

II. ISSUES ARRANGED BY THIS ACT

By this Final Draft Act, the former fiscal rule is replaced by the new one which enables certain countercyclical functioning of fiscal policy, that is, the encouragement of economic growth in the recession conditions and vice versa, and in the same time it is complied with the framework for the economic policy management in the European

Union. In addition, the temporary fiscal rule is introduced since the fiscal rule referred to in Article 4 of this Act will not be able to be applied until the establishment of the adjustment plan, and for the purpose of realizing the medium-term budget target.

The Fiscal Responsibility Act (which is in force) introduces the Fiscal Responsibility Statement. The Fiscal Responsibility Statement is an annual statement by which the head of budgetary and extra-budgetary user of the State Budget and of budgets of local and regional self-government units and the head of a local and regional self-government unit confirm that, within the work performance, they have ensured legal, earmarked and purposeful use of funds, and efficient and effective functioning of the financial management and control system within the framework of the funds determined in the budget, that is, in the financial plan.

The Final Draft Act introduces the obligation of making the Fiscal Responsibility Statement, that is, the application of the Act is also extended to the companies owned by the Republic of Croatia, that is, by one or more local and regional self-government units and to other legal persons founded by the Republic of Croatia, or one or more local and regional self-government units. With the accession of the Republic of Croatia to the European Union, there are new possibilities for using the resources from the European Union funds, and the abovementioned companies and other legal persons are exactly the biggest potential users of these funds. Considering the obligations that have to be fulfilled before and during the use of the European Union funds, potential users of resources from the European Union funds are requested to have a prepared, transparent financial management and control system. Furthermore, some of the mentioned companies and other legal persons, particularly those at local and regional level, obtain significant funds from the competent budget as well. By introducing the obligation of submitting the Fiscal Responsibility Statement to the competent ministry, or to a local and regional self-government unit, the lines of responsibility towards the competent minister, or a county prefect, mayor or municipality prefect, from the level of this group of users, are being strengthened. The Fiscal Responsibility Statements are becoming the instruments of the assessment of the quality of the internal control systems functioning. These systems have

been established by the president of the management board of a company or the head of other legal person in order to ensure, within the work performance, legal, earmarked and purposeful use of funds.

Article 11 of this Act prescribes the way in which the head is accountable for the breach of provisions of the Act. It introduces the political responsibility as another component of each head's personal responsibility for the proper establishment of financial management system which is a precondition for legal and effective use of public money. Political responsibility has been introduced with the explanation that there will be the amendments to the regulations arranging the appointment, that is, the selection of heads of local and regional self-government units, so that this provision might be used efficiently in practice. However, the amendments have not been implemented so far. Considering the aforementioned, in the meantime, the procedure for assessing the compliance of Article 11 paragraph 3 of the Act with the Constitution of the Republic of Croatia has been initiated due to the impossibility to implement it in practice. As a consequence, it is suggested to delete the provisions on political responsibility for the heads of local and regional self-government units, or to replace them with penalty provisions, that is with misdemeanour responsibility which is in line with the regulations referring to misdemeanours in general, bearing in mind the seriousness and consequences occurring by committing these misdemeanours. Political responsibility for the heads of other levels remains in force, and penalty provisions are also introduced for them in case a head does not prepare nor submit the Fiscal Responsibility Statement, and if the Ministry of Finance, competent ministries and local and regional self-government units, when reviewing the contents of the Fiscal Responsibility Statement, notice that the documentation based on which the Fiscal Responsibility Statement has been made, is not authentic. Therefore, the proposed amendments emphasize the authenticity of submitted Fiscal Responsibility Statements, that is, the strengthening of the responsibility system during the procedure of submission and control of Fiscal Responsibility Statements made by the heads.

III. EXPLANATION OF THE PROVISIONS OF THE PROPOSED ACT

Article 1

New Article 1a is added and it states the directive the provisions of which are transferred into this Draft Act. The provisions of the Council Directive 2011/85/EU are not transferred entirely in the Draft Act since they are already part of other legal acts and regulations.

Article 2

This provision extends the scope of the Act. So far, the provisions of the Fiscal Responsibility Act have referred to the State Budget and to the budgets of local and regional self-government units, budgetary and extra-budgetary users of the State Budget and of the budgets of local and regional self-government units determined in the Register of budgetary and extra-budgetary users which is maintained according to the Ordinance on establishing budgetary and extra-budgetary users of the State Budget and budgetary and extra-budgetary users of the budgets of local and regional self-government units and on the way of keeping the Register of budgetary and extra-budgetary users. After the entry into force of this Act, the provisions of the Act will also apply to companies owned by the Republic of Croatia (the ownership means one hundred ownership), or by one or more local and regional self-government units and to other legal persons founded by the Republic of Croatia, or by one or more local and regional self-government units. With the accession of the Republic of Croatia to the European Union, there are new possibilities of using the resources from the European Union funds, and the above-mentioned companies and other legal persons are exactly the biggest potential users of these funds. Considering the obligations that have to be fulfilled before and during the use of the European Union funds, potential users of resources from the European Union funds are requested to have an established and transparent financial management and control system. Furthermore, some of the mentioned companies and other legal persons, particularly at local and regional level, obtain significant funds from the competent budget as well. By introducing the obligation of submitting the Fiscal Responsibility Statement to the competent ministry, or to a local and regional self-government unit, the lines of

responsibility towards the competent minister, or a county prefect, mayor or municipality prefect, from the level of this group of users, are being strengthened. The Fiscal Responsibility Statements are becoming the instruments of the assessment of the quality of the internal control systems functioning. These systems have been established by the president of the management board of a company or the head of other legal person in order to ensure, within the work performance, legal, earmarked and purposeful use of funds.

Article 3

The provisions of this Article amend, that is, introduce the terms used in this Act, and in relation to the determination of persons and entities obliged to submit the Fiscal Responsibility Statement, as well as the concepts linked with fiscal rules prescribed by this Act.

Article 4

Former Article 5 is amended, that is, a new fiscal rule is introduced and it is in compliance with the framework for economic policy management in the European Union. In relation to the previous rule, it acknowledges the existence of economic cycles, which is of significant importance for getting through the recession conditions. The target value of the new fiscal rule becomes the medium-term budget target, that is, the value of the structural balance determined in order to ensure:

- that the general budget deficit does not exceed three percent in gross domestic product (hereinafter referred to as: GDP),
- that public debt does not exceed 60 percent in GDP,
- progress in the direction of the public finances sustainability, and, taking into account all of the aforementioned,
- additional fiscal space, particularly in the part of public investments.

In terms of the sustainable movement of expenditures, the provision was introduced prescribing that the annual growth of the general budget expenditures must not exceed

the referential potential GDP growth rate, increased by the expected price rise, whereby the exemptions for certain categories of expenditures are allowed.

Article 5

The provisions define the standards of fiscal planning in the documents referring to the preparation of the State Budget, as well as of the projections adopted by the Government of the Republic of Croatia, that is proposed by the Government of the Republic of Croatia to the Croatian Parliament for the adoption thereof, and all in line with the Council Directive 2011/85/EU on the requirements for budgetary frameworks of Member States. More precisely, one of the key elements when preparing the projections for the implementation of budget policy is transparency that implies public availability of macroeconomic and budget projections, but also of the assumptions and relevant parameters the projections are based on. This contributes to the efficiency of fiscal planning and, as a consequence, to the strengthening of budget discipline. Furthermore, this Article prescribes the obligation of publishing the information on the effect of tax expenditures on revenues, as well as the information on potential liabilities with significant effect on the budget, such as for example state guarantees, which also derives from the Council Directive 2011/85/EU. In this way, the transparency and efficiency of both national taxation system and public finances system in general will be increased, which will provide the comparison with other member states in order to determine the potential areas for further improvements.

Article 6

The provision on the obligation of the proponent of acts, regulations, other regulations to express their views on the fiscal effect of regulations since such a provision is contained in the Budget Act.

Article 7

This Article determines the way of submitting the Fiscal Responsibility Statement, for the review of the contents thereof, when the person or an entity obliged to submit the Statement is the president of the management board of the company owned by the

Republic of Croatia, head of other legal person founded by the Republic of Croatia, president of the management board of the company owned by one or more local and regional self-government units, head of other legal person founded by one or more local and regional self-government units.

Article 8

This Article defines the circumstances under which the fiscal rule will not be applied, provided that this does not jeopardize the fiscal sustainability in the medium-term. These circumstances are limited to the cases of disasters and major economic disturbances having a significant financial effect on the general budget condition, which is in line with the provisions of the Stability and Growth Pact. The disaster is an event defined by the regulations within the field of protection and rescue, having a significant influence on the financial condition of the general budget. Major economic disturbance refers to inter-annual real decline in gross domestic product or to a cumulative loss of output in the longer period characterized by inter-annual real economic growth rates being significantly lower than the potential ones, and in line with the provisions of the Stability and Growth Pact.

Article 9

Paragraph 2 of Article 9 of the valid Fiscal Responsibility Act is aligned, in terms of legislative drafting rules (nomotechnics), with the amendments referred to in Article 7 of this Act.

Article 10

It is suggested to delete the provisions on political responsibility for the heads of local and regional self-government units taking into account the way in which municipality prefects, mayors and county prefects are directly elected. Considering the aforementioned, the procedure for the estimation of the compliance of Article 11 paragraph 3 of this Act with the Constitution of the Republic of Croatia was initiated in the meantime, due to the inability to implement it in the practice. For the heads of local

and regional self-government units, the political responsibility is replaced by misdemeanour responsibility which is in line with the regulations referring to misdemeanours in general, and bearing in mind the seriousness and consequences occurring by committing these misdemeanours.

Article 11

This Article introduces misdemeanour responsibility for the head of budgetary and extra-budgetary user of the State Budget and of the budgets of local and regional self-government units and for the head of local and regional self-government units and the president of the management board of the company owned by the Republic of Croatia, that is by one or more local and regional self-government units, head of other legal person founded by the Republic of Croatia, or by one or more local and regional self-government units, who do not prepare nor submit the Fiscal Responsibility Statement in a way prescribed by the Act and sub-legal regulations adopted on the basis thereof. Furthermore, the misdemeanour penalties are additionally prescribed if during the review of the Fiscal Responsibility Statement it is determined that the documentation, for instance the Questionnaire on fiscal responsibility, on the basis of which the Statement is made, is not authentic. In practice, this will mean that this misdemeanour will exist for example when in the course of answering the questions from the Questionnaire on fiscal responsibility the given responses may not be proved by any evidence, that is, by documents on the basis of which the given responses are affirmative or partial, or if it is determined that in a precise case the response given was affirmative or partially affirmative and it should have been negative regarding the questions from the Questionnaire on fiscal responsibility. In addition, new Article 11b is added and it clearly establishes who files an information and how the information is filed after it is determined that actions defined as misdemeanours in line with this Act have been committed.

Article 12

The temporary fiscal rule is introduced since the fiscal rule referred to in Article 4 of this Act will be able to be applied only after the adjustment plan is set up by the Government of the Republic of Croatia, on the recommendation of the Council of the European Union, for the purpose of achieving the medium-term budget target.

Article 13

This provision prescribes the entry into force of the obligation of submitting the Fiscal Responsibility Act for companies owned by the Republic of Croatia, or by one or more local and regional self-government units and for other legal person founded by the Republic of Croatia, or by one or more local and regional self-government units. These persons and entities, which are obliged to submit the Statement, prepare the Fiscal Responsibility Statement for the first time in line with the provisions of this Act for the year 2014 in 2015 because the Statement is made on the basis of the completed Questionnaire on fiscal responsibility for which it is necessary to make tests for the whole year.

Article 14

This Article defines the deadline within which the Government of the Republic of Croatia will comply the Regulation on the preparation and submission of the Fiscal Responsibility Statement and reports on the application of fiscal rules with the provisions of this Act.

Article 15

This Article prescribes the entry into force of this Act.

IV. FINANCIAL FUNDS NECESSARY FOR THE IMPLEMENTATION OF THIS ACT

For the implementation of this Act, it is not necessary to provide additional funds in the State Budget of the Republic of Croatia.

V. DIFFERENCES BETWEEN THE SOLUTIONS PROPOSED BY THIS FINAL DRAFT ACT IN RELATION TO THE SOLUTIONS FROM THE DRAFT ACT

The Croatian Parliament at its 10th session, on November 15. 2013, accepted the Draft Act on the Amendments to the Fiscal Responsibility Act, and it provided comments, suggestions and opinions to the proponent, expressed in the discussions in the Croatian Parliament and its working bodies during the first reading, for the Final Draft Act to be prepared. Acknowledging the conclusion of the Committee for Finances and State Budget, the following changes were inserted in this Final Draft:

- In Article 4 (paragraph 1 Article 5 of the valid Act) the following words were added: „increased by the expected price rise.“. Furthermore, Article 4 (paragraph 2 Article 5 of the valid Act) specifies the way of determining the Adjustment plan as well as the sub-legal act by which the Plan is to be brought, as follows: „The adjustment plan referred to in paragraph 1 of this Article shall be determined by the Government of the Republic of Croatia for the purpose of realizing the medium-term budget target, and on the recommendation of the Council of the European Union, whereby inter-annual reduction in structural balance has to amount to at least 0.5 percent of GDP.“. This change is in line with the propositions derived from the discussions on the Draft Act in the first reading.
- In Article 4 (Article 5 of the valid Act) a new paragraph is added as follows: „(8) The application of the fiscal rule referred to in this Article shall be monitored by an expert and independent body the tasks of which shall be defined by a special regulation.“. The Croatian Parliament at its 11th session on December 18, 2013 adopted the

Decision on the establishment of the Fiscal Policy Commission. The Commission monitors the application of fiscal rules determined by this Act.

- In Article 5 (new Article 5a, paragraph 1) the word „real“ is replaced with the word „realistic“.
- In Article 5 (new Article 5a, paragraph 5) after the word „liabilities“ the following words are added: „and information on the investment in stocks and shares in the principal of credit and other financial institutions as well as of companies, within public sector and outside public sector,“. The aforementioned is an obligation prescribed by the Directive (2011/85/EU) the provisions of which we are obliged to transpose into the national legislation.
- In Article 8 (Article 8 of the valid Act) after the word „regulation“ the following words are added: „, defining the tasks of an expert and independent body for monitoring the application of the fiscal rule.“ and in this way it is clarified which regulation it is about.
- Article 10 becomes Article 11, and in Article 10 the provisions on political responsibility from the Fiscal Responsibility Act which entered into force on January 1, 2011 are again prescribed, except for the heads of local and regional self-government units. Since mayors, municipality prefects and county prefects are directly elected, the provisions of the Fiscal Responsibility Act that they offer to resign in case of breaching the provisions of the Fiscal Responsibility Act could not be implemented in practice. Therefore, it is stated in Article 10 that: „In Article 11 paragraph 3 shall be deleted.“.
- In Article 11, the misdemeanour provisions from Article 10 are added. In addition, new Article 11b is added and it clearly establishes who files an information and how the information is filed after it is determined that the actions determined as misdemeanours in line with this Act have been committed.
- Article 12 is amended in a way that it prescribes the temporary fiscal rule. This change is in line with the propositions derived from the discussions on the Draft Act in the first reading.
- Article 12 becomes Article 13, and Article 13 becomes Article 14 in which Official Gazette, no. 130/2013 is added.

- In Article 14, which becomes Article 15, the word „its“ is deleted.

VI. PROPOSITIONS AND OPINIONS ON THE DRAFT ACT THAT HAVE NOT BEEN ACCEPTED BY THE PROPONENT, WITH EXPLANATION

In the discussion of the Committee for Finances and the State Budget, it has been pointed out that in the public debate on the Draft Act on the Amendments to the Fiscal Responsibility Act the position of the Fiscal Policy Committee has been clearly defined as an independent expert working body of the Croatian Parliament. In the meantime, this proposition has been omitted from the Draft Act on the Amendments to the Fiscal Responsibility Act and so the question has been raised on the reasons why it has been done. It was pointed out in the discussion that the omission of the Fiscal Policy Committee from the Fiscal Responsibility Act was irrational, illogical and economically completely unfounded. It was also emphasized that the proposition that by the Draft Act on the Amendments to the State Audit Office Act, the Fiscal Policy Committee is placed within the framework of the State Audit Office, was unacceptable. The Croatian Parliament at its session on December 18, 2013 adopted the Decision of the establishment of the Fiscal Policy Commission. Therefore, the proposition that the Fiscal Policy Committee is not to be placed within the State Audit Office was accepted, but the proposition that it is to be established by the Act on the Amendments to the Fiscal responsibility Act was not accepted.

VII. PROPOSITIONS OF THE VALID ACT THAT ARE AMENDED

Article 1

This Act shall determine the rules which limit the government spending, strengthen the responsibility for legal, earmarked and purposeful use of budget funds, and strengthen the control and supervision system in order to ensure the fiscal responsibility.

Article 3

The provisions of this Act shall refer to the State Budget and to the budgets of local and regional self-government units, budgetary and extra-budgetary users of the State Budget and of the budgets of local and regional self-government units, determined in the Register of budgetary and extra-budgetary users in accordance with the Ordinance on the determination of budgetary and extra-budgetary users of the State Budget and of budgetary and extra-budgetary users of the budgets of local and regional self-government units and on the way of keeping the Register of budgetary and extra-budgetary users (hereinafter referred to as: the general budget).

MEANING OF TERMS/DEFINITIONS

Article 4

Certain terms in the context of this Act shall have the following meanings:

1. Cyclically adjusted primary fiscal balance is a fiscal indicator of the difference between revenues and expenditures without interests in the conditions when there is an equality of real and potential gross domestic product calculated by applying the methodology of the European Central Bank, with the estimation of the discrepancy from the potential gross domestic product, using the HP filter.
2. The Fiscal Responsibility Statement is an annual statement by which the head of budgetary and extra-budgetary user of the State Budget and of the budgets of local and regional self-government units and the head of a local and regional self-government unit (hereinafter referred to as: the head) confirm that, within the work performance, they ensured legal, earmarked and purposeful use of funds, and efficient and effective functioning of the financial management and control system within the framework of the funds established in the budget, that is, in the financial plan.
3. The general budget is a central budget and budgets of local and regional self-government units as well as the financial plans of extra-budgetary users of local and regional self-government units.

4. Primary fiscal balance of the general budget is a difference between total revenues and total expenditures of the general budget reduced by expenditures for the interests of the general budget.

5. Central budget is the State Budget and financial plans of extra-budgetary users of the State Budget.

FISCAL RULES

Article 5

(1) Total expenditures of the general budget expressed by the share in the estimated gross domestic product will be annually reduced by 1 percentage point.

(2) The reduction referred to in paragraph 1 of this Article shall be implemented until the primary fiscal balance of the general budget in nominal amount becomes equal to zero or positive.

(3) As of the moment when the primary fiscal balance of the general budget in nominal amount becomes equal to zero or positive, the goal is to achieve a cyclically adjusted primary fiscal balance of the general budget at the level of zero or at the positive level during the cycle in order to achieve stabilization and reduction of public debt shares in gross domestic product.

RULES FOR STRENGTHENING FISCAL RESPONSIBILITY

Article 6

(1) The level of the financial plan of the budgetary user of the State Budget, in case of creating liabilities with maturity above the level anticipated in the State Budget, shall be reduced in the next budget year by the amount of created liabilities above the level anticipated in the State Budget.

(2) Draft acts, regulations, other regulations and acts adopted by the Government, that is, proposed by the Government to the Croatian Parliament for the adoption thereof, may not

be adopted, that is, established without the opinion of the Ministry of Finance on the Fiscal Impact Statement.

(3) During the execution of the State Budget, the Ministry of Finance may carry out financial control of legal and earmarked use of budget funds at the budgetary user of the of the State Budget and at end users.

(4) The control referred to in paragraph 3 of this Article shall be performed by persons authorized by the Minister of Finance.

(5) Persons referred to in paragraph 4 of this Article shall be obliged to inform the organizational unit of the Ministry of Finance that carries out budget supervision in accordance with the provisions of the State Budget Act, on the detected suspicion of irregularity.

(6) The provisions of this Article shall accordingly apply to local and regional self-government units.

FISCAL RESPONSIBILITY STATEMENT

Article 7

(1) The head shall be responsible for:

1. legal, earmarked and purposeful use of funds, and
2. efficient and effective functioning of the financial management and control system within the framework of funds determined by the budget, that is, by the financial plan.

(2) The head shall be obliged to prepare the Fiscal Responsibility Statement (hereinafter referred to as: the Statement) every year for the previous budget year, for the period in which he or she has held the position, that is , has carried out the tasks of a head.

(3) The head shall confirm, by the Statement referred to in paragraph 2 of this Article:

1. legal, earmarked and purposeful use of funds,

2. efficient and effective functioning of the financial management and control system within the framework of funds determined by the budget, that is, by the financial plan.

Along with the Statement, the plans for the removal of weaknesses and irregularities shall also be attached, together with the report on removed weaknesses and irregularities determined in the previous year and the opinion made by internal auditors on the composition of the financial management and control for the areas that were audited in the previous year.

(4) The head of the budgetary and extra-budgetary user of the State Budget shall submit the Statement to the competent ministry which shall review its contents.

(5) The head of the budgetary and extra-budgetary user of the budgets of local and regional self-government units shall submit the Statement to municipal prefect, mayor or county prefect of the competent local and regional self-government unit who shall review its contents.

(6) Ministers and heads of other state bodies at the level of the division of organizational classification and municipal prefects, mayors and county prefects, shall submit the Statement to the Ministry of Finance, which shall review its contents.

(7) Competent ministries and local and regional self-government units shall be obliged to inform the Ministry of Finance on detected irregularities upon the performed checks referred to in paragraphs 4 and 5 of this Article.

(8) Checks referred to in paragraphs 4 and 5 of this Article may also be carried out by persons referred to in Article 6 paragraph 5 of this Act.

(9) The Government shall, by its Decision, prescribe the layout and contents of the Statement, as well as the procedure and deadlines for the preparation and submission of the Statement and the way and deadlines for the reporting to the Ministry of Finance on the detected irregularities referred to in paragraph 7 of this Article.

APPLICATION OF FISCAL RULES

Article 8

(1) The level of deficit and of net borrowing for a three-year period shall be determined by the guidelines on economic and fiscal policy, and in accordance with the fiscal rules referred to in Article 5 of this Act.

(2) If during the year, due to the occurrence of new liabilities for the general budget or due to changes in economic movements, expenditures are increased, or revenues are reduced, which may lead to the non-fulfilment of fiscal rules referred to in Article 5 of this Act, the Government shall have to propose the amendments to the State Budget and to the financial plans of extra-budgetary users of the State Budget.

(3) The increase in the general budget expenditures which are directly linked with the natural disasters, epidemics and ecological incidents, shall be exempt from the determined fiscal rules referred to in Article 5 of this Act.

(4) The increase in expenditures of the general budget which are directly linked with financing of projects co-financed from pre-accession assistance programmes and European funds in the process of the accession of the Republic of Croatia to the European Union and in the first three years of membership, shall be exempt from the determined fiscal rules referred to in Article 5 of this Act.

REPORTING

Article 9

(1) The reports on the application of the rules referred to in Article 5 of this Act shall be submitted semi-annually and annually, along with the semi-annual and annual reports on the execution of the State Budget, within deadlines anticipated by the Budget Act which is published in the „Official Gazette“ and on the web pages of the Ministry of Finance.

(2) The Government shall, by the Regulation referred to in Article 7 paragraph 9 of this Act, prescribe the form and contents of the report on the application of fiscal rules referred to in Article 5 of this Act.

RESPONSIBILITY FOR THE BREACH OF THE PROVISIONS OF THE ACT

Article 11

(1) In cases when it is determined that the head of budgetary and extra-budgetary user of the State Budget has breached the provisions of this Act, they shall offer their resignation to the president of the Government and to the Government, that is, to the body that had appointed them, in accordance with the regulations on the appointment.

(2) In cases when it is determined that the head of budgetary and extra-budgetary user of a local and regional self-government unit has breached the provisions of this Act, they shall offer their resignation to the body that had appointed them.

(3) In cases when it is determined that the head of a local and regional self-government unit has breached the provisions of this Act, they shall offer their resignation in accordance with the regulations arranging their selection, that is, their appointment.