Závěry předsednictví
Presidency Conclusions
Conclusions de la présidence

Brussels, 5 May 2009

European Union Presidency Conclusions of the Ministerial Dialogue between the Economic and Finance Ministers of the EU and the Candidate Countries on 5 May 2009

On 5 May 2009, the Economics and Finance Ministers of the EU and the candidate countries, representatives of the Commission and the European Central Bank as well as representatives of the central banks of the candidate countries met for their eleventh economic policy dialogue with a view to enhancing the dialogue on fiscal and economic policy, in line with the 26/27 November 2000 Ecofin Council statement.

Ministers welcomed the submission of the 2008 Pre-accession Economic Programmes (PEP) of Croatia and the Former Yugoslav Republic of Macedonia and took note of the economic policies regarding economic stabilisation, fiscal consolidation and structural reforms set out in the programmes. However, they noted that these are based on economic assumptions that are no longer plausible in view the deterioration of the global economic environment since the drafting of the programmes. Ministers also welcomed the dialogue with Turkey and noted that Turkey submitted its PEP on 13 April which is currently being assessed by the Commission.

Ministers acknowledged the progress achieved by the candidate countries in stabilising and transforming their economies and endorsed the following county-specific conclusions:

tel.: +420 257 042 103, GSM: +420 724 845 394; e-mail: radka.kohutova@mfcr.cz

Croatia

- Croatia's fifth Pre-Accession Economic Programme ("PEP 2009-2011"), submitted in February 2009 presents a sufficiently comprehensive and consistent macroeconomic and fiscal framework which is however based on overly optimistic assumptions reaching growth rates close to potential growth, as projected for 2010 and 2011, will require a longer than envisaged adjustment process. The programme's key objectives are to enable sustainable growth, reduce unemployment, increase employment levels and ensure social fairness. The inflation outlook of the programme appears broadly reasonable and the stability-oriented monetary policy framework will be conducive to preventing a re-acceleration of inflation over the medium term. A gradual reduction of the current account deficit appears plausible, also in view of lower domestic demand and a likely reduction in net capital inflows. The main risks to the programme are clearly associated with the possibility of more pronounced negative effects of the global financial crisis on the real and financial sector.

- Economic performance slowed markedly in 2008 and in early 2009 as a result of the global financial crisis. Inflation has decelerated from its peak in mid-2008, mainly as a result of lower commodity and energy prices as well as slowing domestic demand, but picked up again in early 2009 as a result of growth in administratively regulated prices. The current account deficit continued to increase until the last quarter of 2008 and was more than financed by net capital inflows, despite lower net foreign direct investments. External debt remains high, but a comfortable stock of reserves serves as a cushion in the event of lower external financing. The mostly foreign-owned banking sector remained sound, still benefiting from earlier recapitalisations.

- The authorities' policy intention to continue stabilising the exchange rate is appropriate as this has contributed to anchoring inflationary expectations. Inflationary pressures between mid-2007 and mid-2008 required the central bank to tighten its monetary policy stance via tighter restrictions on credit extension and foreign borrowing of the banking sector. More recently, a swift deterioration in external financing conditions resulted in some strains in Croatia's economy, given its reliance on foreign funding due to its large current account deficit and its sizable stock of external debt. The Croatian National Bank has so far been able to cushion major impacts of these developments on its financial sector by effectively releasing some of the considerable amounts of reserves that banks were required to hold with the Bank in the framework of various administrative measures enacted in the past.

– The programme's general direction of continued fiscal consolidation remains broadly appropriate in view of high spending ratios and significant external vulnerabilities. However, fiscal targets are less ambitious compared to last year's PEP and the envisaged gradual approach of balancing the budget by 2011 may not sufficiently reflect much tighter financing constraints. Moreover, the credibility of the fiscal scenario could be enhanced by providing more information on the underlying fiscal measures to support this process. Fiscal risks are likely to materialise and are strongly linked to a possible rapid shortfall in revenues and spending overruns, triggered by possible delays in implementing expenditure reforms as well as by pressures to increase discretionary spending in response to the crisis. Therefore, an appropriate fiscal response would require immediate and bold fiscal measures, including spending cuts and contingency planning, beyond those explained in the PEP, in order to bring spending plans in line with emerging revenue shortfalls and tighter financing constraints. To this end, a fiscal response already took place in the form of a supplementary budget which is based on new macroeconomic assumptions and revised revenue projections including spending cuts and savings.

– The PEP 2009-2011 covers a broad range of structural reforms related to the enterprise and financial sector, labour market, agricultural sector, public administration, education, health care, judiciary, and environment. More emphasis could have been given to measures aimed at improving the business environment, given the related administrative obstacles still in place. The programme contains fiscal estimates on some measures, but the link between the structural reform agenda and the implementation of the fiscal strategy could be further strengthened. The full implementation of the structural reform agenda would in some cases require the establishment of time bound action plans and the definition of concrete measures and clear targets. The structural reform agenda largely reflects the main accession-related policy requirements, but falls somewhat short in fully addressing the economic priorities of the Accession Partnership of February 2008 and the policy challenges identified in the 2008 Progress Report.

Overall, ministers welcomed the measures taken by the Croatian authorities to mitigate the effects of the global financial crisis and to safeguard macro-financial stability. Ministers appreciated recent efforts to re-balance the budget, but highlighted that further budgetary consolidation measures might be needed in order to bring spending plans more in line with possible revenue shortfalls. Ministers noted that fiscal targets are less ambitious compared to last year's PEP also given the changed economic environment, and were of the view that the envisaged gradual approach of balancing the budget by 2011 may not sufficiently reflect much tighter financing constraints.

The Former Yugoslav Republic of Macedonia

- The third PEP (2009 – 2011) of the Former Yugoslav Republic of Macedonia submitted on 30 January 2009 presents a sufficiently comprehensive and consistent macroeconomic and fiscal framework. However, the scenario based on strong economic growth of 5½% to 7% during 2009-2011, which is optimistic in view of the ongoing sharp deterioration in the international environment. In the meantime, this scenario has become increasingly unrealistic and the country authorities are currently revising the growth and budget projections.

- The recent economic performance has been characterised by relatively strong growth in 2007 and first three quarters of 2008. It however started to decelerate in the fourth quarter of 2008. Inflationary pressures subsided towards the end of the year. The current account deficit rose significantly in 2007 and 2008, while the fiscal balance turned from a slight surplus in 2007 into a deficit of about 1% of GDP in 2008 as tax revenues decelerated in line with the underlying economic slowdown whereas expenditures increased significantly in the last two months of 2008. Public finances are planned to register deficits of close to 2¾% of GDP in 2009 and beyond, mainly through higher capital investment in order to raise the country's growth potential and improve the infrastructure. The programme suffers from a lack of reliable and consistent statistical data, impeding the analysis of the country's position in the business cycle and of the assessment of reform measures. Overall, the macroeconomic scenario appears to be too optimistic to serve as a realistic planning tool. In addition, the programme would have benefited from a more extensive analysis of the substantial downward risks, already very present at the time of submission.

– Given the need to counter inflationary pressures in the first half of 2008, the central bank increased the monetary policy rate in several steps to 7%, effective since mid-May 2008. The Bank also aimed to curb household credit growth by a separate measure, considering it as one of the factors behind demand pressures. More recently, the main challenges to monetary policy stem from the impact of the global economic crisis. Monetary policy should stand ready to flexibly react in the case of major changes in the environment, especially if capital flows were to deteriorate. In this regard, the recent increase in the monetary policy rate to 9% (effective since 1 April 2009) demonstrates the Bank's readiness to dampen risks of a further deterioration in external financing conditions.

– The programme's fiscal strategy for 2009-2011 includes a moderately expansionary fiscal policy by lowering the tax burden while keeping public spending relatively high, in particular with respect to capital investment. In 2009, the deficit is expected to increase from 1.5% of GDP in 2008 to 2.8% of GDP, mainly as a result of decline in total revenues by nearly 2 percentage points of GDP. In 2010 and 2011, both revenues and expenditures are estimated to continue declining as a share of GDP, reflecting the impact of the crisis on revenues and a reduction of public spending. However, there is only vague information on how this spending reduction will be achieved. In general, the PEP would have benefited from more clarifications on contingency plans and priorities and on ways to increase revenues or to reduce spending. Given the risk of a decelerating revenue performance, adopting a realistic and responsible fiscal approach is of utmost importance, as shallow local credit markets impede domestic funds raising and the increasingly tight international credit markets limit the availability of financing abroad. In the context of a revised macroeconomic outlook, the government is considering a supplementary budget with fiscal tightening to contain the deficit.

– The country's structural reform programme aims to support the establishment of a functioning market economy, particularly by improving the business climate and strengthening the competitiveness of the country's enterprises. Overall, the programme's reform agenda is broadly consistent with the fiscal scenario. However, the programme would have benefited from a closer alignment with the reform requirements spelled out in the latest Progress Report and the Accession Partnership. Furthermore, the programme does not yet sufficiently take into account the economic and fiscal impact of the global crisis on the country's economy. It would also have gained from devoting more attention to key challenges to the economy, such as the very ill-performing labour market.

Overall, ministers underlined the considerable challenges at the current juncture. The authorities should maintain the sustainability of the country's external balance by reducing the burden on monetary policy through pursuing a prudent fiscal policy. Fiscal risks, in particular the likelihood of a shortfall in revenue, should be monitored closely and may require a significant budget rebalancing exercise in line with the intentions of the supplementary budgetary proposal. Addressing the very high unemployment, among the young in particular remains another important medium-term issues.

Statistics

Ministers welcomed the Progress Report of April 2009 on the Action Plan on Economic, Monetary and Financial Statistics in the Candidate Countries and the ongoing efforts by them towards fulfilling the requirements set-out in the Action Plan. However, ministers stressed that significant efforts are still needed to achieve full compliance. The implementation of the Action Plan should continue to be a top priority in these countries and statistical authorities should have the necessary resources to be able to meet this objective.

In the area of *economic statistics*, the progress made since 2008 and key areas of further work can be summarised as follows:

- National Accounts: Progress continued regarding the implementation of annual national accounts following ESA95 concepts, notably in Turkey and Croatia where major revisions of national accounts took place. Despite significant steps taken by these two countries, a satisfactory level of compliance is not yet achieved. Further work is still needed and priority must be given to the full implementation of ESA95 and to the regular, complete and timely transmission of the main output and expenditure aggregates, gross national income, employment and population.

As regards regional accounts, Croatia consolidated the steady progress on the most relevant aggregates; Turkey is called to resume the transmission of such data following the implementation of the major revision in national accounts, and the former Yugoslav Republic of Macedonia should step up efforts to complement the initial transmission of key aggregates with more details according to a regular transmission calendar.

- Government deficit and debt statistics: The candidate countries provide the Commission with annual general government deficit and debt statistics aiming at the same standards as the Member States under the Excessive Deficit Procedure. However, efforts should be stepped-up to achieve full compliance with the methodological requirements. The role of national statistical institutes in this area should be enhanced.

- Harmonised Index of Consumer Prices (HICP): There has been some progress in this area. However, Croatia should enhance comparability with EU Member States' figures for this indicator and the former Yugoslav Republic of Macedonia is required to start to transmit data on HICP.

- Infra-annual statistics: Despite some improvements since 2008, important gaps continue to exist in several infra-annual statistics and significant progress is needed in almost all domains, in particular quarterly national accounts, quarterly public finance statistics, labour market and short-term business statistics. Hence, candidate countries are called upon to generally enhance efforts to improve availability, coverage and timeliness of short-term indicators. Concerning, the area of balance of payments, some improvements are observed for Croatia and Turkey, but additional efforts are still needed to achieve full compliance with the requirements of the Action Plan. Candidate countries are also required to step up the implementation of the new nomenclature of activities, NACE Rev 2, according to the specific area calendars set up for EU Member States.

- Structural indicators: Progress has been achieved by the three candidate countries in this area but further work is needed to enhance availability, coverage and timeliness, especially in the case of the Former Yugoslav Republic of Macedonia.

In the area of *monetary and financial statistics*, Ministers welcomed that contacts between the European Central Bank (ECB) and the central banks of candidate countries have taken place in recent years, with the aim to raise the awareness in the candidate countries of the ECB's statistical requirements.

Conclusions against the background of the economic crisis

On the whole, the two programmes submitted describe a medium-term macroeconomic and fiscal framework conducive to maintaining the momentum in the catching-up process. In the context of the marked deterioration of the global economy, the discussion showed that the appropriate policy response has to take into account the specific situations in each affected country. In Croatia and the Former Yugoslav Republic of Macedonia, also given the small size of their economies, the scope for counter-cyclical measures in the present crisis context is limited. Such measures may rather exacerbate external imbalances. Furthermore, the financing of substantial spending plans might not be possible through tax revenues, at times of decelerating output and declining inflation. Credit financing on the domestic sector risks to crowd out domestic investors, while tapping international financial markets could be rather difficult and expensive, given the current scarcity on financial markets.

To enhance the countries' resilience to the crisis, improvements in the prioritisation of budget expenditure and revenue measures should play a key role, in particular by better targeting those measures that contribute to the functioning of the market economy and to raising the countries' competitiveness. In case additional public expenditures are approved, they will need to be financed from savings elsewhere in the budget. Overall, establishing the appropriate policy mix has become significantly more challenging than in previous years, which makes the pursuit of a prudent fiscal policy even more important.

Ministers underlined their commitment to carry on monitoring with the support of the Economic and Financial Committee, the Economic Policy Committee and the Commission the progress achieved with respect to macroeconomic, budgetary and structural policies in the candidate countries to ensure continued anchoring of their medium-term economic programmes. Ministers will meet again in the course of 2010 to continue their dialogue. Likewise, the dialogue at the level of the Economic and Financial Committee and its counterparts will continue in 2010.

____