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PRESS RELEASES

Government in the jaws of the pandemic: how to ensure health of population, the economy and public finances?

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The Tax Policy Center¹ recommends four basic economic policy steps governments should take to address the effects of the coronavirus crisis. This text analyzes what has already been done and what else can be done in Croatia in relation to these four steps. A number of good moves have been made, but there is still a lot of work to be done for the Government in the sense of providing detail explanations of existing and of rapid introduction of new measures to give entrepreneurs and citizens a very clear signal that the Government stands behind them.

Although no one knows at this point how long the coronavirus pandemic will last, nor is it possible to determine its effects on the economy in advance, a number of sources (such as the [OECD](#)) predict that it may end this year. With such uncertainty and such a lack of quality information, it is difficult to make decisions, so governments need to adopt measures that are flexible and focused on delivering key public services, especially health care, as well as on minimizing long-term economic and social consequences. These measures must also be decisive and quick in order to give entrepreneurs and citizens a very clear signal that the Government stands behind them.

The Tax Policy Center recommends four basic economic policy steps governments should take to address this crisis:

- 1 Accept the health and economic costs of the epidemiological crisis.
- 2 Help citizens to overcome a sudden financial shock.
- 3 Assist entrepreneurs to maintain their production capacities.
- 4 Encourage domestic demand.

The first step is to **accept the rising health and economic costs of the epidemiological crisis**. The costs of the public health sector are increasing because more ventilators, masks and protective equipment are needed, as well as additional hospital accommodation, tests and so on. Subsequently, the vast majority of economic activities have entirely or mostly ceased to operate. Although we are probably only in the initial stages of fighting the pandemic, according to the [Tax Administration](#), as early as the week of March 16-22, decreases in the number of invoices issued (32%) and in the total

¹ Although numerous institutions and individuals have offered their recommendations how governments should address the economic consequences of the coronavirus crisis, the recommendations of Tax Policy Center, jointly run by the Urban Institute and the Brookings Institution, have been chosen as the framework for this analysis because they seem simple, meaningful and applicable to Croatia.

amount of these invoices (11%) were seen in all economic activities, compared to the same period in 2019. In addition, most citizens have to stay at home, give up their usual way of life (going to work, school, shopping, public events and travelling), while some are suffering from coronavirus. All of these are the consequences of a new situation that everyone needs to accept and which will have the effect of reducing economic activity, GDP and public revenues, as well as increasing public expenditures, deficits and public debt.

Therefore, the Government must urgently **help citizens to overcome this sudden financial shock**. Some citizens have already lost or will soon lose their jobs, and a large number will surely suffer losses of income. It is imperative to expand existing welfare programs to best assist low-income citizens. Some measures have already been introduced by the **Government**, such as 100% financing of the cost of net minimum salary to employees who would otherwise be fired. Other useful measures are being introduced, such as the announced moratorium on the repayment of loans to citizens who, due to loss of income, are unable to meet their credit obligations. However, the procedures for implementation of each measure need to be further simplified and clarified as soon as possible so that citizens can use them as quickly and as easily as possible.

As soon as possible and as much as possible, the Government should **assist entrepreneurs in maintaining production capacities** so when the crisis passes they can continue with their businesses. The crisis should not destroy healthy enterprises and crafts. The Government and the CNB should provide sufficient funding to enterprises and crafts that are faced with liquidity problems due to the crisis. Some measures to disabled entrepreneurs have already been given by the **Government**, such as interest-free personal income tax and corporate income tax deferral, as well as interest-free deferral of health and pension contributions or „ESIF micro loans“ by HAMAG-BICRO. However, all existing measures need to be clarified as soon as possible and additional quick and easy measures should be introduced. For example, an analysis should be made of the possibility of completely or partially forgiving a portion of public levies, which could provide more security and optimism for entrepreneurs, and help a larger number of crisis-hit but still healthy entrepreneurs to solve liquidity problems as quickly as possible without too much red tape. The implementation of the announced measure of a moratorium on the repayment of loans to entrepreneurs who, due to loss of revenue, cannot fulfil their credit obligations will certainly be useful. It is also worth reviewing the decision to close almost all stores and open as soon as possible those that are vital to the functioning of the population: home appliances, building materials, services such as plumbers, electricians, etc. It is necessary for the economy to start „breathing“ as soon as possible. The sooner the economy recovers, the sooner the whole of society and public finances will recover, so the economy should be helped to keep economic and all other problems as brief as possible.

Once the health threat ceases, the Government needs to **encourage domestic demand**, because encouraging supply (helping enterprises and crafts to maintain their production capacities) only makes sense if someone is going to buy those goods and services. Therefore, a serious analysis of the possibilities and point of long-term public sector pay cuts should be made. Domestic personal consumption has been the most important generator of GDP growth for many years, and according to **CBS** data, the share of domestic personal consumption in GDP in 2019 was 57%. A large number of employees work in the public sector. According to the latest available **International Labour Organization** data, around 31% of the total number of employees worked in the Croatian public sector in 2014 (19% in the general government and 12% in public companies). Reducing their salaries also means reducing their purchasing power and reducing their personal spending. However, it makes more sense to analyze the possibilities of progressive short-term public sector pay cuts, taking care not to reduce the lowest salaries and the salaries of those in the front line: health professionals, police, the military, firefighters. Of course, it will certainly also be difficult to draw the line about whose salaries should be reduced, and whose not, depending on the increased engagement caused by the fight with coronavirus and grappling with the consequences of the earthquake.

Given these circumstances, the Government will quickly have to embark on a revision of the budget and see how, in the face of declining tax revenue, it will finance all newly incurred expenditures. As it will have to take into account the level of public debt (which stood at around 75% of GDP in the third quarter of 2019 according to **Eurostat**) and avoid interest rate hikes, the Government will have two

options in the coming months to address this crisis and deficit expected in the general government budget:

- 1 financing the deficit by borrowing and using available grants from the EU, i.e. obtaining funds as efficiently as possible from the EU, international financial institutions (IMF, World Bank, EBRD) and financial markets;
- 2 cutting public sector expenditures, with a focus on material and employee costs, while capital investment should not be touched.

As soon as possible, the Government should implement all or at least some of the key structural reforms that will contribute to the significant reduction on the expenditure side of the budget (related to the health and pension systems, territorial reorganization, public administration and public procurement) that we have been waiting for years.