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Source / Izvornik: **Press releases, 2020, 13, 1 - 3**

Journal article, Published version
Rad u časopisu, Objavljena verzija rada (izdavačev PDF)

https://doi.org/10.3326/pr.2020.112

Institute of Public Finance | No. 112 | Zagreb April 20, 2020 | INSTITUTE OF PUBLIC FINANCE ured@ijf.hr | www.ijf.hr TEL: +385 (0)1 4886 444

PRESS RELEASES

Public sector economics in the time of coronavirus

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The preliminary response of the Croatian government to economic disbalances caused by the coronavirus pandemic did not deviate significantly from those in other European countries. However, as the situation keeps changing on a daily basis, we are likely to see more abundant financial support for the economy. Since every single policy measure comes at a price, in normal circumstances it would be of vital importance to conduct cost-benefit analysis prior to its introduction. Nevertheless, this is an extraordinary situation which requires extraordinary and swift action.

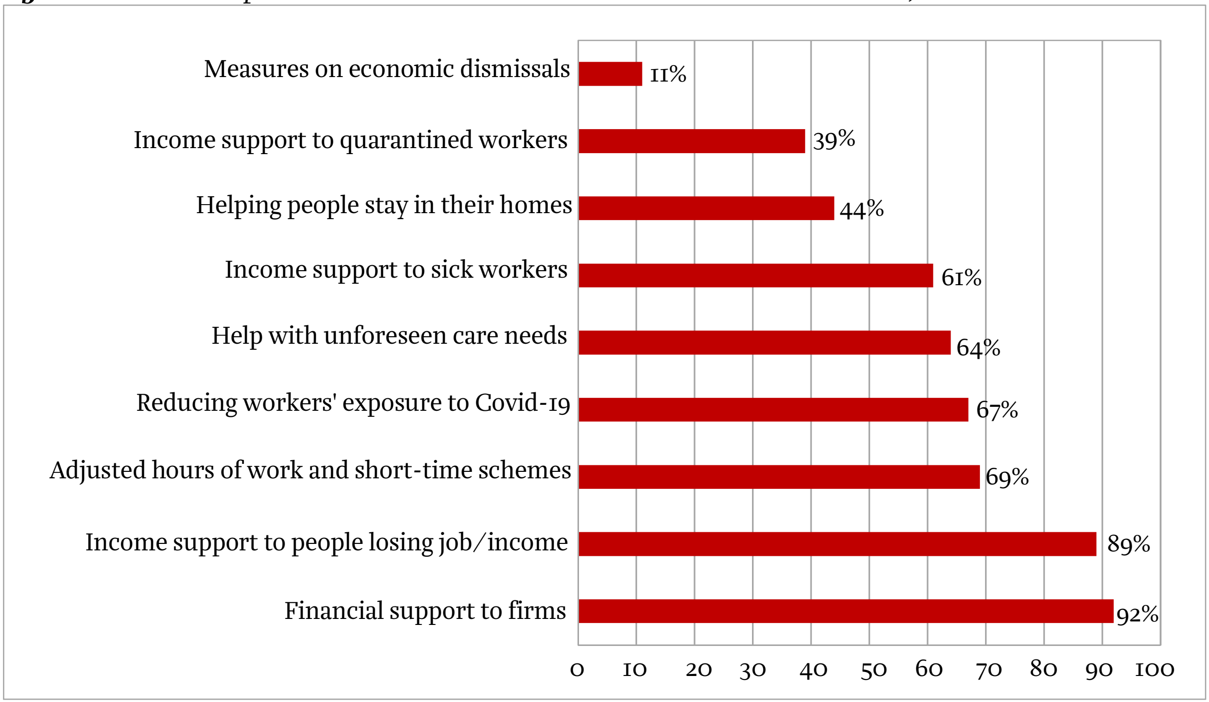
The world has changed rapidly and irretrievably following the outbreak of the coronavirus pandemic. Indeed, most countries are already witnessing severe disturbances in their economies and public budgeting. While sharing the same destiny, Croatia also has to deal with the consequences of the earthquake that hit Zagreb and its surroundings. Challenges posed to Croatian public finance are, therefore, perhaps even larger than those from the 1990s. The issue is additionally exaggerated by the failure of the ruling elites to conduct structural reforms over the last several decades. Contrary to the previous few years, which were characterised by a drop in public debt as a share of GDP, balanced public budgeting and reduction of unemployment, the situation has suddenly changed, putting public finance under significant pressure.

The European Union (EU) has so far allocated EUR 37 billion to help member states in this respect, but countries are also developing own strategies, not only to combat the pandemic but also to support citizens and companies affected by the lockdown.

Figure 1 gives an overview of policy responses applied in OECD countries so far, grouped as follows: reducing workers' exposure to Covid-19 in the workplace; income support to sick workers and their families; income support to quarantined workers who cannot work from home; helping to deal with unforeseen care needs; income support to persons losing their jobs or self-employment income; helping firms to adjust working time and preserve jobs; financial support to firms affected by a drop in demand; measures on economic dismissals; and making it possible for economically insecure workers to stay in their homes. A detailed description of individual actions can be found at the following link, which is being constantly updated with the latest information.

The first package of 63 measures introduced by the Croatian government encountered strong opposition from the business community (the second wave of measures is to be presented on April 2, 2020). From their standpoint, the current level of financial support is far from being sufficient for companies to get through the crisis and to preserve jobs. The strongest criticisms are of the decision of the government to defer taxes, social contributions and other financial liabilities, instead of completely liberating companies from these duties for the time being.[1] Given that the government has not shown particular interest in their requests, enterprises (especially micro and small ones)[2], have started to cut their personnel (which is per se quite expensive from the perspective of public finance). It remains to be seen how they will react to the second set of measures.

Figure 1 *Prevalence of various "anti-corona" measures in OECD member states*, in %*



* *Data from March 27, 2020.*
Source: OECD.

However, a detailed insight into the list of measures introduced in Europe and beyond[3] reveals that the initial reaction of the Croatian government was pretty much in line with those of their counterparts elsewhere. In general, in the first round of state support:

- Dominant are tax deferrals (e.g. in Austria, Belgium, Denmark, France, Lithuania, Luxembourg, the Netherlands, Spain and Slovenia), exemptions from tax prepayments (Austria, the Czech Republic and Germany) and eliminations of penalties for late tax returns (for instance, in the Czech Republic and Estonia);
- Only a few European countries decided to exempt companies that are severely hit by the lockdown from taxes. Hungary, for instance, exempted approximately 80,000 micro enterprises (mostly from the service sector) from all taxes, while all other affected companies do not have to pay social security contributions (except for health insurance) until the end of June. Greece, on the other hand, is not going to levy social security contributions until June and VAT for March, while the United Kingdom freed all retail, tourism and entertainment industry companies from property taxes over the course of the next 12 months;
- A few countries reduced tax rates. In Greece, for instance, VAT on vital products is now being levied at 6% instead of 24%. Norway temporarily reduced the personal income tax rate by 4%,

[1] Company owners suggested the following changes to be introduced: the temporary abolition of personal income tax, social security contributions and surtax (3+3 months), as well as utility charges, public property rent payments and all other financial liabilities towards local governments (3+3 months); 12-month penalty-free payment holiday for loans and leasing; VAT payments to be made in the moment of transaction (not in the moment of invoice issuance); elimination of corporate tax prepayments for 2020; substantial reduction of public spending; suspension of all public procurements which are not vital for the functioning of the state; temporary decrease of pensions for certain groups of citizens and; reduction of salaries in the public sector (see Dnevnik, tportal, Direktno)

[2] Initiative 'GLAS PODUZETNIKA', which gathered 22,000 companies, entrepreneurs and self-employed individuals in a short period of time, calls for the second package of policy measures targeting micro-, small- and mid-sized enterprises (see Dnevnik).

[3] The overview of measures presented here was compiled from various sources, such as: IMF, OECD, and Tax Foundation.

while Turkey decreased the VAT rate on domestic flights from 18% to 1% so as to help airline companies which are strongly hit by the crisis;

- Acceleration of VAT refunds is employed by many states (e.g. Romania, France and Belgium);
- Most EU member states are subsidising the wages of workers from companies that were forced by the government to cease their operations, as well as the wages of all other workers who cannot perform their duties because they are infected or in self-isolation. In Denmark and the Netherlands, for instance, up to 90% of workers' wages will be paid from the public budget (depending on the type of work contract and the nature of business activity), while in the Czech Republic this share accounts for 80%, in Latvia 75%, and in Bulgaria 60% ;
- Fast access to credit for endangered companies was secured in most countries, mainly through loans by development banks and/or by public guarantees (e.g. in Austria, the Czech Republic, Belgium, Denmark, Estonia, Germany and Finland).

The overall size of support packages varies significantly among countries, which is not only a result of differences in development and the size of the public debt but also has a lot to do with the magnitude of disturbances caused by the pandemic. For the sake of illustration, the German government allocated 28.5% of GDP for this purpose (24% for public guarantees, and 4.5% for direct aid), while in Cyprus and Romania this share accounts for 3% of GDP.

To summarise, the opening response of the Croatian government to the current crisis did not deviate significantly from the responses of other European governments. However, the adverse effect of the pandemic on the economy makes it is reasonable to expect more abundant financial support in the days to come. Since every single policy measure has its price, in normal circumstances it would be of vital importance to conduct cost-benefit analysis prior to its introduction. Nevertheless, this is an extraordinary situation which requires extraordinary and swift action.