



Fiscal Policy Commission
Class: 021-19/20-10/03
Number: 6524-3-20
Zagreb,

7th Position Paper of the Fiscal Policy Commission of the Croatian Parliament on the Draft Semi-Annual Report on the the execution of the State Budget of the Republic of Croatia for the first semester of 2020

At its 5th meeting held on 22 September 2020, the Fiscal Policy Commission (hereinafter: the Commission) deliberated on the Draft Semi-Annual Report on the execution of the State Budget of the Republic of Croatia for the first semester of 2020, which was adopted by the Croatian Government at its 9th session on 10 September 2020¹ and submitted in the form of an act to the Speaker of the Croatian Parliament on 10 September 2020.

The Commission supports the fiscal policy measures aimed at reducing the impact of the pandemic, but also warns that due to the high level of public debt and low rates of potential economic growth, it is necessary to use as much as possible those measures that will most efficiently mitigate the effects of the pandemic on the population and economy and contribute to increasing the medium- and long-term potential of the Croatian economy.

In the spring of 2020, due to extraordinary circumstances caused by the COVID-19 epidemic, the application of numerical fiscal rules in the Republic of Croatia and the European Union was temporarily suspended². Thus, in order to protect the population and economic potential and to ensure the medium and long-term sustainability of public finances, a temporary postponement of the fulfilment of numerical rules is allowed. In such circumstances, the task of the Commission is to monitor the implementation and execution of macroeconomic and budgetary projections and to analyse the current situation and medium- and long-term sustainability of public finances.

The macroeconomic projections for 2020, which are the basis of the amended budget, are being realized, but with a slightly different dynamic. On the one hand, the economic downturn in the second

¹ Available at: <https://www.sabor.hr/hr/prijedlog-polugodisnjeg-izvjestaja-o-izvršenju-drzavnog-proracuna-republike-hrvatske-za-prvo-9>

² See the Decision on Temporary Suspension of Numerical Rules (official gazette of the Republic of Croatia *Narodne novine* 41/2020) and the 5th Position Paper of the Fiscal Policy Commission on economic and fiscal consequences of the COVID-19 epidemic and on the implementation of fiscal rules during the crisis period, available at:

https://www.sabor.hr/sites/default/files/uploads/inline-files/5_stajali%C5%A1te_Povjerenstva_za_fiskalnu_politiku_0.pdf

quarter will be partially offset by slightly better economic results than expected in the third quarter of 2020. However, contrary to budget projections, the risks of prolonging the pandemic in the second half of 2020 with a tendency to accelerate are materialising. Thus, the normalization of the system and a stronger economic recovery will be postponed for the next period. In such conditions, the planned economic decline of 9.4% (on which the estimate of budget revenues is based) could still be realized, but the increased risks for the planned recovery in 2021 are worrying.

According to the data on the execution of the state budget in the first half of 2020, notwithstanding the measures taken, such as temporary write-off of taxes and subsidies, the budget revenues are well realized, primarily due to good results from the first part of the tourist season, which could lead to the realisation of planned budget revenues at the level of the whole of 2020. On the other hand, the Government's fiscal measures on the expenditure side caused slightly higher expenditure growth in the first half of 2020. However, with the assumption used for the preparation of the Amendments to the State Budgets in May 2020³, most of these fiscal measures should be phased out in the second half of 2020, which would reduce the pressure on expenditures. However, no one knows at this time how long the pandemic will last, and the longer it lasts, the duration of existing measures on the expenditure side could be prolonged or even new measures could be required. Despite such uncertainty and circumstances, the projected state budget deficit could still be realised.

On the other hand, strong pre-financing has also affected the large increase in public debt in the first half of the year. The results of economic growth and fiscal consolidation from the previous period, favourable external circumstances and large purchases of government bonds by the Croatian National Bank contributed to favourable financing conditions and confirmation of the investment rating of the Republic of Croatia, without the borrowing affecting the risk premium. However, the high level of public debt limits the scope for fiscal policy to operate in times of crisis, which is why in the future the emphasis will have to be on fiscal instruments and the necessary reforms within the public sector.

In these circumstances, more attention needs to be paid to the quality of public finances and their structure, concentrating on measures that will help combat the negative consequences of the pandemic as effectively as possible, and preserving and increasing the economic potential necessary for long-term fiscal sustainability. All this should be kept in mind when adopting new fiscal measures for this year and next 2021, but also when programming investments and reforms in the National Recovery Plan.

³ Available at: <https://www.sabor.hr/hr/prijedlog-izmjena-i-dopuna-drzavnog-proracuna-republike-hrvatske-za-2020-godinu-i-projekcija-za>