

FISCAL POLICY COMMISSION'S ASSESSMENT OF THE ANTI-INFLATION MEASURES PACKAGE ADOPTED BY THE GOVERNMENT OF THE REPUBLIC OF CROATIA

On 28 May 2026, the Government of the Republic of Croatia adopted and presented a new package of anti-inflationary measures aimed at “preventing the further spillover of the energy shock into broader price increases and inflation expectations,” as a response to the recent rise in inflation. When presenting the measures, the Government emphasized that inflation rates in Croatia had been comparable to those in the euro area prior to 2022, but have consistently exceeded the euro area average since then. However, inflation developments over the past several years suggest that rising energy prices are not the sole factor explaining Croatia’s higher inflation rate relative to the euro area. Between 2023 and April 2026, inflation in Croatia was driven primarily by increases in the prices of services and food. At the same time, the contribution of energy prices was relatively limited and, during certain periods between 2023 and 2025, even occasionally negative. It was only at the beginning of 2026 that the contribution of energy prices strengthened more noticeably.

The announced package represents an attempt to combine short-term price stabilization with medium-term fiscal tightening, while continuing to support households facing higher living costs resulting from elevated inflation. According to official information provided by the Government of the Republic of Croatia and the Ministry of Finance, the anti-inflationary measures can be grouped into four main categories.

The first category consists of energy-related and social measures, including the continuation of subsidies for electricity, natural gas, and fuel prices through existing support schemes for households and businesses. In addition, the Government plans to maintain price caps on a number of essential products, continue monitoring and improving price transparency through mandatory public disclosure of price lists, and retain reduced VAT rates on a broad range of goods and services. As part of the planned tax changes, the Government also intends to abolish personal income tax on pensions, which is estimated to reduce annual tax revenues by approximately EUR 180 million.

The second category comprises administrative measures, most notably a moratorium on increases in administratively regulated prices set by government authorities and state-owned enterprises. The moratorium is expected to remain in force until the end of the first quarter of 2027.

The third category consists of tax measures aimed at increasing budget revenues. These include the introduction of a tax on excess profit margins (windfall profits) from the beginning of 2027 and amendments to the lump-sum taxation regime applicable to sole proprietorships and tourism-related activities.

The fourth category encompasses fiscal discipline measures, including reductions in selected budget expenditures, the transfer of financing for certain expenditures to European Union funding sources, and the maintenance of existing material rights and benefits for public and civil servants at their current level until the end of the first quarter of 2027. The Government also plans to maintain the current level of social benefits while postponing the introduction of new forms of social assistance during the same period.

The proposed measures do not constitute a significant shift in fiscal policy. Rather, they build upon previously adopted interventions, including amendments to the Value Added Tax Act that enabled the application of a floating VAT mechanism on energy products. Consequently, the new package should primarily be viewed as an adjustment of existing policy instruments to changing economic circumstances. According to Government estimates, the fiscal discipline measures could generate savings of approximately EUR 1.3 billion, equivalent to around 1.4% of GDP.

In the Fiscal Policy Commission's assessment, the package could produce several positive effects. First, subsidies for energy products and price caps on selected goods may mitigate the short-term impact of inflation on living standards, particularly for lower-income households, given that increases in energy prices tend to be regressive and disproportionately affect economically vulnerable groups. Furthermore, the tax on excess profit margins is intended to capture part of the extraordinary profits generated in sectors that benefited during the inflationary period. Finally, the announced reforms of the taxation framework for sole proprietorships and tourism activities may be viewed as an attempt to correct existing tax distortions and improve the fairness of the tax system.

On the other hand, implementation of these measures is associated with certain risks. Higher tax burdens could negatively affect investment activity and private consumption, thereby slowing economic growth. In addition, the excess profit margin tax raises questions regarding its economic efficiency and its potential impact on business investment decisions and overall policy predictability. Changes to the lump-sum taxation system may increase operating costs for small entrepreneurs,

particularly in the tourism sector, which represents a significant component of the Croatian economy. Finally, continued subsidies for energy products and other forms of government intervention may delay market adjustment to new economic conditions and increase the long-term fiscal burden on the state budget.

Given that most of the announced anti-inflationary measures fall within the domain of fiscal policy, several important questions arise. First, to what extent has fiscal policy contributed to Croatia's higher inflation rate relative to the euro area? Second, can the proposed measures genuinely produce anti-inflationary effects? Third, what consequences will their implementation have for the fiscal position and the general government budget?

At present, no empirical studies have quantified the contribution of increased fiscal deficits to inflation growth in Croatia over recent years. However, available research has examined the effects of strong wage growth in the public sector and identified potential inflationary pressures associated with expansionary fiscal policy. At the same time, elevated inflation has significantly increased government revenues, primarily through higher nominal tax receipts. The Government responded to these additional revenues by expanding public expenditure. As a result, nationally financed general government expenditure—defined as total general government expenditure net of expenditures financed through EU transfers—increased from 42.5% of GDP in 2022 to 47.6% of GDP in 2025.

It should also be recalled that the 2024 reform of the Stability and Growth Pact is based on the assumption that fiscal policy complying with its rules automatically becomes more restrictive when inflation exceeds previous projections. The new fiscal framework relies on predetermined annual growth rates of net nationally financed primary expenditure over the medium term, as established in Croatia's National Medium-Term Fiscal-Structural Plan for the period 2025–2028. Under such a framework, deviations between actual and planned expenditure growth should remain minimal or be entirely absent. Nevertheless, according to the Progress Report, the cumulative deviation of actual net expenditure growth from the planned rate amounted to 4.1 percentage points in 2025 and is projected to reach 5.3 percentage points in 2026. Such deviations suggest that fiscal policy was more expansionary than planned and may therefore have contributed to inflationary pressures.

Additional uncertainty arises from the fact that some of the announced measures have not been sufficiently specified, nor have their expected effects been adequately explained. For example, expenditure reductions have been announced without a clear indication of which expenditure categories will be affected. Given the simultaneous commitment to maintain existing material rights for public and civil servants, preserve current social benefit levels, and continue energy support measures involving subsidies for electricity, gas, and fuel prices, it may reasonably be assumed

that most of the planned savings will be achieved through reductions in public investment expenditure and intermediate consumption.

In addition to their direct fiscal effects, the potential secondary effects of the proposed measures on economic activity, inflation, and tax revenues must also be taken into account. Consequently, all measures should be incorporated into updated macroeconomic and fiscal projections in order to assess their overall impact on public finances. Such an analysis inevitably raises questions regarding the realism of current budgetary projections and the potential need for a budget revision following implementation of the measures.

The Commission notes that maintaining existing consumer protection measures—such as price caps on selected products, enhanced price monitoring and transparency, and reduced VAT rates—will continue to exert downward pressure on the overall price level. However, it should also be emphasized that Croatia has continued to experience relatively high inflation compared with the euro area average despite the active implementation of these measures in recent years. Consequently, the new package appears more as a recalibration of existing instruments and their intensity than as the introduction of fundamentally new anti-inflationary mechanisms.

Conversely, the abolition of personal income tax on pensions, while intended to improve the living standards of one of the most vulnerable population groups, is primarily a social policy measure. Although it may positively affect pensioners' disposable income, it may also stimulate additional consumption and is therefore more difficult to classify as a conventional anti-inflationary measure.

The moratorium on increases in administratively regulated prices may potentially have a direct and relatively rapid effect on slowing inflation, given that it applies to prices determined by the state or significantly influenced by public authorities and state-controlled enterprises. Nevertheless, the Commission cautions that this is a temporary measure that does not address the underlying causes of price growth and may lead to deferred price adjustments once the measure expires. For this reason, its duration should be clearly defined, its fiscal and market effects regularly evaluated, and a strategy for the gradual removal of administrative controls prepared in advance.

The tax measures included in the package possess a partially anti-inflationary character but can also be viewed as structural reforms aimed at correcting existing imbalances within the tax system. Reforms of the lump-sum taxation regime for sole proprietors and tourism-related activities respond to the sustained increase in the number of taxpayers covered by these schemes, as well as to differences in the tax treatment of various forms of work and income generation. Together with the introduction of the excess profit margin tax, these measures may contribute to a

modest reduction in aggregate demand, effectively “cooling” the economy. Such an effect could have certain negative consequences for economic growth and investment activity while simultaneously contributing to lower inflationary pressures. Particular attention should be paid to the potential impact of the excess profit margin tax as a mechanism signalling to firms that price increases should not substantially exceed increases in input costs, thereby limiting the possibility of additional inflationary spillovers through the business sector.

Finally, the fiscal discipline measures are being introduced under circumstances in which the general government deficit in 2025 slightly exceeded the 3.0% of GDP reference threshold established under the ESA 2010 methodology, while a reduction to 2.9% of GDP is projected for 2026. Under such conditions, stronger fiscal discipline may be justified even if inflation were lower than it currently is. The period from 2023 to 2025 was characterized by substantial wage growth in the public sector and increases in various forms of social benefits, both of which significantly contributed to higher general government expenditure. Consequently, a temporary halt to their further expansion was expected and, to some extent, necessary in order to contain future pressures on public finances.

It should also be emphasized that, according to state budget and general government budget projections prepared at the end of the previous year, fiscal policy in 2026 was expected to be broadly neutral, unlike the preceding three-year period characterized by pronounced fiscal expansion. In this context, additional measures aimed at reducing aggregate demand could shift fiscal policy from a neutral stance toward a moderately restrictive one, consistent with the objective of easing inflationary pressures and stabilizing the macroeconomic environment.

The Commission concludes that the announced package does not constitute a comprehensive anti-inflationary programme, although one of its fundamental objectives is to preserve social security and protect the living standards of citizens, particularly lower-income households. At the same time, the package seeks to limit the transmission of the energy shock into broader price increases and to mitigate inflationary pressures in the short term through administrative price-control measures.

According to the Commission, the most significant contribution to reducing inflationary pressures could arise from effective control of general government expenditure and limitations on the growth of administratively regulated prices. By contrast, measures that increase the disposable income of specific population groups or maintain broad-based subsidy programmes have only a limited anti-inflationary effect and may even operate in the opposite direction if they stimulate additional consumption or sustain high levels of fiscal expenditure. Furthermore, the proposed tax changes may increase uncertainty in the business environment, negatively affect

investment activity, and slow long-term economic growth. Compared with previous policy packages, the current package is therefore more strongly focused on strengthening fiscal discipline than on directly combating inflation.

In light of the above, the Commission supports the orientation toward more responsible public finance management and stronger budgetary discipline. At the same time, it emphasizes the need for transparent implementation of the planned savings, a clear distinction between social and anti-inflationary measures, a comprehensive assessment of their effects at the general government level, and the preparation of a credible strategy for the gradual withdrawal of temporary administrative restrictions and subsidy programmes. Only such an approach can ensure that the package simultaneously contributes to reducing inflationary pressures, preserving fiscal sustainability, and avoiding adverse effects on long-term economic growth and investment activity.