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CROATIA – REVIEW OF PROGRESS ON POLICY MEASURES RELEVANT FOR THE  
CORRECTION OF MACROECONOMIC IMBALANCES

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## Executive summary

**This report is the second specific monitoring report under the Macroeconomic Imbalances Procedure (MIP) for countries experiencing excessive macroeconomic imbalances.** It reviews the latest economic developments and the main policy measures targeted at the correction of imbalances taken by Croatia since the publication of the first monitoring report in October 2014.

**Croatia is emerging from recession but recovery is set to be muted.** Croatia spent six years in recession but the pace of contraction in 2014 (0.4%) was slower than in the previous year. A mild recovery is now forecast for 2015, with growth set to reach 1% in 2016, spurred by EU-funded investments. With the fall in energy and commodity prices, price dynamics are expected to be negative in 2015, but to turn positive in 2016. Labour market conditions are set to improve only marginally due the weak growth environment.

**There is a need for further macroeconomic rebalancing.** Contrary to several Central and Eastern European Member States, external adjustment in Croatia has principally relied on import compression. Export growth gained ground in 2014, but remains far below its potential, in particular as regards export of goods. The net international investment position remained broadly stable in 2014 but gross external debt continued rising. The deleveraging needs in parts of the private sector and the public sector together with tight credit condition still hamper the recovery of internal demand. Deleveraging amongst the non-financial corporations, however, stopped in 2014 for the sector as a whole. Domestic debt held steady, while private non-financial corporations continued to increase their external debt. Deleveraging is nevertheless likely to have progressed in the construction sector and among the highly leveraged state-owned enterprises. The status of imbalances was analysed in detail in the 2015 Country Report.<sup>1</sup>

**While some progress in addressing the 2014 Country Specific Recommendations has taken place overall, the delivery of strong policy action on imbalances and growth remains a cause for concern.** The main findings of this monitoring report are as follows:

- **Areas where a policy response is on track are few.** As regards fighting youth unemployment, the most important measures include a 5-year waiver of mandatory contributions (17.2% of gross wage) for employers who offer permanent employment to workers below 30 and expanded workplace training schemes for youth. As already acknowledged in the first monitoring report, the second stage of the Labour Act reform is being implemented. The reform increases flexibility in the organisation of working time, facilitates the use of flexible types of work and simplifies the procedures for termination of employment. A diagnostic scrutiny of bank portfolios is underway; with preliminary results confirming that the financial sector has overall remained resilient.

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<sup>1</sup> See COM(2015) 85: [http://ec.europa.eu/europe2020/pdf/csr2015/cr2015\\_croatia\\_en.pdf](http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_croatia_en.pdf)

- **In several areas the policy response has been initiated but some implementation risks remain.** These areas include tax compliance, health care, active labour market policies, education and improving the capacity for the management of EU funds. Several important organisational changes in the tax administration are underway. An action plan to improve VAT compliance is being implemented but several steps are yet to be introduced. In health care, the financial situation of the sector remained problematic in 2014 but several measures are being implemented as of 2015. Increasing the reach of active labour market policies (ALMP) is continued through strengthening of the capacities of the Croatian Employment Service (CES) and increasing the scope of and expenditure for ALMP, but the pace of the reform needs to be sustained and the targeting of some vulnerable groups remain insufficient. Regarding the management of EU funds, the number of staff dealing with the funds is set to significantly increase in 2015. In addition, targeted training and a number of projects strengthening implementation capacities at local level are being prepared. However, the current state of play is likely to result in a low absorption of the 2014-20 allocation in 2015. The recently adopted Budget Act streamlines the budget preparation timeline and clarifies the medium-term budgetary anchor and the use of ESA standards. The main outstanding issues concern the consistency of multiannual budgeting between the Budget Act and the Fiscal Responsibility Act and the establishment of safeguards against overspending. A draft of the Insolvency Act, in an advance stage of preparation, integrates the pre-insolvency and insolvency procedure under a common framework and enhances the efficiency and transparency of both procedures. The implementation of the new framework by overburdened commercial courts may, however, turn out challenging.
- **There are a growing number of areas where technical analysis is taking place but policy action is yet to be defined or adopted.** This concerns in particular the ongoing expenditure (and tax expenditure) review, measurement of administrative burdens and the reviews of the tax and benefits system, wage setting and undeclared work.
- **Finally, there remain broad policy fields where stepping up the reform momentum or delivering a firm commitment is warranted.** Regarding the introduction of the real-estate recurrent property tax, the timeline for its technical implementation is back-loaded, which in combination with still pending decisions on some key modalities of the tax increases the implementation risks. Still on the fiscal-structural front, stepping up the reform momentum is warranted as regards strengthening the budgetary planning, including enhancing the quality of the budgetary forecasts, reinforcement of control over expenditure and addressing early exits from the labour market. Further significant policy effort is required to improve the business climate, in particular as regards i) decreasing para-fiscal charges, where progress to date has been slower than expected; ii) enhancing the governance of publicly-owned enterprises, where only partial steps are being prepared; iii) modernising the public administration, where the Strategy for Modernisation of the Public Administration and specific guidelines for establishing and functioning of state agencies have been prepared but time-bound action plans are yet to be developed. The reform agenda on addressing the fragmented decision-making and weak accountability framework across government levels is proceeding at a slow pace; iv) specifying the response to identified corruption risks; and v) improving the performance of commercial courts.

## 1 Introduction

On 13 November 2013, the European Commission presented, as part of the Macroeconomic Imbalances Procedure (MIP), its third Alert Mechanism Report, which concluded that an in-depth analysis was required to understand whether macroeconomic imbalances exists in Croatia. The nature and severity of macroeconomic developments and risks was examined in the subsequent In-depth Review, published on 5 March 2014.<sup>2</sup> The Commission concluded that *"Croatia is experiencing excessive macroeconomic imbalances, which require specific monitoring and strong policy action. In particular, policy action is required in view of the vulnerabilities arising from sizeable external liabilities, declining export performance, highly leveraged firms and fast-increasing general government debt, all within a context of low growth and poor adjustment capacity. The Commission will put in motion a specific monitoring of policy implementation, and will regularly report to the Council."*<sup>3</sup>

On 24 April 2014, the Croatian authorities submitted the Convergence Programme and the National Reform Programme, respectively outlining updated fiscal targets and planned policy measures to restore economic growth and help unwind imbalances. After assessing the two documents, on 2 June 2014 the Commission proposed a set of policy recommendations<sup>4</sup> to address macroeconomic imbalances which were adopted by the Council<sup>5</sup> on 8 July 2014. The recommendations related to the MIP cover (i) fiscal policy and fiscal-structural measures; (ii) the functioning of the labour market and education and effectiveness of social protection; and (iii) structural measures to boost growth and competitiveness. In addition, a specific financial-sector recommendation aims at improving the understanding of bank balance sheets. On 30 July 2014, the government adopted a plan on the implementation of CSRs (hereafter referred to as the "implementation plan"). An overview of the recommendations related to the MIP is provided in Annex 1.

Progress on implementing reforms was for the first time assessed in the 1<sup>st</sup> monitoring report in October 2014.<sup>6</sup> The present report assesses the main policy measures taken by Croatia since then; the cut-off date for this note is 12 February 2015. For this purpose, a second specific monitoring mission to Croatia was conducted on 20-23 January 2015. Regarding fiscal policy, on 2 June 2014, the Commission published its assessment of effective action in the framework of the Excessive Deficit Procedure. Since then, the procedure is held in abeyance. Though also MIP relevant, these issues will not be covered in this report, in order to avoid an overlap of surveillance processes.

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<sup>2</sup> [http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2014/pdf/ocp179\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp179_en.pdf)

<sup>3</sup> [http://ec.europa.eu/economy\\_finance/economic\\_governance/documents/2014-03-05\\_in-depth\\_reviews\\_communication\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/documents/2014-03-05_in-depth_reviews_communication_en.pdf)

<sup>4</sup> [http://ec.europa.eu/europe2020/pdf/csr2014/csr2014\\_croatia\\_en.pdf](http://ec.europa.eu/europe2020/pdf/csr2014/csr2014_croatia_en.pdf)

<sup>5</sup> [http://ec.europa.eu/europe2020/pdf/csr2014/csr2014\\_council\\_croatia\\_en.pdf](http://ec.europa.eu/europe2020/pdf/csr2014/csr2014_council_croatia_en.pdf)

<sup>6</sup> [http://ec.europa.eu/economy\\_finance/economic\\_governance/documents/2014-11-07\\_croatia\\_mip\\_specific\\_monitoring\\_report\\_to\\_epc\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/documents/2014-11-07_croatia_mip_specific_monitoring_report_to_epc_en.pdf)

## 2 Macroeconomic context

**Croatia emerges from a protracted recession but the need for further macroeconomic rebalancing is set to continue to drag on economic growth.** In the fourth quarter of 2014, real GDP increased by 0.3%, as compared to the same quarter of 2013. Household demand and government consumption contracted by 0.6 and 0.5 respectively, while investment registered another sharp contraction of 3.7%, driven by another reduction of activity in the construction sector (-4.9% y-o-y). Export performance continued to be strong, though it partially reflected re-exports of extra-EU imports following accession. The pace of growth abated to 4.5%, down from 11.4% in the first quarter. In 2014 as a whole, real GDP decreased by 0.4%. Growth is projected to be just above zero in 2015 and to attain 1.0% in 2016. The figures below show the cumulative loss in real GDP in comparison with selected peer economies.

**The negative NIIP was only marginally affected by the turnaround in the current account and gross external debt remains a factor of vulnerability.** Following a sharp import contraction, the current account balance turned to a small surplus in 2012 (see below). On the back of the recent improvement in export performance, the current account balance is set to achieve a surplus of 0.9% of GDP in 2014. In the third quarter of 2014, nevertheless the negative NIIP deteriorated marginally to -88.2% of GDP, as opposed to -87.9% at the end of the previous year. Gross external debt increased slightly reaching 107.9% of GDP in Q3 – up from 105.3% at the end of last year (essentially due to valuation adjustments related to appreciation of US dollar against euro).

**The labour market seems to have reached a trough, but the labour market absorption capacities are slowed down by the sluggish recovery.** LFS data for the third quarter of 2014 signalled an increase in the activity rate (67.6%) and employment rate (56.9%): both rates registered an increase with respect to the previous quarter and the same quarter of previous year. Unemployment decreased in the third quarter, reaching 15.8%, down from 17% of the same quarter of the previous year. Recent data on registered unemployment signal the same trend. These data are nevertheless surprising, considering the on-going contraction of the economy and household disposable income – especially in light of the stagnating wage dynamics. A comparative perspective on the dynamics of unemployment is shown below. Despite these modest improvements in 2014, the current outlook foresees only a mild contraction of the unemployment rate for 2015 and 2016.

**Adjustment in prices and wages is hindered by the low inflationary dynamics.** Wages in 2014 stagnated in nominal terms. From January to November 2014, the average monthly gross earnings per person in paid employment in legal entities increased by 0.1% in nominal and by 0.3% in real terms compared with the same period of 2013. Price dynamics continued to be subdued according to the Harmonised Index of Consumer Prices (HICP), whereas the Consumer Price Index (CPI) currently used by Croatian authorities is already negative. On the annual average, the CPI decreased by 0.2% in 2014. The development in the main components of the HICP index is shown below. The outlook for inflation for 2015 continues to be subdued on the back of falling energy and commodity prices, whereas a slight pick-up in core inflation is expected with economic growth in firmer positive ground in 2016. In the

short term, however, the subdued price dynamics will slow down adjustments in relative prices and in wages.

**Household debt broadly stabilised in the third quarter of 2014, while deleveraging in non-financial-corporation seems to have come to a halt.** Total household debt broadly stabilised at around 40.4% of GDP. The total amount of outstanding loans to household further decreased in the second half of 2014, despite historically low interest rates, reflecting negative expectations on the labour market as well as tightening of credit conditions from the banks. The debt-to-GDP ratio (non-consolidated) of non-financial corporations, on the other hand, increased marginally from 88.2% at the end of 2013 to 89.2% at the end of the third quarter of 2014 (see below).

**Public debt is set to continue on its rapidly increasing trend.** The general government debt is expected to have increased from 75.7% of GDP in 2013 to 81.4% of GDP in 2014. The level of debt was strongly affected by the inclusion under the new accounting rules of two major state-owned enterprises, which have contributed to the debt-to-GDP ratio in the period 2008-2013 on average by 7.8 pps. In 2015 and 2016 the debt-to-GDP ratio is expected to increase to 84.9% and 88.7% of GDP as a result of the underlying deficit trends.

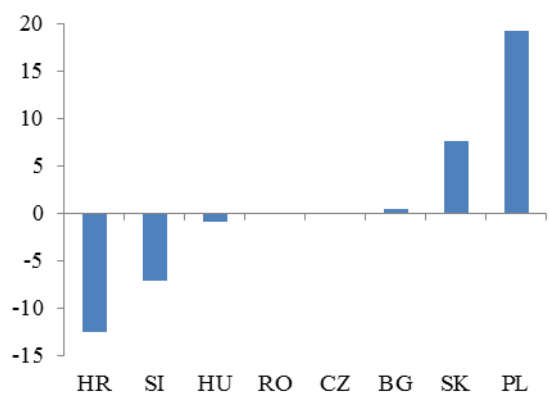
**The recent reviews of banking sector portfolios have confirmed the picture of a stable financial sector, albeit one facing challenges from a weak economic environment.** The Single Supervisory Mechanism (SSM)'s Asset Quality Review (AQR) has led to a relatively small revision of the NPL, coverage and capital adequacy ratios of the four Croatian credit institutions included in the exercise as they were part of euro area banking groups. Despite the relative strength of most domestic credit institutions, financial sector vulnerabilities persist. In September 2014 the NPL ratio reached 17.2%, up from 15.3% one year earlier. The highly-indebted corporate sector (the corporate NPL ratio stands at 30.6%) represents a source of concern for the financial system, despite the significant level of external and state-guaranteed debt.

**The correction in the housing market has been sharp, but recent indicators suggest that the real estate prices are stabilising.** The hedonic real estate price index is now broadly back to the value at the end of 2004, thus offsetting the sharp increase registered before the crisis. Following a 0.6% increase in the second quarter of 2014, the real estate prices further grew by 4.7% in the third quarter, on the back of a strong rebound along the Adriatic coast. In year-on-year terms, the index registered its first increase since the offset of the crisis (2.5%).

**All in all, recent indicators at outlook present a mixed picture.** The process of internal devaluation is delivering some fruits, specifically in terms of external rebalancing, though the external adjustment essentially operated until recently through import compression. However, strong headwinds stemming from the deleveraging needs in parts of the private sector and in the public sector (including SOEs) and to a lesser extent from tight credit condition still hamper the recovery of the internal demand. Subdued price dynamics support disposable income and competitiveness, but hinder the adjustment process due to nominal rigidities.

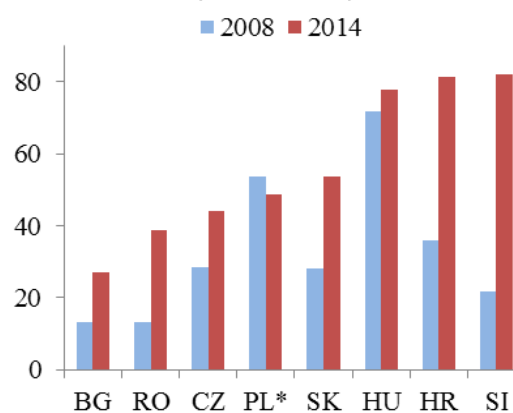
## Recent macroeconomic developments

**Cumulative real GDP growth 2008 - 2014 (% change)**



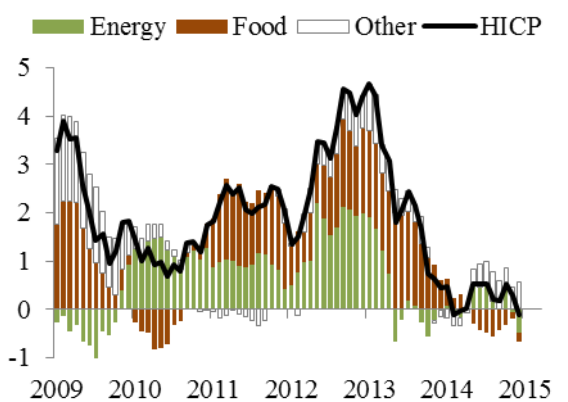
Source: AMECO

**General government debt (% of GDP)**



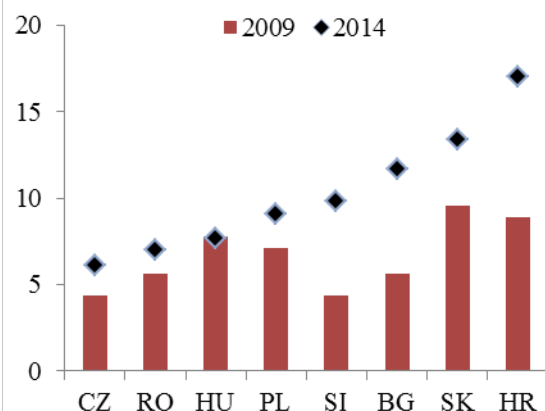
Source: AMECO, PL 2010-2014

**Inflation (year-on-year growth)**



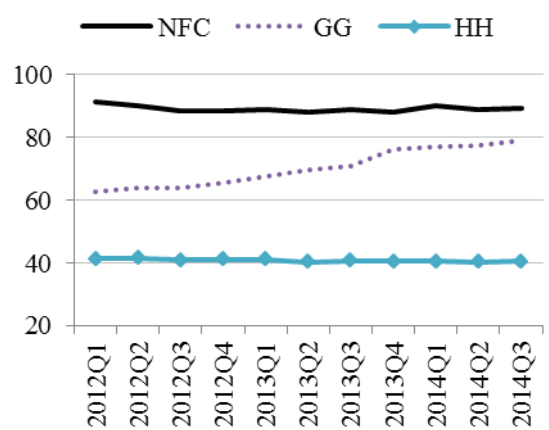
Source: Eurostat

**Unemployment rate (%)**



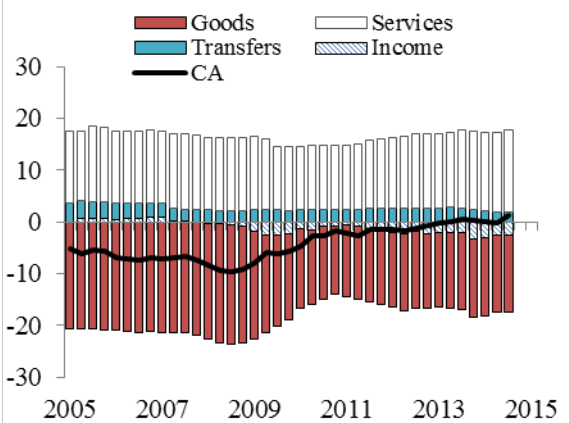
Source: AMECO

**Non-consolidated debt by sector (% of GDP)**



Source: Eurostat

**Current account (% of GDP)**



Source: Eurostat



### 3 State of play with MIP-related reforms

This section gives an update of policy measures taken since the discussion of the 1<sup>st</sup> monitoring report in October 2014. More details by single reform item can be found in the table annexed to this report.

#### *3.1 Measures to enhance the quality and long-term sustainability of public finances*

**Progress on important fiscal structural reforms remains uneven and subject to implementation risks.** Policy areas where measures are being implemented include healthcare reforms, improving tax compliance, and the re-assessment of disability claims. Nevertheless, uncertainty remains as to their full effectiveness and ambition. The draft of the Fiscal Responsibility Act which grounds the Fiscal Policy Commission in law has been prepared and work is ongoing as regards aligning budgetary projections to ESA standards. Stepping up the reform momentum is warranted as regards addressing early exits from the labour force and strengthening the budgetary planning, including the improvement of the budgetary forecasts as well as to reinforcement of control over expenditure. A commitment to introduce recurrent property tax and fully implement the expenditure review findings has not been publicly declared yet.

**Some limited steps towards increasing the alignment of budgetary projections to ESA standards and reinforcing control over expenditure have been taken.** Differences in terms of coverage and delimitation between the data used for budgetary statistics by the Ministry of Finance and data used in the production of ESA fiscal statistics are being identified, but a note on this issue has still not been published. The authorities reiterated their intention to have the first ESA-aligned projections ready for the 2015 Convergence Programme. However, so far the authorities have not been able to provide an estimate of the ESA aligned deficit outturn for 2014.

**The preparation of the expenditure review has advanced.** A government decision on the expenditure review has been endorsed. Five sub-committees, each responsible for designing options for potential savings in their policy areas, have been established. They are chaired by the local experts from public research institutes in the area of economics and public finance. The authorities plan to review spending in state-budget wages, health care, public subsidies, operations of agencies, as well as the government spending through tax expenditures. A central committee with a task to coordinate the work of sub-committees has also been established. Sub-committees are expected to deliver their reports to the central committee by 1 February 2015. These reports should propose a package of measures leading to a 10% reduction in expenditure against the 2014 revised targets. By 1 March 2015, the government was supposed to decide which of the proposed measures will be implemented. Importantly, there is not yet a clear commitment on how the findings of the review will be implemented.

**With some delay, changes to the Fiscal Responsibility Act have been drafted.** The application of current fiscal rules remains challenging and they are also not defined in terms of variables which are aligned with the fiscal targets stemming from EU rules. Furthermore, despite recent steps taken to make the Fiscal Policy Commission (FPC) – which is

established and operating – more independent from the Ministry of Finance, a further upgrade of its status and autonomy from the Parliament, through amendments to the Fiscal Responsibility Act, is warranted. The authorities have proposed amendments to the existing legal framework which are currently being discussed, also with the Commission services.

**Amendments to the Budget Act have been adopted in the parliament; notwithstanding several improvements, several issues still remain.** The new act is bringing several improvements to the Croatian budgetary framework. The budgetary process is now harmonised with the timeline of European Semester, including the submission dates for the Convergence Programme and the National Reform Programme. Economic and Fiscal Policy Guidelines are clearly identified as the medium-term budgetary anchor. There is a clear reference to ESA 2010 as a standard for the application of the act. Additional transparency has been introduced, by dividing budgets into limits dedicated to existing and new policies. This should enable more realistic expenditure planning, because an introduction of new programmes will not be allowed if the existing programmes are not fully covered by the available funds. However, several issues have not been addressed in the final version of the act, including a clear consistency of multiannual budgeting between the Budget Act and the Fiscal Responsibility Act, the establishment of sufficient safeguards against overspending, transparency of and the follow-up to the ex-post evaluation of forecasts. It is regrettable that the act has been put into accelerated adoption procedure without prior consultation with the Commission services.

**Work on improving tax compliance is underway; a catalogue of tax expenditure has been prepared.** The tax administration has prepared a document named "Measures for collection improvement", which defines priorities in relation to collection of overdue tax debts. An action plan with measures to improve VAT compliance has been finalized, adopted by the tax administration and is being implemented. The plan is broad, addresses a couple of significant issues such as better control of the reverse charge mechanism and the introduction of a more systematic risk assessment procedures. Implementation of the plan is on track, however many important steps are yet to be introduced. In addition, at this point it is too early to isolate the effect of the action plan from other factors contributing to the improved VAT revenue. In addition, a new organisational unit within the Ministry of Finance (Independent Sector for Detection of Tax Fraud) has been created. Also, amendments to the Act on Tax Administration Office have been adopted, creating a basis for improvement of the corporate management and territorial organisation of the tax administration. The authorities have finished a 'catalogue' of tax expenditure. In addition, a document that defines the obligation of a regular reporting of tax expenditure has been drafted. It is expected to be adopted following the introduction of amended Fiscal Responsibility Act.

**Technical preparations for the introduction of a recurrent property tax are underway, but political commitment is still missing.** In October, the Ministry of Finance has adopted a decision for the establishment of a working group for the implementation of a fiscal (tax-base) register. A roadmap for the introduction of property taxation has been prepared. In addition, an analysis of registers of real estates (source registers) and additional registers that might be used for cross-checking the data in source registers has been completed. The

authorities have decided to use the Joint Information System (JIS), comprising cadastre and land register data, as a basis for the assessment of tax liability. This will be complemented and corrected by the information from the local governments' databases on communal fees and the database of electricity consumers in Croatia. While these activities are a useful and necessary step towards the successful implementation of a real estate tax, a clear decision about the exact modalities and expected revenue from this tax is still missing.

**Addressing early retirement and tackling other inefficiencies in the pension system remain a challenge.** In the first nine months of 2014, more than 35% of all retirements under the general pension system involved early retirement, with 'standard' early pensioners accounting for around ¾ of early exits and early retirement of workers in arduous or hazardous professions for the rest. The authorities have not put forward policy measures that would make standard early retirement less attractive. The reform of pension entitlements of persons working in arduous or hazardous professions, announced initially for December 2014, has been postponed to the third quarter of 2015, together with a transfer of their pension assets from the 2<sup>nd</sup> pillar to the state budget. Regarding disability pensions, 1<sup>st</sup>-instance assessment of disability claims was moved from the Croatian Pension Insurance Institute to a newly established institution, the Single Expert Evaluation Body, which centralises expert evaluations in several areas previously scattered among various government departments. Finally, the harmonisation of special pension rights of military and police officers, announced for December 2014, is facing delays while further steps on harmonising special and general-system pensions have not been announced.<sup>7</sup>

**Regarding health care, the budget allocation for hospitals increased in 2015, which is expected to help stabilize the system financially; however, further efficiency gains are still necessary.** The build-up of arrears continued in 2014. Despite a one-off payment of 3.2 bn (1% of GDP) from the state budget to cover the outstanding obligations of hospitals and the Health Insurance Fund (HZZO), the level of arrears reached HRK 3.1 bn (0.9% of GDP) in November 2014. To stop the accumulation of arrears, the authorities are increasing the budget allocation for hospitals, strengthening the HZZO and implementing measures to improve efficiency of health care.<sup>8</sup> Specifically, the health care budget is increased by 10%, most of which will be attributed to hospitals. The increase partially institutionalises the past ad-hoc reimbursements but does not cover them fully, meaning that hospitals will be expected to achieve savings in order to avoid a further build-up of arrears and to gradually repay the existing ones. Health contributions are as of January 2015 removed from the Treasury and channelled to the HZZO. The authorities argue that was a prerequisite to the

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<sup>7</sup> Future steps on harmonising special and general-system pensions will need to reflect the August ruling of the Constitutional Court, which declared unconstitutional the retroactive removal of special pension rights for MPs and high-level state officials.

<sup>8</sup> Apart from the reform of hospital financing and the National Plan, outlined in detail below, a number of other measures are being implemented. For instance, the authorities are enhancing quality assurance and prevention programmes and expect to achieve savings by further strengthening of the joint procurement project, referrals, sick-leave applications, e-Health and primary care financing. A Strategic Plan of Developing Human Resources for 2014-2015 will be prepared to assess the overall situation and the need for human resources development.

reforms outlined below. It is yet to be established whether greater autonomy of the fund will help ensure financial discipline.

**The authorities are putting in place a new model of contracting for hospital care, which is a step in the right direction but its implementation may be challenging.** The current hospital financing system has motivated hospitals to overspend and only vaguely took into account the local specificities.<sup>9</sup> In 2015, a transition to a partial retrospective payment system, based on diagnosis-related groups (DRG), is scheduled to take place, which is expected to decrease the share of the ex-ante component (independent of the level of care provided) to 45% by November 2015. The new financing system aims to channel funds to where care is provided and thus provide an incentive to rationalise existing, but underused, capacities. The authorities expect that, where the new payment mechanism (and ongoing monitoring) reveals unsustainable financial positions, the hospital management will opt for a functional integration of the units concerned with another hospital in the region or achieve savings in another way. The introduction of more competitive and performance-based contracts for hospital managers to support these changes is under discussion. However, the enforceability of changes involving reallocation of staff, adjustments in operational processes or space capacities in the given timeframe (a year) may turn out difficult, which constitutes a residual risk for the financial stability of the system. Strengthened quality assurance, support to hospital administration (e.g. trainings) and improved managerial systems are foreseen to help overcome these issues.

**The National Development Plan, adopted by the government in November 2014, identifies and initiates much-needed changes to the healthcare system but may be difficult to implement fully.** The Parliamentary adoption of the plan is pending. The plan aims to reduce the acute hospital treatment rate and increase the number of patients treated in outpatient and day care setting. As a result, it is expected to support the harmonisation and rationalisation of the bed occupancy rate, reduce the length of hospital treatment and improve access to hospital care.<sup>10</sup> The implementation of the plan is not intended to result in sizeable aggregate savings. Since hospital managers will ultimately be designing the appropriate adjustment in individual hospitals, close monitoring of the plan's implementation and strict enforcement will be needed. Furthermore, switching to alternative treatment modes requires training and equipment adjustments, which could become a bottleneck for reaping full benefits of the plan.

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<sup>9</sup> The monthly spending limits for individual hospitals were not set in a transparent way. See European Observatory on Health Systems and Policies (2014): Croatia – Health System Review. Health Systems in Transition, Vol. 16, No. 3.

<sup>10</sup> Specifically, by 2016 acute hospital care should decrease by 10%, day cases and outpatient care should increase by 10%, the average length of hospital stays should be reduced by 10-40% in individual hospitals and the average bed occupancy rate should rise to 85%.

### ***3.2 Measures to improve the functioning of the labour market, education and the effectiveness of social protection***

**Some concrete policy actions in the area of labour market reforms have been taken, but progress in compliance with the recommendations remains uneven and a number of key action plans are still pending.** The implementation of the new Labour Act and addressing high levels of youth unemployment are policy areas where concrete measures have been carried out. Effective implementation and impact monitoring will enable assessment of actions taken to strengthen the reach of active labour market policies. In other areas, policy actions commensurate to the challenges identified in the Croatian labour market are yet to be outlined based on the findings of the reviews of tax and social benefits systems, wage setting and undeclared work.

**The 2014 Labour Act has entered the implementation and monitoring phase.** A Joint Committee – composed of representatives from the Ministry of Labour and Pension System, social partners, the Croatian chamber of commerce and the Croatian chamber of crafts – has been established with the purpose of monitoring the implementation of the new Labour Act.<sup>11</sup> The committee defined a methodology for analysing and evaluating the effects of the Labour Act and decided to focus its monitoring efforts primarily on three areas of the reform: (i) working time arrangements; (ii) company restructuring and dismissal procedures; and (iii) use of other flexible employment contracts under the new staff reallocation rules. The Ministry of Labour and Pension System has established a new coordination mechanism with local authorities at county level where part of the collective agreements are registered, as well as with the Ministry of Justice, to analyse labour-related court proceedings. The Ministry, in cooperation with representatives from unions and employers organisations, is also holding regional workshops to inform and educate relevant stakeholders about the changes introduced by the new Labour Act. The provisions which seem to have received most appreciation from the stakeholders – especially from employers – are the ones linked to the newly introduced flexibility in working time arrangements. There are plans to use the databases of the Pension Institute to monitor the observed increase in the use of fixed-term contracts and possible risks related to labour market segmentation, as well as the pick-up of the new provisions on additional work (over full-time). Overall, the collection of data remains a weakness in the current setup and the establishment of adequate statistical databases for policy evaluation remains a priority. The authorities plan to strengthen the capacities of the Labour Inspectorates granting them a more prominent role in the enforcement of extended collective agreements and in the implementation of the Labour Act, with the aim to increase coordination and assure a coherent application of the provisions. A first impact assessment report of the 2013-14 labour market reforms is scheduled for March.

**The Act on Representativeness of Employers' Associations and Trade Unions aims at eliminating legal uncertainties.** The 2012 Act on criteria for participation in tripartite bodies

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<sup>11</sup> The bylaws regulating the dismissal procedures of protected categories of workers are still under discussion, and should be adopted in February. All other bylaws are in force.

and representativeness for collective bargaining<sup>12</sup> established the first legislative framework prescribing criteria and procedures related to the representativeness of trade unions. Even though the act partially fulfilled its function, a number of legal uncertainties and inconsistencies with existing regulations emerged in its application. The 2014 Act on Representativeness<sup>13</sup> had the aim of aligning the regulation on representativeness with the 2014 Labour Act, thus clarifying and simplifying its application. The main areas addressed by the new regulation include the structure and procedures for bargaining and concluding collective agreements, the question on non-representative trade unions, the right to strike and its application, and the cancellation of collective agreements.

**With the assistance of external experts, the authorities have completed a review of the wage-setting system, and the results should guide future policy action.** The main findings of the review indicate that there is no uniform system of collective bargaining in Croatia: features of collective bargaining vary considerably both in terms of the sector of activity, ownership, and the size and age of the business entity. The review further notes that the government has limited possibilities for direct intervention in segments such as local government, local public enterprises and the private sector. The conclusions of the review indicate that there is scope to foster wage dynamics better aligned with the macroeconomic environment or microeconomic indicators, and that a greater degree of coordination in the system of wage bargaining could be considered. The Ministry of Labour and Pension System has initiated a debate with independent experts from the Advisory Committee of the minister and social partners on the possible measures – of either legislative or administrative nature – that could address the findings of the analysis. The envisaged next steps in response to the wage-setting review include: (i) inter-sectoral meetings and a consultation with relevant ministries on establishing centralized coordination of collective bargaining in the public sector and SOEs (April) and an employers' association for public companies; (ii) the strengthening of coordination mechanisms among responsible institutions for each economic sector (February); and (iii) formulating a research programme in the field of wages, employment and productivity (April) and a monitoring system of the influence of the minimum wage in specific sectors (June). The reform of the current institutional setup – especially with regards to the existing collective agreements within SOEs (which are more favourable than the Labour Act) – may prove challenging and largely depends on reaching a consensus with ministries and bodies in charge of SOEs.

**Weaknesses in administrative capacities of the Croatian Employment Service (CES) persist.** The CES is undergoing a far-reaching and lengthy restructuring process. The first half of 2015 will be dedicated to establishing the IT infrastructure, planning and the preparatory work for the modernisation measures contained in the CES Action Plan.<sup>14</sup> The

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<sup>12</sup> Official Gazette 82/2012 and 88/2012

<sup>13</sup> Official Gazette 93/2014

<sup>14</sup> The implementation of the Action Plan foresees: 1. Strengthening the administrative capacities; 2. Reorganization of five regional and seventeen local offices; 3. Establishing Youth Centres; 4. Establishing Information and Career Guidance Centres (currently eleven Centres are operating and by the end of 2017, twenty-two Centres are foreseen); 5. Establishing the EURES and Migration and Information Centres; 6.

implementation of these measures is planned to start in the second half of 2015, with the majority of the reorganisation carried out through 2016 and completed in 2017. The whole process is however heavily reliant on financing from the Operational Programme Efficient Human Resources (European Social Fund – ESF), therefore its completion faces implementation risks as it is contingent upon the successful realisation of ESF funded projects.

**The 2015-2017 Guidelines for the development and implementation of active labour market policies (ALMP) were adopted in December 2014.** The guidelines will serve as the basis for the development of annual plans for all institutions involved in ALMP planning and implementation. ALMP expenditure has increased from HRK 625 million in 2013 up to HRK 972 million in 2014. A further increase is planned in 2015 through EU funding. The national ALMP expenditure for 2015 stands at 0.3% of GDP (including training allowances), when adding the ESF / Youth Employment Initiative investments, the total allocation for ALMP reaches 0.5% of GDP. ALMP interventions planned for 2015 continue to be focused on youth, but also envisage some measures targeted on other vulnerable groups (long-term unemployed, low-skilled and older workers).

**Targeted measures have been put in place to address the situation of youth.** The Workplace Training Initiative will be rolled out as of March 2015, with the objective of providing 500 young unemployed individuals with work experience for a period of 6 months. Both the trainees and the employers will receive financial subvention during the training period, while trainees will remain in the unemployment register. There have been some substantial modifications in eligibility criteria of the main youth ALMP measure 'Occupational Training without Commencing Employment'. Along with removing the requirement for private sector employers to offer employment, participation was broadened to mid-sized employers, increasing the allowed ratio of trainees per number of employees in 2014,<sup>15</sup> and as of 2015 the gross monthly financial support provided to programme participants increased from HRK 1600 to HRK 2400. In November 2014, the amendment to the Act on Contributions (in force since 1st January 2015) stipulated that the employers who offer permanent employment contracts to individuals under 30 are exempt from paying mandatory contributions (in the amount of 17.2% of the gross salary) for a period of 5 years. The exemption is valid for private and public employers, who both welcomed the measure. In November 2014 the webpage of the Youth Guarantee was launched and serves as a central point of access for all relevant information on opportunities for education, work and employment and other available forms of support and career guidance. The introduction of other projects under the Youth Guarantee is planned for February 2015 and will be financed through the ESF. Overall, there have been measures taken, aiming at addressing the situation

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Establishing two Self Employment Centres in 2015; 7. Setting up of Job-shops; 8. Reorganising business processes; 9. Setting up of contact-centres.

<sup>15</sup> The measure is intended to target the sector of crafts, as work experience is required for their profession by the legislation. However, since eligibility is not limited to trainees under such obligations, the effects of such changes in eligibility criteria may vary and are difficult to assess, until the results of close monitoring are made available.

of youth, but close monitoring is needed on their effects, to enable assessment of their impact and the development of effective follow-up actions.

**In November 2014 the Commission for combating undeclared work completed an analysis of measures taken over the past years, with the aim of assessing their effectiveness and proposing possible amendments.** Based on the results of the analysis and feedback received from the Labour Inspectorates, the Ministry of Labour and Pension System has identified four key areas where new measures will be implemented in the short-term. First, in the fisheries sector, the Ministry of Sea, Transport and Infrastructure and the Ministry of Agriculture are considering the introduction of a voucher system for the employment of auxiliary fishermen.<sup>16</sup> Second, an enhanced coordination and data exchange framework between the Labour Inspectorate, the Ministry of Science, Education and Sports, and the Ministry of Labour and Pension System has been put in place in order to identify and prevent abuses in the use of students' contracts. Third, the legislative framework used in the application of the Cooperatives' Act was found to be unclear in the definition of activities which can be performed by members of cooperatives, thus leaving room for interpretation and increased risk for undeclared work. In this regard, the competent ministries<sup>17</sup> will prepare an opinion on the application of the Cooperatives' Act, and an amendment to the Act later this year. Fourth, the Ministry of Public Administration and the Ministry of Labour and Pension System will analyse the possible risks existing in the non-governmental organisations performing economic activities. Finally, there is an ongoing dialogue on the incidence of undeclared work within the Economic and Social Councils at national, local and sectoral level<sup>18</sup>, under the coordination of the Ministry of Labour and Pension System. The most recent measures already implemented include the mandatory registration of workers before they start work, introduced by the Pension Insurance Act, and the possibility for full-time workers to take up additional contingent work with different employers, introduced by the 2014 Labour Act. Furthermore, the authorities are planning to strengthen Labour Inspectorates and explore possibilities to better exploit the databases created by the introduction of the Single Tax, Surtax and Contributions Form (JOPPD), which should become available as of February. An analysis of the underlying causes of undeclared work was completed by the end of 2014.

**The Strategy for Education, Science and Technology was adopted in October 2014 announcing a number of ambitious measures.** These include the preparation of a comprehensive vocational education development plan, the reform of curricula and quality assurance mechanisms. The scope and complexity of the announced measures put into question the full realisation of the reform agenda within the set deadlines. The ongoing implementation of the Croatian Qualifications Framework (CROQF) is set to facilitate the harmonisation of tertiary and vocational education system with labour market needs. The National Committee for Human Resources Development has been operating since September

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<sup>16</sup> A similar measure has been implemented successfully in the agriculture sector targeting seasonal workers.

<sup>17</sup> The Ministry of Labour and Pension System and the Ministry of Entrepreneurship and Crafts

<sup>18</sup> Furthermore, a number of awareness raising campaigns have been carried out at local level.



2014 as a central strategic body for the development of the CROQF. For the time being, seven economic sector profiles have been developed and further sectoral councils are being appointed, whose role will be to approve qualification standards. A project for tracking labour market outcomes of higher education graduates from 38 professional study programmes has successfully merged student data with social security and unemployment data. The new database will be used from mid-2015 to conduct analysis on graduate employability. Finally, a study on the availability of work-based learning in vocational schools has been initiated in order to inform policy making.

**The review of the tax and benefits system is proceeding according to plan. Concrete reform proposals are expected in June.** In early 2015, the authorities completed mapping and compiling a consolidated catalogue of all benefits provided at central and local level in the country. The next step entails categorizing each benefit through an "ID" (description, status, expenditure, beneficiaries, and eligibility criteria) and listing all the benefits by target group in order to have a clearer overview of what kind of support is currently provided to each group. The analysis of the tax system is still pending. A comprehensive database on tax expenditures is being compiled as part of the expenditure review coordinated by the Ministry of Finance. Over the next months the information will be analysed by external experts with a view to identifying possible negative impacts of the tax system on inactivity and unemployment. The review of the tax and benefits system serves as a basis for the Ministry of Social Politics and the dedicated working group to develop an Action Plan with concrete reform options to be presented to the government in June 2015. For the moment it remains unclear which direction the reform of the social security system will take, as it depends on the proposed policy options and on the political backing they receive.

**Further steps have been taken in establishing the One-Stop-Shop (OSS) that serves as the single administrative point for the provision of social services.** In September 2014 a World Bank loan was signed for the project "Modernisation of social protection system", for the implementation of the OSS and the Management Information System One Stop Shop (MISSOS) – the electronic system which keeps records of all beneficiaries via a joint inter-institutional database. By end 2014 a number of framework agreements were signed for the purchase of equipment, design of business processes and development of the software necessary to the implementation of the OSS. Currently there are more than 500 offices that deal with the provision of social benefits across Croatia. The authorities have identified 126 existing public administration offices<sup>19</sup> that will serve as the OSS, and that will gradually take over the management and provision of all benefits. As a first step, in September 2015 the Guaranteed Minimum Benefit (GMB) will be transferred from the Social Welfare Centres to the OSS.<sup>20</sup> Secondly, the MISSOS will be tested from September to December 2015, and the authorities plan to switch the administration of the GMB from the current IT system (SocSkrb) to MISSOS by the end of the year. The Action Plan foresees the functional transfer

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<sup>19</sup> Regional branches of the Ministry of Public Administration

<sup>20</sup> The establishment of the OSS is also aimed at relieving the Social Welfare Centres from the administration of social benefits, allowing them to focus on their other functions. Civil servants from the Social Welfare Centres will accompany the transition period and will be involved in the training process of colleagues from the OSS.

of all child allowances (currently scattered across a number of institutions) to the OSS in the course of 2016, and to have the unemployment allowance and 5 different maternity benefits integrated in the OSS system by the end of 2016. The extraction of the unemployment allowance from the CES should allow a more efficient use of its scarce administrative capacities. The consolidation of social benefits through the full implementation of the OSS and the use of MISSOS should enable analysing micro-data for better policy design and targeting, as well as the establishment of a binding cap on social benefits.

### ***3.3 Structural measures to promote growth and competitiveness***

**Despite several important measures that have been adopted or initiated, measures promoting a growth-friendly environment overall face the largest implementation gaps.**

The most salient measure taken since October 2014 is the decision to strengthen the administrative capacity for the management of EU funds. The new pre-insolvency and insolvency framework is near parliamentary adoption and a rigorous measurement of administrative burdens has been initiated. However, the reform momentum needs to be stepped up as regards reducing para-fiscal charges, enhancing the governance framework of SOEs, modernising the public administration, addressing the fragmented decision-making and weak accountability framework across government levels, specifying the response to corruption risks identified in the draft Anti-corruption Strategy and improving the performance of commercial courts. Inadequate quality of the regulatory framework, insufficient capacity and difficulties in the implementation of policy measures represent additional uncertainties on the outreach of planned reforms.<sup>21</sup>

**In November 2014, the government decided to pilot measurement of administrative burdens using the Standard Cost Model.** The project concerns administrative requirements under the Trade Act and the Act on Mediation in Immovable Properties Transactions. It is carried out by the Agency for Investment and Competitiveness, which reports to the Ministry of Economy, in close co-operation with experts from the Netherlands. The pilot was expected to be completed by the end of February 2015, following which an action plan for regulatory simplification is to be presented for the areas covered by the pilot.

**However, progress in removing or decreasing para-fiscal charges is considerably slower than expected.** At the beginning of 2014, the register of para-fiscal charges contained 244 charges generating revenue of HRK 6.4 bn (1.9% of GDP). Collection of these charges is currently dispersed among the benefiting institutions, leading to high collection costs. The 2014 Implementation Plan announced the removal or reduction of 58 charges in 2014, with an expected decrease in revenues by 0.16 % of GDP. However, only 15 para-fiscal charges were actually reduced or eliminated, decreasing the para-fiscal burden by 0.03% of GDP. However, in total 63 levies were written off the registry (as it turned out that they were not 'para-fiscal' but other payments, such as concession fees), lowering its value by 0.9% of GDP.

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<sup>21</sup> See for instance the 2014 Member States Competitiveness Report (EC), the 2014 SBA Fact Sheet (EC), the WEF global Competitiveness Report 2014-2015, the World Bank Doing Business report 2015 and the 2014 Bertelsmann Stiftung's Sustainable Governance Indicators.

An additional 12 minor levies were added to the register. Insufficient prioritisation in terms of which charges should be reduced and the large fluctuations in the registry of charges, caused by weak coordination between competent ministries and the Ministry of Finance as the administrator of the registry, decrease the transparency of government efforts. The authorities plan to reduce the administrative burden associated with paying the charges by reducing the number of individual payments but a specific plan has not yet to be presented.

**In the field of public administration, reform progress remains limited, especially in addressing the fragmented decision-making and accountability framework across different levels of government.** The public consultation on the Strategy for Modernisation of the Public Administration 2014–20<sup>22</sup> is now closed. The final proposal for the Strategy is to be presented by end-March and discussed by Parliament in June 2015. The authorities are currently gathering data and carrying out an analysis on the functional distribution, costs, and administrative capacities of local self-government units. The results should inform the development of structural reform options and an Action and Implementation Plan, to be prepared by all relevant ministries under the supervision of a central coordination unit. The excessive fragmentation and the administrative weaknesses of the Croatian local (municipal) authorities directly affects a number of areas such as tax collection, the provision of social benefits, the management of ESI Funds, public procurement processes, the provision of public services at the local level, and others. The reform agenda in this area is proceeding at a slow pace and remains unclear. The authorities have carried out a review of the existing legal framework for the establishment and management of state agencies. Having found very large heterogeneity in the system of state agencies, the Ministry of Public Administration has prepared Guidelines which introduce a unified set of rules and criteria for the management, establishment, supervision, independence, and regulatory powers of agencies. A time-bound plan for the rationalisation of existing agencies is still missing, and should be presented in March 2015 together with the final report of the expenditure review.

**A number of initiatives still await adoption by parliament and full implementation.** The amendment to the State Administration System Act – which merges the management structures of regional administration offices (from 20 to 5) – was presented by the government in September 2014. Its adoption by Parliament is currently at a standstill in second reading. The public consultation on the proposed amendments to the Civil Servants Act<sup>23</sup> is closed. However, due to the observations raised by the representatives of the Croatian Legislation Office and a number of ministries, the legislative act has been put on hold and a new proposal is under preparation. The Implementation Plan<sup>24</sup> related to State

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<sup>22</sup> The Strategy defines broad reform objectives in three areas: provision of public services, human resources in the public administration, allocation of competences in system of public administration.

<sup>23</sup> The amendments aim at simplifying recruitment and dismissal procedures in the civil service, as well as redefining decision-making procedures concerning the rights, duties and accountability of servants.

<sup>24</sup> The plan consists of the following elements: (1) Regulation on the public register 'ProDII' which was adopted in November 2014 and will be implemented as of January 2015; (2) Meta-register which is in the final phase of development and for which training-courses have started in January 2015; (3) Regulation on organizational and technical standards for connection to SII, conditions and activities for implementation, supervision of projects,

Information Infrastructure Act – which ensures interoperability of public registers and information systems of public sector bodies – was adopted in November 2014. The Central Salary Management System (COP) has been successfully implemented, allowing a better overview and management of human resources within the public administration. The implementation of the Joint Information System of Land Registry and Cadastre (JIS) is ongoing; currently it is in use by 16 land registry offices and 13 cadastral offices. The new system displays first positive results, with the average time recorded for administrative proceedings significantly shortened in the offices that use the JIS.

**The authorities have continued improving electronic communication between citizens, businesses and the public administration.** The e-citizen portal is in continuous development and expansion, with the introduction of 12 more services by end 2014 and further upgrades planned for 2015. The participation of the Ministry of Interior to the project will allow within the following six months the emission of a larger variety of e-certificates and the payment of administrative taxes through the e-citizens portal. An electronic construction permit system, which allows issuance of the permit within 30 days, was rolled out to all administrative offices in January 2015. The system is part of a comprehensive physical planning portal. The authorities also plan to develop a new e-platform that would integrate and enhance the existing services for businesses, which are currently scattered between the Point of Single Contact and other electronic services.

**Further measures have been implemented to improve administrative capacity and strategic planning of European Structural and Investment (ESI) Funds, but implementation risks remain.** The difficulties linked to the switchover from the Instrument for Pre-accession Assistance (IPA) to Structural Funds and the Cohesion Fund delayed the absorption of the 2007-13 programme allocation. The contracting and implementation of the 2007-13 projects thus overlapped with the intensive preparation of the 2014-20 Partnership Agreement and the two Operational Programmes, all adopted by end 2014. At the moment the main short-term challenges stem from the necessity of meeting the 2007-13 programme cost eligibility criteria by end 2016, and simultaneously launching the implementation of the 2014-20 programmes. The current state of play is therefore likely to result in a low absorption of the 2014-20 allocation in 2015 and a significant pick up in 2016. Over the past months the authorities have put in place a number of targeted measures to improve funds management and reinforce administrative capacity. These include the recruitment of 349 additional staff<sup>25</sup> across ministries and agencies in the course of 2015. New capacities will also encompass technical experts, depending on the needs of the ministries. The authorities plan to carry out targeted training programmes<sup>26</sup> for staff throughout 2015, part of which will be dedicated to the development of the specific actions under the new sectors of the 2014-20 programme (education, health, energy, protection of natural resources). A number of projects are planned to strengthen capacities also at the local and regional level. The support of external experts in

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management development which is planned to be prepared by September 2015; and (4) Development of the e-citizen service.

<sup>25</sup> The salaries of the new staff are financed through the ESI Funds.

<sup>26</sup> The focus will be on public procurement, state aid, ITI, FI, irregularity management and anti-fraud measures.

a number of fields will be financed through technical assistance funds. This option however could be explored to a greater extent than currently envisaged, especially during the transition period of internal capacities building. In November 2014, the Ministry of Regional Development and EU Funds adopted the regulation on eligible expenditure for the programming period 2014-20. All budgetary users have included in their financial and strategic plans the projects within their sectors which are eligible for ESI financing. A detailed analysis of the planned public investments within the framework of the 2015-17 state budget has been carried out. The identification of priority projects for contracting and implementation in 2015 and 2016 is on-going. The publication of first 'Programme Complements' – defining implementing details for each Priority Axes, Specific Objective and Investment Priority – is scheduled for the end of March.

**The authorities plan to strengthen managerial nominations in SOEs.** Following the release of a register of board members and management of SOEs in September 2014, the authorities announced an overhaul of the nomination procedure for CEOs, to be adopted in the first half of 2015<sup>27</sup>, and a revision of remuneration rules for SOEs' management by the end of 2015. The proposed nomination procedure for the CEOs aims at allowing the (optional) use of professional staffing agencies for assessing candidates for managerial appointments but the proposal will require further work to ensure that top candidates are recruited.

**Despite its economy-wide significance, the supervision of publicly owned enterprises is fragmented and incomplete.** The ownership function for 59 companies or agencies of strategic or special interest for Croatia is shared between competent ministries and the State Office for State Property Management (DUUDI). The ownership function for other, more than 500 companies owned by the central government, most of them with a minority public share, is performed by the Centre for Restructuring and Sale (CERP). Subsidiaries owned by the above-mentioned SOEs and companies established by local entities and their subsidiaries are not considered state property and are not directly and systematically monitored by any public authority. While a differentiation in the exercise of ownership rights according to the level of public ownership appears appropriate, the monitoring framework currently in place is too narrow in view of the central government's responsibility in ensuring proper functioning of local labour and product markets and the fact that it ultimately bears the fiscal risks.

**The new Anti-corruption Strategy for 2015-2020 has been adopted by the Government but the specific way forward on tackling the identified corruption risks is yet to be outlined.** Parliamentary adoption of the strategy is foreseen in the course of 2015. The strategy outlines 31 horizontal measures and 33 sector-specific.<sup>28</sup> These measures identify, at a high level of generality, the issues that are expected to be addressed by biennial action plans

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<sup>27</sup> The CSR Implementation Plan adopted in July 2014 indicated that the nomination procedure would be accomplished by October 2014, with first tenders carried out by December 2014.

<sup>28</sup> The horizontal measures include areas such as public procurement, public enterprises and conflicts of interests. The sector-specific measures target, for instance, judiciary, economy, public finances, agriculture, health care and science / education / sport, and infrastructure / environment / transport.

(forthcoming). However, the strategy is not sufficiently clear as regards two specific areas singled out in the CSR: i) improving the transparency and efficiency of public procurement, where the gaps vis-à-vis best practices in preventing and detecting corruption are still relatively large, and ii) increasing the verification powers of the Conflict of Interest Commission.<sup>29</sup> As regards public procurement, apart from the measures that will be specified in the above-mentioned action plan for the Anti-corruption Strategy, the authorities are also preparing amendments to the Public Procurement Act (to be presented by the end of 2015) aiming to transpose provisions of the relevant EU Directives<sup>30</sup> and are refining the criteria for using the most economically advantageous tender specifications. The efficiency of public tenders for electricity, fuel and telecommunication services is likely to be enhanced by expanding the scope of centralised procurement from 34 to 658 public entities. The resources of the Central Procurement Office are planned to be strengthened.

**The government has adopted a new Insolvency Act to facilitate debt restructuring and streamline the insolvency procedure.** The Act is planned to be adopted by the Parliament in the first quarter of 2015; draft has benefitted from the comments from Commission services, which are currently being integrated into the law. The reform aims to facilitate an earlier access to the procedure when there is a risk of insolvency by making the insolvency/illiquidity test somewhat less strict than in the current law. The reform also gives a stronger role to commercial courts as regards verifying the reported claims and validating restructuring plans which appear to undermine the efficiency and credibility of the current regime. It is, however, unclear whether this change will result in tangible improvements given the limited resources (and hence efficiency) of commercial courts. The reform is likely to provide for stricter deadlines and therefore lead to a reduction of the length of proceedings. Some concerns, however, remain. In particular, it remains to be seen whether the reform strikes the right balance between ensuring protection of creditors and the efficiency of the deleveraging process.<sup>31</sup> In addition, the claims of secured creditors appear exempted from the stay on individual enforcement actions.

**The amendments of insolvency could contribute to speeding up the procedure.** The main novelties concern limiting the effects of parallel cases on the insolvency proceeding and streamlining the process of asset liquidation. The success of the application of the procedures will depend on pro-active involvement of commercial courts, which requires that the courts are equipped to deal with the procedure, in particular as regards appropriate training and the

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<sup>29</sup> The main measures of the anti-corruption strategy as regards public procurement include: i) harmonisation of laws and procedures, ii) improving the supervision of public procurement contracts, iii) establishment of a strategic approach to corruption risks through e.g. better monitoring of the implementation of transparency requirements and conflicts of interest, and iv) education and training. As regards conflicts of interest, the main measures include: i) administrative and technical capacity building, ii) expanding the scope of the Conflict of Interest Commission, iii) integration of relevant provision in internal rules of procedure, iv) enhanced verification, v) establishing a registry of officials, and vi) education and training.

<sup>30</sup> The Member States have until April 2016 to transpose the new rules into their national law (except with regard to e-procurement, where the deadline is September 2018).

<sup>31</sup> The procedure sets a cap of 10% on the size of the haircut that dissenting creditors (not accepting the settlement) may be forced to accept. In most other legislations, where such limitations are imposed, the limit is equal the liquidation value of the concerned claims.

business processes in courts (including case management) in light of the very tight deadlines envisaged for several procedural steps. The authorities also envisage introducing personal bankruptcy to allow natural persons to discharge their debts.

**The rationalisation of municipal, misdemeanour and county courts is in progress but strong policy action is yet to be delivered to improve the efficiency of commercial and administrative courts.** The reform, affecting municipal, misdemeanour and county courts, was adopted in October 2014 and is set to enter in force in April 2015. It aims to increase specialisation and balance out the uneven workload of judges through the merging of courts and improved allocation of cases. However, the reform does not concern commercial and administrative courts, where the disposition time remains relatively long.<sup>32</sup> In 2014, an upgraded ICT system was introduced in all 1<sup>st</sup> instance courts except administrative courts (which use a separate system), and the High Commercial Court and Supreme Court (which are expected to be included in 2015). However, the use of ICT systems in communication between courts and parties is underdeveloped, as electronic processing of claims and of undisputed debt recovery are still not possible.

### **3.4 Monitoring financial sector stability**

**The supervisory diagnostic exercises on the Croatian banking sector are nearing completion.** Croatia's largely foreign-owned banking sector has been stable in recent years, with the largest banks reporting some of the highest capital ratios in the region, but the economy continues to weigh on banks' profitability. Non-performing loans (NPLs) have been steadily increasing since 2008, notably in the corporate sector. In September 2014 the overall NPL ratio was 17.2% (up from 15.3% at end-2013), while corporate NPLs reached 30.6% (up from 27.4%) on the back of worsening asset quality and some reduction in credit volumes. As subsidiaries of euro area banking groups, the four largest Croatian banks – representing approximately 65% of banking sector assets – recently participated in the comprehensive assessment exercise (CA) organised by ECB in view of the imminent establishment of the Single Supervisory Mechanism (SSM). The CA consisted of a supervisory risk assessment, an asset quality review (AQR) and a stress test. Portfolios included in the SSM AQR were chosen on the basis of relevance at a banking group level. However, this meant that, from a Croatian perspective, some potentially important portfolios in some banks would not be included in the euro-area exercise. Furthermore, the SSM AQR, by its nature, did not include mid-size and smaller Croatian banks. In line with the Council recommendations, the Croatian National Bank (HNB) therefore performed additional supervisory diagnostic scrutiny on a wider sample of portfolios and banks. This exercise was referred to as a Portfolio Screening Exercise (PSE). This work stream began at the end of September 2014, i.e. once the CA had been completed, and was due to be completed in early 2015.

**The results from the PSE are in line with the SSM AQR for the largest institutions.** The CNB has prepared a report summarising the final results of the PSE exercise. Preliminary

results seem to confirm that the largest institutions are well capitalised, while some weaknesses in governance and risk management practices have been uncovered in a small number of mid-size and smaller institutions. In overall terms, the PSE also provides further evidence that Croatia's financial sector has been resilient to the economic downturn thus far, notwithstanding concerns about rising NPLs, notably to corporate borrowers, and the increasing exposure of the banking sector to the state.

**Banks' profitability is likely to be adversely affected by the exceptional measures taken by the government to address the appreciation of the Swiss franc.** Following the recent sharp appreciation of the CHF against the EUR and the HRK (from HRK 6.39 on 15 January 2015 to HRK 7.52 on 28 January 2015), the Croatian Parliament adopted on 23 January 2015 a law to freeze the exchange rate for the CHF at 6.39HRK on the HRK 22 bn CHF-indexed assets (of which 80% of housing loans) held by Croatian banks, for maximum one year. The costs of this operation (estimated at around HRK 400 million end of January) are to be borne exclusively by the banks. The risks associated with unanticipated exchange rate movements for borrowers, especially households, with large unhedged positions in a foreign currency have been increasingly stressed by European institutions in recent years. However, the Croatian authorities did not reduce the FX risk faced by households before the risk actually materialised. Instead, they decided to assign the whole loss to the banks ex post. While it is legitimate to find solutions for borrowers who are in payment difficulties, any remedy should be proportional, equitable and have a solid legal basis with a focus on helping generally distressed borrowers. This principle should also be borne in mind when designing the permanent solution that will replace this temporary exchange-rate freeze. Moreover, prior consultation with the relevant stakeholders and EU institutions on such policy actions would be recommendable, to ensure full compliance with existing EU legislation as well as to avoid negative spill-over effects.

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<sup>32</sup> For instance, the disposition time at the High Commercial Court reached 1243 days in 2014, up from 1142 in 2013.



#### 4 Annex Table

|   | 2014 CSRs                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
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| 1 | <i>Fully implement the budgetary measures adopted for 2014. Reinforce the budgetary strategy, further specifying announced measures for 2015 and 2016, and considering additional permanent, growth-friendly measures in order to ensure a sustainable correction of the excessive deficit by 2016. At the same time, ensure that the structural adjustment effort as specified in the Council recommendation under the Excessive Deficit Procedure is delivered. Align programme projections with ESA standards and Stability and Growth Pact requirements. Take measures to reinforce control over expenditure. By March 2015, carry out a thorough expenditure review. Reinforce the budgetary planning process, in particular by improving the accuracy of macroeconomic and budgetary forecasts and strengthening the binding nature of the annual and medium-term expenditure ceilings and improve the design of fiscal rules. By October 2014, ground in law the newly established Fiscal Policy Commission, strengthen its independence from all budgetary authorities, broaden its mandate, in particular with respect to the monitoring</i> | <p><u>By 1 March 2015:</u> The government is supposed to decide which of the proposed measures resulting from an expenditure review will be implemented.</p> <p><u>By 30 April 2015:</u> Production of ESA aligned projections to be delivered for National Reform Programme and Convergence Programme.</p> <p><u>By 1 January 2016:</u> Introduction of a recurrent property tax has been announced.</p> <p>Following the adoption of Fiscal Responsibility Act, a document that defines the obligation of a regular reporting of tax expenditure is expected to be adopted.</p> | <p><u>23/10/2014:</u> The government adopted a decision on the expenditure review.</p> <p><u>20/11/2014:</u> The government appointed chairs of the working groups and of the coordination group for the expenditure review.</p> <p><u>December 2014:</u> A catalogue of tax expenditures has been prepared.</p> <p><u>December 2014:</u> Tax Administration has prepared a document named "Measures for collection improvement", which defines priorities in relation to collection of overdue tax debts.</p> <p><u>October 2014:</u> Action plan for VAT with measures to be implemented to improve VAT compliance has been finalized.</p> <p><u>November 2014:</u> A new organisational unit within the Ministry of Finance (Independent Sector for Detection of Tax Fraud) has been created.</p> <p>November 2014: Amendments to the</p> | <p><u>25/11/2014:</u> Parliament adopted supplementary 2014 budget. Central budget deficit in 2014 has been increased by 0.7% of GDP compared to the plan from April 2014. According to the preliminary outturn, deficit in 2014 was 0.9% of GDP lower than envisaged by the revised budget. Measures that led to such reduction in the deficit were not sufficiently specified.</p> <p><u>02/12/2014:</u> Parliament adopted 2015 budget. The most important measure is expansionary PIT rebate. No additional consolidation measures are sufficiently specified or credibly announced.</p> <p><u>30/01/2015:</u> Parliament adopted new Budget Act. New act is bringing several improvements to the Croatian budgetary framework. However, several issues have not been addressed in the final version of the act, including a clear consistency of multiannual budgeting, formulation of the deficit constraint and the establishment of safeguards against overspending.</p> |

|   | 2014 CSRs                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Action taken                                                                                                                                                                                                                                                                                                                                                                                                 |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                 |
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|   | <i>of all fiscal rules and the ex ante and ex post assessment of forecasts, and ensure adequate resourcing. Building on plans outlined in the National Reform Programme, present a concrete strategy to reform recurrent property taxation. Initiate a process of reporting and reviewing of tax expenditures. Improve tax compliance, in particular by further enhancing the efficiency of the tax administration; present an action plan to this end by the end of 2014.</i> |                                                                                                                                                                                                                                                                                                                                                                                                              | <p>Act on Tax Administration Office have been adopted, creating a basis for improvement of the corporate management of TA.</p> <p><u>January 2014</u>: Amendments to the Fiscal Responsibility Act have been drafted.</p> <p><u>Q3.2014</u>: Activities related to property tax include: establishment of a working group for the implementation of fiscal (tax-base) register; preparation of a timetable of the next steps for the introduction of property taxation and the organisational structure of the project; an analysis of registers of real estates (source registers) and additional registers that might be used for cross-checking the data in source registers.</p> |                                                                                                                                                                                                                                                                                                                                                                                                 |
| 2 | <i>Reduce access to early retirement. Adopt legislation by March 2015 to accelerate the planned harmonisation of statutory retirement ages of women and men and to advance the planned increase of the statutory retirement age to 67 years. Ensure enforcement of tighter disability pensions assessments and controls and accelerate the integration of pensions under special schemes into the general pension system.</i>                                                  | <p><u>Dec 2014</u>: Reform of pensions for arduous or hazardous professions and the transfer of the associated assets from the 2<sup>nd</sup> pillar to the 1<sup>st</sup> pillar. Postponed to Q3 2015.</p> <p><u>Feb 2015</u>: Decision on next steps in the pension system based on the Ageing and Adequacy Reports.</p> <p><u>Dec 2014</u>: Harmonisation of pension rights for military, police and</p> | <p><u>26 Nov 2014</u>: The government adopted a final version of the National Development Plan for hospitals, which aims at improving the quality, availability, and efficient provision of hospital care. Parliamentary adoption should follow within weeks. The plan outlines harmonisation of the average bed occupancy towards 85%, a reduction of the average length of</p>                                                                                                                                                                                                                                                                                                     | <p><u>2014</u>: Transfer of assets from the 2<sup>nd</sup> to the 1<sup>st</sup> pillar of persons retiring under special regulations governing pension rights of active military personnel, police officers and authorized officials.</p> <p><u>Jan 2015</u>: Single Expert Evaluation Body (SEEB) became operational. The institution centralises expert evaluation that was prior to its</p> |

|  | 2014 CSRs                                                                                      | Action taken                                                                                                                                                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
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|  | <p><i>Strengthen the cost-effectiveness of the healthcare sector, including hospitals.</i></p> | <p>authorized officers.</p> <p><u>Nov 2014</u>: E-health Strategy (Jan 2015: Public consultation).</p> <p><u>End 2014</u>: Draft Strategic Plan of Developing Human Resources.</p> | <p>stay in hospitals by 10-40%, a reduction in acute hospital care by 10%, an increase in day care services at least by 10% and an increase in outpatient services at least by 10%. The Plan is still to be complemented by the definition of the approved and contracted activities; the number of beds and chairs and capacities (National Register).</p> <p><u>Jan 2015</u>: National Register of Health Care Providers established.</p> | <p>establishment scattered among various government departments (pensions, social security, war veterans, education, health care). The methodology for its harmonised evaluations was adopted by the government on 17 Dec 2014. Concerning disability pensions, SEEB has taken over medical experts from Croatian Pension Insurance Institute and is responsible for assessing disability applications. The Ministry of Labour and the Pension System continues to audit every disability pension granted by SEEB.</p> <p><u>End 2014</u>: Improved tracking system for the monitoring of approval of sick leave applications tested and presented.</p> <p><u>End 2014</u>: The new tender for medicines was closed and is being processed.</p> <p><u>Jan 2015</u>: Health Insurance Fund separated from the State Treasury.</p> <p><u>From the beginning of 2015</u>: New model of contracting of hospital care is being implemented (test phase, full application from Q1 2015). The model gradually implements a partial retrospective</p> |

|   | 2014 CSRs                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
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|   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | Nothing significant to report as regards making early retirement less attractive. No action was taken to accelerate the harmonisation of statutory retirement ages of women and men.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| 3 | <i>Implement the second phase of the labour law reform, following consultation with the social partners, in particular as regards conditions for dismissals and working time, and with a view to preventing further labour market segmentation including for young people, by March 2015. Review the wage-setting system with a view to better aligning productivity developments and wage conditions. Present the conclusions of this review by the end of 2014. Strengthen the effectiveness and reach of active labour market policies by reinforcing the administrative capacities of the public employment services, including at regional level, and by increasing the coverage of the young, long-term unemployed and older workers. Prioritise outreach to non-registered youth and mobilise the private sector to offer more apprenticeships, in line with the objectives of a youth guarantee. Outline plans, by the end of 2014, to address undeclared work. Implement measures to improve the labour market relevance and quality of education outcomes by</i> | <p><u>Dec 2014:</u> Contracted project "Evaluation of ALMP measures".</p> <p><u>March 2015:</u> First results of the evaluation of ALMP measures.</p> <p><u>Dec 2014:</u> CES Results of the assessment of effects of restructuring.</p> <p><u>Dec 2014:</u> Establishment of the system for monitoring and reporting on the implementation of the Youth Guarantee.</p> <p><u>Jan 2015:</u> Establishment of a system for having access to and monitoring people in NEET.</p> <p><u>March 2015:</u> Results of the analysis of young people in NEET.</p> <p><u>Early 2015:</u> Results of the analysis of the distribution and need for work experience in secondary and tertiary education.</p> <p><u>End 2015:</u> Government strategy for the reform of the vocational education system to be adopted (VET</p> | <p><u>15 Jul 2014:</u> the Parliament adopted the new Labour Act, which is in force as of 07 Aug 2014 (National Gazette 93/14). The act amends the rules for dismissals and company-restructuring procedures, improving forms of temporary employment and working time arrangements.</p> <p><u>Aug 2014:</u> the Act on Representativeness of Employers' Associations and Trade Unions entered into force.</p> <p><u>End 2014:</u> the analysis of the wage structure and wage setting practices in Croatia was completed.</p> <p><u>Autumn 2014:</u> the Action Plan for the restructuring of the Croatian Employment Service. New Career Guidance Centres and Youth Centres have been established.</p> <p><u>Sept 2014:</u> establishment of the Forum for lifelong learning and career guidance and its work programme.</p> | <p>Most secondary legislation of the new Labour Act has already been implemented, and the remaining ordinances are entering into force.</p> <p><u>Jan 2015:</u> Amendments to the Act on Contribution exempt employers from paying contributions when offering permanent employment contracts to people under-30.</p> <p><u>Dec 2014:</u> Guidelines for the development and implementation of ALMPs and system for monitoring the implementation.</p> <p><u>Nov 2014:</u> the criteria for Occupational Training without Employment were simplified, and the gross monthly financial support provided to programme participants increased as of 2015.</p> <p><u>Nov 2014:</u> the webpage on Youth Guarantee was launched.</p> <p><u>2013/2014:</u> New VET curricula in experimental use.</p> |

|   | 2014 CSRs                                                                                                                                                                                                                           | Action taken                                                                                                                                                                                |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                      |
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|   | <i>modernising the qualification systems, by putting in place quality assurance mechanisms and by improving school-to-work transitions, in particular through strengthening vocational education and work-based learning.</i>       | development plan).                                                                                                                                                                          | <p><u>Dec 2014:</u> The Analysis on the implementation of measures for combating undeclared work was completed. Additional measures to suppress undeclared work were proposed.</p> <p><u>14 Jul 2014:</u> the Council for the Youth Guarantee Implementation Plan was established.</p> <p><u>March 2015:</u> Start the implementation of the measure "Training in the Workplace".</p> <p><u>Sept 2014:</u> the implementation plan for the NEETs trucking system was adopted.</p> <p><u>July 2014:</u> Croatian Qualifications Framework Act adopted. National Human Resources Development Council set up to steer the implementation of CROQF.</p> <p><u>Oct 2014:</u> Strategy for Education, Science and Technology adopted in the Croatian Parliament.</p> |                      |
| 4 | <i>Review tax and benefits systems by the end of 2014, and present an action plan to improve the reactivation of inactive and unemployed persons. Strengthen the effectiveness and transparency of the social protection system</i> | <u>Spring 2015:</u> categorization of each benefit through an "ID" (description, status, expenditure, beneficiaries, and eligibility criteria) and listing of all benefits by target group. | <u>Since mid-2014:</u> Joint project with UNDP and World Bank with the objective of mapping and analysing the benefits provided at central and local level. The results of the project                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                      |

|   | 2014 CSRs                                                                                                                                                                                                                                                              | Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                                                                                                                                                          |
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|   | <i>by further consolidating benefits, unifying eligibility criteria and linking data from all relevant levels and government entities in the 'one-stop shop'. Improve the effectiveness and adequacy of social assistance benefits through their better targeting.</i> | <p><u>May 2015</u>: complete analysis of the tax system under the process of expenditure review.</p> <p><u>June 2015</u>: Action Plan with concrete reform options of the social security system to be presented to the government.</p> <p><u>Sept 2015</u>: the GMB to be transferred from Social Welfare Centres to the OSS. MISSOS to be tested from Sept to Dec 2015, and fully implemented for the administration of GMB by end 2015.</p> <p><u>2016</u>: functional transfer of all child allowances (currently scattered across a number of institutions) to the OSS.</p> <p><u>End 2016</u>: have eight different benefits (GMB, unemployment allowance, child allowance and 5 different maternity benefits) merged and managed via the One-Stop-Shop (OSS).</p> | <p>to guide the reform of the system.</p> <p><u>Sept 2014</u>: Basic Strategic Directions adopted for Consolidation of the Social Protection System and the One Stop Shop project. A loan was signed with the World Bank for the project "Modernisation of social protection system". The aim is to administer all benefits through OSS and MISSOS</p> <p><u>Nov 2014</u>: agreements/contracts were signed for development of the investment and action plans for the implementation of the OSS.</p> <p><u>Jan 2015</u>: completed mapping and compiling a consolidated catalogue of all benefits provided at central and local level in the country.</p> |                                                                                                                                                                          |
| 5 | <i>Take further measures to improve the business environment. In particular, by March 2015 set a target for considerably lowering administrative requirements,</i>                                                                                                     | <u>Jan 2015</u> : 13 para-fiscal charges are planned to be reduced/abolished in 2015 (amounting to 1% of the total value of the registry of charges).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <p><u>26 Nov 2014</u>: Pilot for measurement of administrative burdens initiated.</p> <p><u>04 Sept 2014</u>: The government adopted the amended State</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | <u>Dec 2014</u> : 15 para-fiscal charges were reduced or eliminated (for a total amount of HRK 91m), while 63 levies were written off the registry (HRK 3097m) due to an |

|  | 2014 CSRs                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
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|  | <p><i>including para-fiscal charges. Address the high level of fragmentation and overlapping responsibilities by streamlining administrative processes and by clarifying the decision-making and accountability framework across various levels of government and at central government level between ministries and agencies. Improve administrative capacity and strategic planning of units entrusted with the management of European Structural and Investment Funds and provide them with adequate and stable staffing levels.</i></p> | <p><u>March 2015</u>: Action plan to reduce administrative burdens</p> <p><u>Dec 2015</u>: Introduction of an e-register of trades</p> <p><u>Dec 2014</u>: Amendments to the Land Registration Act.</p> <p><u>Oct 2015</u>: Establishment of a Joint Information System for the land register and cadastre (ZIS).</p> <p><u>March 2015</u>: plan for the rationalisation of existing agencies to be presented together with the final report of the expenditure review.</p> <p><u>March 2015</u>: signed arrangement with the EIB on co-financing of EU projects (Structural Programme Loan).</p> <p>New proposal for Amendments to the Civil Servants Act.</p> <p><u>June 2015</u>: Parliament adoption of the Strategy for Modernisation of the Public Administration 2014–2020, accompanied by an implementation plan.</p> <p><u>Jan 2015</u>: Government adoption of Guidelines for the regulation of agencies.</p> | <p>Administration Act.</p> <p><u>Sept 2014</u>: Plans on the implementation of the Joint Information System for the land register and cadastral offices.</p> <p><u>Nov 2014</u>: the Implementation Plan related to State Information Infrastructure Act was adopted.</p> <p><u>Jan 2015</u>: The analysis of the legal framework for the establishment of agencies was completed. Guidelines for the regulation of state agencies were adopted.</p> <p><u>Aug 2014</u>: the Regulation on the common national rules on management of EU Funds entered into force.</p> <p><u>18 Sept 2014</u>: Regulation on the internal reorganization of the Ministry of Regional Development and EU Funds.</p> <p>Government Decision on the employment of 349 staff in the management and operational system of the EU funds for the period 2015–2017.</p> <p><u>Nov 2014</u>: Regulation on the eligible expenditure for the programming</p> | <p>incorrect classification. Plan was to abolish 58 charges.</p> <p><u>Jan 2015</u>: The e-construction permit made operational in all administration offices.</p> <p>Continued development of the e-citizen web-portal with the implementation of new services.</p> <p>The Joint Information System of Land Registry and Cadastre (JIS) is implemented in 16 land registry offices and 13 cadastral offices.</p> <p>The Central Salary Management System (COP) has been implemented.</p> <p><u>From Sept 2014 onwards</u>: bi-monthly reports on the status of implementation of the key EU-funded projects.</p> |

|  | 2014 CSRs | Action taken                                                                                                                                                                                                                                                                                                                                                                            |                                                                                                                                                                      |                      |
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|  |           | Announced measures                                                                                                                                                                                                                                                                                                                                                                      | Adopted measures                                                                                                                                                     | Implemented measures |
|  |           | <p>Identification of priority projects for contracting and implementation in 2015 and 2016.</p> <p>Detailed analysis of the planned public investments within the framework of the 2015-17 state budget.</p> <p><u>March 2015</u>: publication of first 'Programme Complements' – defining implementing details for each Priority Axes, Specific Objective and Investment Priority,</p> | <p>period 2014-2020.</p> <p><u>Dec 2014</u>: proposed Action Plan for strengthening the capacity of EU projects 'holders' at central, regional and local levels.</p> |                      |
|  |           | <p>Nothing significant to report on measures taken to address the high level of fragmentation and overlapping responsibilities across various levels of government.</p>                                                                                                                                                                                                                 |                                                                                                                                                                      |                      |



|   | 2014 CSRs                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Action taken                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                                                                                                                                 |                                                                                                                                                                                                                                                                                                                                                                                            |
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| 6 | <i>Present, by October 2014, a detailed plan for public property management for 2015. Ensure that companies under state control are governed in a transparent and accountable manner, in particular, strengthen the competency requirements for members of management and supervisory boards nominated by the State and introduce a public register for appointments. Reinforce prevention of corruption in public administration and state-owned and state-controlled enterprises, including by increasing the verification powers of the Conflict of Interest Commission. Strengthen transparency and efficiency of public procurement at both central and local levels, and the capacity to monitor implementation and to detect irregularities.</i> | <p><u>Oct 2014</u>: Regulation on the criteria for selecting management boards of SOEs, followed by associated legislated changes.</p> <p><u>Dec 2014</u>: Enhancing reporting rules for SOEs.</p> <p><u>March 2015</u>: Implementation report on the 2014 State Property Management Plan.</p> | <p><u>Jan 2015</u>: Anti-corruption strategy for 2015-2020 adopted by the Government.</p>                                                                                                                                                                                                                                                                                                       | <p><u>Sept 2014</u>: The register of managerial appointments in SOEs was made public.</p> <p><u>20 Nov 2014</u>: The 2015 State Property Management Plan was adopted.</p> <p><u>End 2014</u>: The extension of central procurement services to 624 new users was completed. Tenders for electricity and fuel have been closed; a tender for telecommunication services is in progress.</p> |
|   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | All measures improving the SOE governance framework are still in the planning phase.                                                                                                                                                                                                           |                                                                                                                                                                                                                                                                                                                                                                                                 |                                                                                                                                                                                                                                                                                                                                                                                            |
| 7 | <i>By the end of 2014, reinforce the role of commercial courts in the monitoring of transparency and legality in the application of the corporate pre-bankruptcy procedure. Review the compulsory test of insolvency/illiquidity to access pre-bankruptcy settlement proceedings and streamline the insolvency/liquidation process to reduce its length. Improve the quality and efficiency of the judicial system, in particular</i>                                                                                                                                                                                                                                                                                                                   | <p><u>Dec 2014</u>: Analysis of the Civil Procedure Act with regard to improving performance of courts.</p> <p><u>April 2015</u>: Introduction of obligatory mediation in small claims before commercial courts.</p>                                                                           | <p><u>24 Oct 2014</u>: Laws on the territorial reorganisation of the judicial system in municipal, misdemeanour and county cases were adopted by Parliament (effective from 1 April 2015, following amendments of the Courts Act and State Attorney's Act, which were adopted by the government on 19 Nov 2014).</p> <p><u>17 Dec 2014</u>: Amendments to the pre-insolvency and insolvency</p> | <p><u>Dec 2014</u>: The Wide Area Network (WAN) available in all courts.</p> <p><u>End 2014</u>: The roll out of the Integrated Case Management System (ICMS) proceeds according to plan. By Q1 2015, they should be introduced in all municipal, country and commercial courts and the High Commercial Court.</p>                                                                         |

|   | 2014 CSRs                                                                                                                                                                                                                                                                                                                                                         | Action taken                                                                                        |                                                                                                                                                                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                |
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|   | <i>by providing incentives to resolve proceedings in litigious civil and commercial cases and in administrative cases in a timely manner and to resort to out-of-court settlement especially for smaller claims.</i>                                                                                                                                              |                                                                                                     | framework were adopted by the government in the form of the new Insolvency Act. The new framework aims at encouraging restructuring at an early stage, strengthening of the role of commercial courts and speeding up the insolvency procedure.                                                                                                                                                                               |                                                                                                                                                                                                                                |
|   |                                                                                                                                                                                                                                                                                                                                                                   | No significant action was taken to improve the performance of commercial and administrative courts. |                                                                                                                                                                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                |
| 8 | <i>Complement the 2014 European Central Bank's asset quality reviews and stress test exercises, undertake a comprehensive portfolio screening exercise designed specifically for the Croatian financial sector, with a focus on important portfolios that are not covered by the European Central Bank exercise and including key mid-size and smaller banks.</i> |                                                                                                     | <p>The scope and methodology of the Portfolio Screening Exercise was defined over the summer by CNB in cooperation with DG ECFIN.</p> <p>Implementation has started in October 2014, according to plans. The supervisory exercise was planned to take place till the end of year, while the final report was announced for mid-January with an interim report in November. It should be completed by early February 2015.</p> | The Portfolio Screening Exercise done by CNB on the Croatian banks proceeded according to plans and is now approaching its final stage. The EC has received the final draft report, which is in the process of being assessed. |