

THE REPUBLIC OF CROATIA



2013 ECONOMIC PROGRAMME OF CROATIA

April 2013

Foreword

The 2013 Economic Programme of Croatia was adopted by the Government of the Republic of Croatia. The document has been prepared pursuant to the obligations arising from the acceptance of the invitation of the General Secretariat of the European Commission for the informal participation of Croatia in the European semester, prior to the date of Croatian accession to the European Union. The 2013 Economic Programme of Croatia was prepared jointly by the Ministry of Regional Development and EU funds and the Ministry of Finance, in collaboration with representatives from all of the line ministries and representatives of the Prime Minister's Office, the Government Office for Cooperation with Non-governmental Organizations, the Government Asset Management Agency, the Croatian Competition Agency, the Croatian Institute for Health Insurance, the Croatian Employment Service, the Central Bureau of Statistics and the Croatian National Bank.

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List of abbreviations

BSI	Business Support Institutions
CBRD	Croatian Bank for Reconstruction and Development
CBS	Croatian Bureau of Statistics
CCOSA	Croatian Compulsory Oil Stocks Agency
CEB	Central European Bank
CES	Croatian Employment Service
CFSSA	Croatian Financial Services Supervisory Agency
CNB	Croatian National Bank
COFOG	Classification of the Functions of Government
CROQF	Croatian Qualifications Framework
EC	European Commission
EDP	Excessive Deficit Procedure
EEA	European Economic Area
EIB	European Investment Bank
EU	European Union
EZ	Entrepreneurial Zones
FEC	Development of funds for economic cooperation
GDP	Gross Domestic Product
HAMAG INVEST	Croatian Agency for Small Entrepreneurship and Investments
ICMS	Integrated Court Case Management System
ICT	Information and communication technologies
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
KET	Key Enabling Technologies
LPE	Local Partnerships for Employment
MF	Ministry of Finance
NGO	Non-Governmental Organization
PEP	Pre-Accession Economic Programme
R&D	Research and development
SEE	South East European countries
SME	Small and medium-sized enterprises
VET	Vocational education training

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The main challenge of the economic policy in the next medium-term period is the activation of a sustainable economic growth after a five-year expressed recession. In the conditions of a very unfavourable external environment, the economic recovery of the Croatian economy is based on investments in the areas in which in the past two decades there has not been enough investment, but which may ensure a significant future growth of added value. The initial impulse to the investment cycle will come from the public sector, where projects will to a large extent be financed through the Instrument for Pre-Accession Assistance (IPA), structural and Cohesion funds and favourable sources of financing by international financial institutions. This primarily refers to the environmental protection sector, transport, water-utility, entrepreneurial and scientific research infrastructure. A big contribution will also come from the public-private partnership projects, in particular in the area of production of electricity and air transport. Additional investment impetus is expected from the private sector, to which the accession to the EU and the common market, through increase in attractiveness of the Republic of Croatia as a member of the EU and the elimination of physical barriers, will enable the competitiveness of production for the common market, which in the previous period has been absent due to a long process of European integration. The above investment projects will serve as a basis for the sustainable growth of the domestic production, which will reflect on the improvement of net export, by the substitution of import and the recovery of the domestic production, primarily in the sectors of energy and food production as well as by an increased export of goods and services to the common market. In this context, it is worth emphasizing that the accession to the EU and the final elimination of barriers towards the common market will provide a positive impulse in the first years of the membership, which can lead to a significant growth of direct foreign investments and export even in the conditions of slow recovery in the area.

With the aim of promoting investments of the public and private sector, a particular big contribution is expected from the Act on Investment Promotion and on Improving the Investment Climate, which was adopted last year, and from changes in the taxation of profit with the aim of increasing domestic and foreign investments. The Strategic Investments Act, which will be adopted in the second quarter of 2013, will reduce administrative barriers and shorten the periods for the implementation of major investments. Also, implementation of a series of measures aimed at increasing the productivity of small and medium-sized enterprises and strengthening the innovation potential, including the removal of administrative barriers to business will continue. The reforms in the area of labour market and better connection of the education system with to the labour market, as well as improvement of legal security through the increase in the efficiency of the judicial system will contribute to a more competitive business climate, which will have the additional positive impact on the increase in investments. This will also be contributed by the process of a rapid addressing of the problem of restructuring and the winding down of illiquid and insolvent companies and further market liberalization.

The second pillar of the economic policy is the continuation of the fiscal consolidation which is necessary because of the growing public debt and the costs of its financing. In this context it is important to adjust the structure and the speed of fiscal consolidation due to the expressed negative contribution to the growth of the governmental sector in the next period. The financing cost in the state budget is approaching the level of 3% of the GDP, which means that in the next period, the Republic of Croatia will have to realise the primary surplus to align its

public finance with the European rules, where the payments to the EU budget will represent a significant additional fiscal effort.

On the revenue side of the budget the tax policy reform is continued by directing the tax burden from labour towards spending and assets to increase the competitiveness of labour, preserve potential growth and create preconditions for positive changes in the labour market. The activities on increasing tax discipline and the collection of tax revenues also continue through new measures of the suppression of grey economy (fiscalisation), and the reorganisation and improvement of efficiency of the Tax Administration.

Further reforms in the area of social welfare system, health care and pension system are necessary for ensuring fiscal sustainability. In the area of social welfare better allocations of transfers to socially most vulnerable layers of the society are expected. In the health care system planned reforms have been undertaken, including the restructuring of the health care system, with the aim of increasing the efficiency of the existing spending and the slowing down of the growth of expenses, i.e. their adjustment to the available funds for health care spending. Finally, the measures on the side of fiscal sustainability of the pension system, through the slowing down of the entry of new pensioners in the pension system, the limiting of the growth of pensions by special regulations, and measures for the activation of the existing pensioners upon the economic growth recovery, will give a significant contribution to the participation rate and to the future economic growth as well as to the process of real convergence within the EU.

Public spending efficiency will be strengthened by the application of a differentiated approach to budgetary funds spending, where special attention will be paid to the improvement of competitiveness and the business climate, the strengthening of development through an intensified absorption of the EU funds and protecting socially most vulnerable social groups of the society. Further activities on the improvement of the framework for the management of fiscal policy will contribute to the strengthening of fiscal adjustment through time. Thus the improvement of budgetary planning, fiscal transparency, the strengthening of the quality of fiscal rules as well as of expert bodies responsible for the monitoring of their implementation and the enhancement of the effectiveness of the public finance will be continued.

Special emphasis is placed on further reform and improvement of the efficiency of public administration, including its informatization through the introduction of a number of IT solutions aimed at improving the functioning of public administration and services provided to customers. In this sense, intensive strengthening of the capacity to absorb EU funds at national, regional and local levels, including administrative capacity strengthening and preparation of projects whose implementation will be financed by the allocated funds continues. This also becomes extremely important in the context of current preparations for EU financial perspective 2014 - 2020 and programming process by which the implementation of measures defined in the Economic Programme focuses on channelling funds to the key areas.

2. MACROECONOMIC OUTLOOK AND FISCAL POLICY

2.1. Macroeconomic developments

2.1.1. Current macroeconomic developments

Negative developments in the Croatian economy, which began in 2009, have continued for four consecutive years now. Although in 2011 the real economic activity stagnated (0.0%), 2012 again ended with a decline in gross domestic product (GDP). Namely, the GDP recorded a real decrease of 2.0% in 2012. The decline of the GDP in 2012 primarily resulted from a decrease in household consumption and gross fixed capital formation, the components which in the pre-crisis period had been the key drivers of economic growth. Household consumption movements were primarily affected by unfavourable labour market conditions, as well as the continuation of the process of deleveraging of households. The real decline of gross fixed capital formation, a component that has seen the greatest corrections in the period since the beginning of the crisis, is primarily the consequence of weak demand, deteriorated conditions of financing and pessimism with regard to future trends. In addition, due to the time required for the preparation of investment projects, this trend has not been reversed in 2012 already. Negative trends in 2012 were partly mitigated by the positive achievements of foreign demand, i.e. by a real decline of imports and the growth of exports of goods and services. As observed from the side of production, the biggest contribution to the real decrease in gross value added in 2012 came from the industry and trade, the activities which have the biggest share in the total gross value added, and construction, the activity which had recorded the most expressed decrease in gross value added since the beginning of the crisis.

At the time of drafting of the latest Pre-Accession Economic Programme (PEP) 2012 – 2014, the real growth of the GDP of 0.8% was expected for 2012. The main precondition for the GDP growth in 2012, a strong real growth of gross fixed capital formation, based on public sector investments, was not realised. Significant divergences between the projected and realised values also result from the imports of goods and services, since their forecast growth in 2012 is based precisely on the growth of investments. In addition, a real decrease in household consumption in 2012 was much more expressed than expected. As to 2011, the differences between the values projected by the latest PEP (0.4% growth) and actual values, in the largest part result from international trade, since in the period after the PEP's drafting the GDP estimates for the first three quarters of 2011¹ were corrected downwards due to the revision of the data on foreign trade in goods for 2011².

Weak economic activity during 2012 had effect on the continuation of unfavourable trends in the labour market. According to administrative data, the average number of the total employed fell by 2.4%, primarily due to a decrease in employment in the manufacturing, construction and trade. The latest available data of a labour force survey show that the average survey unemployment rate was 15.1% in the first three quarters of 2012, which is a year-on-year growth of 1.8 percentage points. Despite their nominal growth, a trend of real decrease in salaries continued in 2012, so that the average gross monthly salary recorded a

¹First release by the Croatian Bureau of Statistics No. 12.1.1/4. of 2 April 2012.

²First release by the Croatian Bureau of Statistics No. 4.2.1/12. - CORR. of 29 March 2012.

real decrease of 2.3%, while the average paid net monthly salary declined by 2.6%³ in real terms.

The average inflation measured by the consumer price index, accelerated to 3.4% in 2012, or up by a 1.1 percentage point over 2011. Inflation movements in 2012, to the largest extent, were subject to the increase in general value added tax (VAT) rate⁴, the adjustment of administrative prices of electricity and gas for households⁵ and the increase in prices of unprocessed food products caused by draught and by a rise in the prices of food raw materials in the world market. The most important contribution to the rise in prices in 2012 was thus made by the prices of energy and food. The core inflation rate, excluding agricultural products prices and administratively regulated prices, was 1.9% in 2012. Primarily due to the strong inflation spillover effect from the previous year, the average inflation was 5.1% in the first two months of 2013.

The latest PEP for 2012 projected the average inflation of 2.4%. The main reasons for a higher realised inflation than expected result from the unexpected increase in individual administratively determined prices, primarily of energy, and the disturbances related to the trends in prices of food raw materials and products.

In 2012, the narrowing of the current account imbalances continued.⁶ Following a current account deficit of 0.9% of the GDP in 2011, in 2012 the balance of payments balanced (with a surplus of 0.1% of the GDP). This was mostly due to an increase in the surplus in the trade of services, primarily due to the growth of revenue from the services provided in tourism. The negative balance in the goods account declined. At the same time, the deficit in the factor income account slightly decreased and the surplus in the current transfers account increased. The coverage of the imports of goods and services by their exports amounted to 102.0%, or up by 1.8 percentage points over 2011.

The achieved balance of payments equilibrium in the current account in 2012 corresponds to the forecasts from the latest PEP. Nevertheless, the year-on-year trend was much more different because instead of the expected balance deterioration (from 0.2% of GDP in 2011 to 0.0% of GDP in 2012) its improvement was recorded (from -0.9% of GDP to 0.1% of GDP), as the result of a decrease in the domestic demand and imports. It is worth saying that the difference between the estimated and actual level of the balance in the current account for 2011 is primarily the consequence of the mentioned revision of the data on foreign trade in goods in 2011⁷.

Net foreign capital inflows were very modest in 2012. A net inflow of EUR 0.4 billion⁸ was recorded in the financial and capital account. Net direct investment inflow was EUR 1.0 billion, where half of the direct investments value in Croatia was determined by the increase

³Salaries of employees at legal entities.

⁴ From 1 March 2012 general VAT rate was raised from 23% to 25%, while at the same time a lower VAT rate of 10% was introduced on certain goods and services (edible oils and fats, water supply, sugar and food for children).

⁵ Electricity and gas prices increased from 1 May 2012.

⁶ Data on balance of payments for 2012 are preliminary.

⁷ As a result of the revision, foreign trade deficit increased by EUR 0.9 billion or 1.9% of GDP.

⁸ Excluding international reserves change.

in debt of the newly founded special-purpose company⁹, and the new equity investments and retained earnings were below the previous year's levels. EUR 1.9 billion was recorded in the portfolio investment account, as a result of the issue of government bond and the bonds of several companies. Contrary to this, in the other investments account net capital outflows amounted to EUR 2.6 billion, which was mostly affected by the deleveraging of commercial banks.

International reserves of the Croatian National Bank (CNB) increased in 2012 by 0.4%, reaching EUR 11.2 billion at the end of December. Their increase was a consequence of foreign currency net purchasing from the government (EUR 770 million) and the realised investment gains (EUR 110 million), while the selling of foreign currencies to the banks (EUR 666 million) had the reverse effect. The remaining difference is the consequence of a decrease in government foreign currency deposits, as well as a decrease in foreign currency reserve requirement. In the first two months of 2013 gross international reserves slightly decreased, mostly because of net selling of foreign currency to the government, amounting to EUR 11.1 billion at the end of February.

Price and cost competitiveness indicators of the Croatian export indicate at its improvement in 2012, by which the trend of strengthening the competitiveness has continued for a third consecutive year. Thus the kuna (HRK) real effective exchange rate deflated by consumer prices in 2012 depreciated by 1.4%, when compared with 2011, as a consequence of a nominal depreciation of the kuna to the currency basket, while the movement of domestic consumer prices was somewhat less favourable in comparison with the prices in the majority of main trade partners. The real effective exchange rate of the kuna deflated by unit labour costs in the total economy in the first three quarters of 2012 depreciated by 3.0% at the annual level, due to the nominal depreciation of the kuna and a more favourable movement of the domestic unit labour costs than in most of the most important international trade partners.

Monetary and credit aggregates in 2012 reflected a continuation of unfavourable trends in the real sector of the economy. The banks' credit activity slowed down notably. Excluding the exchange rate effect, the effects of the taking over of the debt of shipyards and the transfer of nonperforming placements to the special-purpose company, bank placements to the non-banking sector in 2012 decreased by 1.9%.¹⁰ Loans to households also decreased, by which a moderate deleveraging of this sector continued, which had been going on since the beginning of the crisis. At the same time, bank placements to the central government, excluding the shipyards' debt taken over, generated a growth of 8.9%. The growth of total liquid assets (M4) accelerated moderately, from 2.1% in 2011 to 3.2% in 2012 (excluding exchange rate effect), contributed by the increase in savings and time deposits. The growth of domestic deposits and a decreased credit activity enabled the banks to use the free funds for deleveraging towards abroad, i.e. parent banks, which resulted in the improvement of their net foreign position. In the beginning of 2013, bank placements to the non-banking sector almost stagnated, while bank placements to the government continued to rise.

⁹This company is in the ownership of a foreign bank, nonperforming placements and corresponding international obligations of the Croatian subsidiary of that bank were transferred to it. These transactions have resulted in a decrease in foreign debt of the banks.

¹⁰Nominally, the decline of placements was higher (HRK 16.5 billion or 6.3%), but this is the consequence of the transactions of a commercial bank, which in December, with the objective of reducing partly and fully nonperforming placements, transferred a total of HRK 5.6 billion of its claims to a company in the ownership of the parent bank. In addition, in accordance with the Croatian government decisions on the restructuring of shipyards, in 2012 the MF assumed HRK 6.7 billion in credit liabilities of shipyards, which also resulted in a decline of corporate loans, i.e. in the growth of loans to the government.

Unfavourable macroeconomic trends influenced on the continued deterioration of the banks' credit portfolio quality. Thus at the end of 2012, the share of partly and fully nonperforming bank placements in total placements reached 13.8%, or up by 1.4 percentage points when compared with the end of 2011.¹¹ Despite this, the banking system in Croatia is still very stable, with an average capital adequacy ratio at the end of 2012 of a high 20.6%.

The Croatian kuna to euro average exchange rate was HRK/EUR 7.52 in 2012, marking a depreciation of 1.1% when compared with the previous year. The exchange rate at the end of 2012 was HRK/EUR 7.55, and it was weaker by 0.2% when compared with the end of 2011. The beginning of 2012 was marked by stronger depreciation pressures on the Croatian kuna to euro exchange rate, which the CNB fended off by interventions in the foreign exchange market and by raising the reserve requirement rate. After May, mild appreciation pressures mostly prevailed due to a stronger foreign currency inflow from tourism. The appreciation was also affected by a significant inflow of capital from government borrowing abroad. With the aim of mitigating stronger appreciation pressures present in September, fuelled by the expectations of foreign borrowing by several large public and private companies, the CNB intervened in the foreign exchange market by the purchase of foreign currency from commercial banks. In the last quarter, mild depreciation pressures were recorded due to the seasonal current account deficit.

2.1.2. Medium-term macroeconomic scenario

At the end of 2012, negative economic trends intensified, both in the national economy, and in the international environment. Namely, 2012 ended with a decline of domestic economic activity of 2.0%, which represented less favourable realisation than expected, while the EU economy, with which the Croatian economy is very connected both in terms of trade and finance, recorded a decline of 0.3%.

Macroeconomic projections are based on the available statistical indicators published until the middle of March 2013, and they carry the projections of the effect of the adopted economic policy measures, as well as those whose adoption is soon expected.

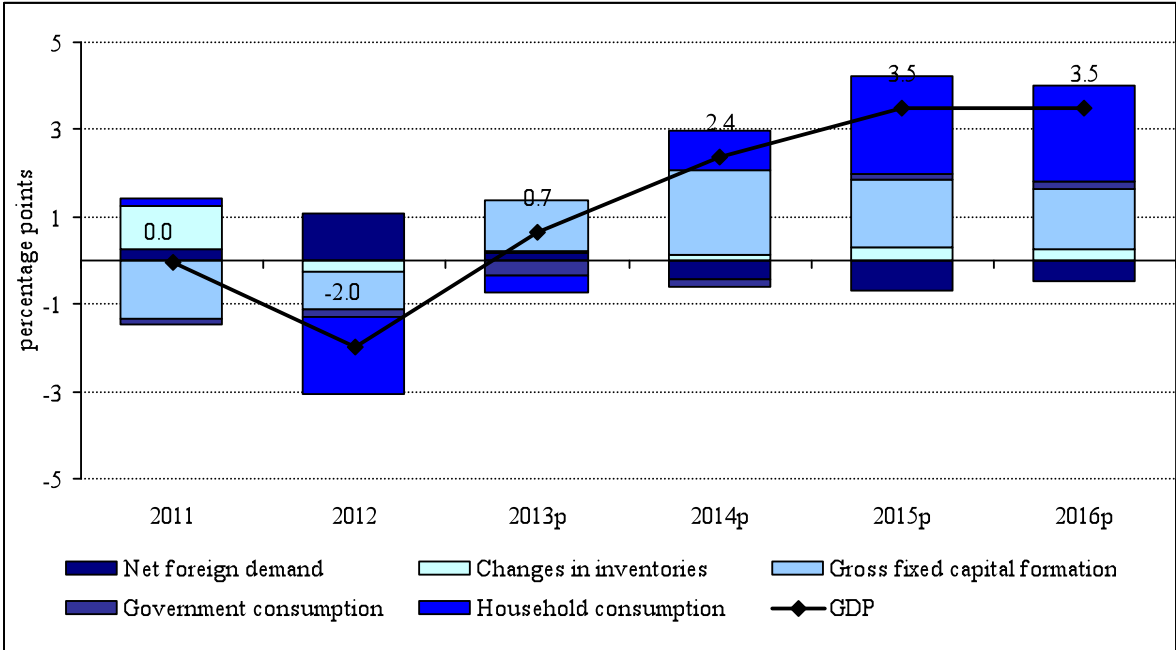
Real sector

The stopping of a negative trend in the Croatian economy and the beginning of a gradual recovery of the economic activity is expected in 2013. Thus the real growth of gross domestic product of 0.7% is forecast for 2013, which will primarily be based on domestic demand, exclusively due to a positive contribution of investment spending. The contribution of the changes in inventories to the growth of the GDP will be insignificant, and the contribution of net foreign demand is slightly positive. Gross fixed capital formation will be the main economic growth generator in 2013, for which a real growth of 6.3% is projected. The growth investments will result from the already started public sector investment cycle, while for private sector investments a decrease is still expected, although weaker than in the previous years. The foreseen strengthening of private investments towards the end of 2013 is based on the assumption of the beginning of the recovery of the domestic and foreign demand and the return of business optimism, but also on the efforts put by the Croatian government in creating preconditions for a positive investment climate, the improvement of liquidity in the

¹¹The previously mentioned transfer of claims of a commercial bank to a company in indirect ownership of the parent bank influenced on a slower growth of this share.

economy as well as the financing conditions for the private sector and in the engagement of private capital in public-private partnership models. A stronger absorption of EU funds, should contribute to the investments in 2013. Due to a gradual recovery of the European economy and the positive effect of the Croatian accession to the EU, the strengthening of foreign direct investments is expected in the second half of the year. Household consumption in 2013 will continue to record negative outputs, although its decrease will be significantly lower than last year. Its real fall of 0.7% is thus expected. A negative effect on the trends in household consumption will come from the disposable income of households, which will record a stronger real decrease than household consumption, due to a real decline of net wages, lower employment and a continued real decrease in government transfers to the households. However, the beginning of the consumer confidence rebound is expected in 2013, motivated by more favourable economic trends and the EU accession, and further real decrease in net households' assets. The continuation of the implementation of the fiscal consolidation process in 2013 will determine the trends in government consumption, for which a 1.7% real decrease is expected. A stopping of the negative trends in the economy of Croatia's most important trading partner, the EU economy, is expected in 2013. As a result, the strengthening of foreign demand for domestic goods and services is expected, so that the real growth of the export of goods and services of 1.6% is projected, which will thus, following gross fixed capital formation, will give the biggest positive contribution to the economic growth. In the conditions of a slight recovery of final demand, in 2013 the growth of the imports of goods and services of 1.2% is projected, generated primarily by a stronger investment activity.

Figure 1: Contributions of aggregate demand categories to real GDP growth



Source: CBS, MF

Until the end of the projection period, further recovery of the economic activity is expected and the acceleration of real gross domestic product growth to 2.4% in 2014, and 3.5% in 2015 and 2016. It is foreseen that even in the subsequent years the economic growth will rely on the growth of domestic demand, where the biggest contribution to its growth in 2014 will come from investment spending and in the remaining projection period from household consumption. The contribution of net exports to the economic growth in the whole period will

be negative and will rise until 2015, while the reversal of the trend is expected in the last year of the projection period. Thus the exports of goods and services in 2016 will give the largest positive individual contribution to the gross domestic product growth. With the expected strengthening of foreign demand towards the end of the projection period, such a projection of exports implies a decelerating and lower decline of the domestic share in the Croatian export markets when compared with the period before 2012. The strengthening of the competitiveness of the Croatian exports will contribute to it due to the finalisation of the restructuring of the main industrial branches, the reduction of the rate of contribution for compulsory health insurance, the reduction of the VAT rate on services of food preparation and food and drinks serving in hospitality facilities, the ensuring of more favourable conditions of financing of exporters through the programmes of the Croatian Bank for Reconstruction and Development (CBRD) and, in general, the continuation of the implementation of a set of structural reforms directed towards the export expansion. A special contribution is expected from the Croatian membership in the EU and the final elimination of barriers to the entry to the common market, which has so far limited the competitiveness of the Croatian exports. In addition, it is worth mentioning that within the above projection of net exports movements a certain substitution of the import of energy by domestic production is expected as a result of the new energy policy, which will be reflected in somewhat lower elasticity of imports in relation to final demand when compared to the earlier periods.

In comparison with the macroeconomic projections of other institutions, the Croatian government's projections rely on the Public Investments Programme and are much more positive. The biggest difference between the projections of other institutions and these projections results from the projection of gross fixed capital formation, since other institutions have not integrated the expected effect of the public sector investment cycle in their macroeconomic projections.

It is estimated that in 2012 the unemployment rate will rise¹² up to the level of 15.5% and employment will decline¹³ by 2.2%. As a result of a stronger decline of employment than the real decline of the GDP, the average labour productivity will slightly rise by 0.3%. Due to a faster nominal growth of compensation per employee than labour productivity, the unit labour cost is expected to rise in 2012. Since the employment recovery will lag behind the economic activity recovery, a continuation of negative trends in the labour market is expected in 2013, yet at a slower rate, when compared with the previous years. Labour market indicators are expected to improve gradually by the end of the year. Thus for 2013 a decrease in employment of 1.0% is forecast, and a rise of the unemployment rate to 16.0%. On the basis of a stronger growth of the average labour productivity than the growth of compensation per employee, a slight decrease in unit labour costs is expected in 2013. From 2014 on, the stopping of negative trends in the labour market is expected. Namely, the growth of employment will be 0.9% in 2014, and it will accelerate to 1.6% in 2015 and 1.8% in 2016. At the same time, the unemployment rate will record a decrease to 15.2% in 2014, 14.1% in 2015 and 13.0% in 2016. In the period from 2014 to 2016 the unit labour cost will rise, with a trend of acceleration by the end of the projection period, since the growth of compensation per employee will exceed the growth of average labour productivity.

Monetary and exchange rate policy and inflation

¹²Unemployment rate is calculated as the share of the unemployed according to the International Labour Organisation (ILO) methodology in the labour force which represents the sum of the unemployed according to the ILO methodology and the employed according to the data from the national accounts.

¹³ According to the data from national accounts.

The CNB implements the policy of keeping a stable kuna to euro nominal exchange rate for the purpose of preserving the price stability, as well as of the overall financial stability. Such monetary policy results from the circumstances in which the central bank is functioning: a highly euroised banking system, high degree of openness of the Croatian economy and a high level of foreign debt.

The past year was marked by a high liquidity of the monetary system and the stability of the domestic currency. The policy of supporting a favourable liquidity of the monetary system has resulted in historically low levels of the overnight interbank interest rate, and interest rates on short-term government borrowing (treasury bills) have been notably reduced, especially by the year-end. The CNB will continue to support a high primary liquidity of the banking system in the forthcoming period to have a favourable effect on the domestic conditions of financing, while keeping a stable kuna to euro exchange rate.

In 2013, a mild slowdown of inflation is foreseen and an average rise of the consumer price index of 3.2%. In accordance with the expected weak growth of prices of raw materials in the global market¹⁴, there should not be stronger imported inflationary pressures. As to the domestic inflationary pressures, they could also be weak, due to a suppressed household consumption and a mild decrease in the unit labour cost. However, a significant contribution to the growth of consumer prices in 2013 will come from the carry-over effect of the inflation from 2012. In addition, the inflation movements in 2013 will be under the effect of the changes of the tax policy, mostly related to the alignment of the legislation with the *acquis communautaire*, which includes the reduction of the VAT rate from 25% to 10% on the services of food preparation and food and drinks serving in hospitality facilities, the abolishment of the zero VAT rate and a gradual alignment of the Croatian excise duty system with the EU legislation. In the remaining years of the projection period, the inflation is expected to slow down to the levels of 2.3% in 2014, and 2.0% in 2015 and in 2016.

Table 1: Inflation (consumer price index), in %

200	200	201	201	201	2013	2014	2015	2016
8 6.	9 2.	0 1.	1 2.	2 3.	3 2.	2 3.	2 0.	2 0.
			3		2	^		^

Source: CBS, MF

External sector and its medium-term sustainability

In 2013, a surplus in the balance of payments current account of 0.6% of the GDP is expected. It will mostly benefit from a decrease of negative balance of income and current transfers, and positive effect will also come from continuation of the improvement of balance of goods and services. In subsequent years, with the strengthening of the economic recovery, negative balance on the current account will be recorded.

A further rise of the surplus in the trade in goods and services is expected in 2013, because the growth of exports, based on the growth of foreign demand¹⁵ will be stronger than the growth of their imports which will be limited by the suppressed domestic demand. In this way the process of re-directing towards the export sector would continue, by which, from 2009 to

¹⁴According to the latest projections by the EC, the prices of primary commodities in the global market will rise by 0.6% in 2013.

¹⁵The rise of foreign demand for Croatian goods and services in 2013 is estimated at 2.3%.

2012, the share of exports of goods and services in the GDP increased from 36% to 43%, so that in the medium-term its further increase to over 45% can be expected.

The deficit in the trade in goods will increase in 2013, while it would deepen further with the strengthening of the economic activity in the subsequent years. The fully-fledged membership in the EU could have a beneficial effect on the exports of goods in 2013 (the simplification of administrative procedures, the effect of the EU country of origin), which should override the negative effects of exiting CEFTA.¹⁶ Exports of goods could gradually strengthen until the end of the projection period also under the influence of a continued improvement of the cost competitiveness of the domestic exports, which has been present in the past three years. In this case, exporters' cost competitiveness could improve in 2013 due to a decline of unit labour costs, and in the subsequent years, their slower growth is expected than in the trade partner countries. Price competitiveness could deteriorate in 2013 due to the expected nominal effective appreciation of the kuna (triggered by the strengthening of the euro in the global foreign exchange markets) and a slightly expressed growth of domestic over consumer prices in the countries - main trading partners. The economic recovery will be followed by stronger imports, especially of capital goods, in relation to the investments in the energy sector and infrastructure. In the second half of 2013, imports could be strengthened as a result of a stronger import of agricultural and food products from the EU after the protective customs cease to apply. Trade in services will also continue to stimulate the improvement of the current account balance in 2013, i.e. primarily thanks to the revenues from tourism. At the same time it can be expected that the fully-fledged EU membership, except on the export of goods, will also have a positive effect on the perception of Croatia among foreign tourists. Factor incomes will probably not exert pressure on the worsening of the current account balance in 2013 either. This trend could be reversed later in the projection period, with economic recovery. Such assumptions are based on the fact that, with the continuation of foreign deleveraging by the banks and companies and the maintaining of low interest rates on foreign financial markets, no increase in interest expenses should be expected. With the recovery of economic activity, growth of negative balance of investment income can be expected, which could overrun the positive effect of higher compensation of employees. In current transfers in 2013, an increase in the surplus is expected, primarily on the basis of positive net transfers from the EU, related to growth in transactions on the basis of contributions to the EU budget and larger withdrawal of EU funds.

A strong contraction of the balance of payments current account deficit since the beginning of the economic crisis has been accompanied by an expressed decrease in capital flows. In the current year, with the expected weak economic activity in Croatia and the EU, the capital inflow might remain modest. In this regard, a stronger growth of debt can be expected only in the government sector, while the private sector could continue with foreign deleveraging. The strengthening of the economic recovery in the coming years may mitigate, or even reverse the trend of deleveraging, and result in a repeated growth of the foreign debt stock. Nevertheless, the relative indicators of gross foreign debt could, towards the end of the projection period, gradually lower towards the levels of about 93% of the GDP, or 200% of the exports of goods and services, thanks to a more dynamic growth of the gross domestic product and the export of goods and services.

¹⁶ It is estimated that in 2013, the export to the CEFTA countries should not change significantly due to the increased shipments to the regional markets in the first half of the year, prior to leaving this multilateral free-trade agreement, which would neutralize the decline of exports in the second half of the year.

One of the indicators of external imbalances includes a very high negative value of the international investment position of the Republic of Croatia (at the end of 2012 it was 88.1% of the GDP). A strong borrowing by the public and private sector, followed by the inflow of direct investments and the growth of the value of companies in foreign ownership in the years before the economic crisis, resulted in a significant worsening of the investment position. At the beginning of the crisis, however, a correction of the value of companies in foreign ownership followed, and the weakened inflows of debt and equity capital mitigated its worsening in the later years. The indicator of the international investment position, after a strong correction at the beginning of the crisis, thus returned to the level approximate to the one at the end of 2007. Stagnation or only a mild worsening of the investment position of the Republic of Croatia is expected in the medium-term, which will primarily depend on the position of the public sector. The investment position of the private sector will probably not change in particular because the market value of direct investments will very slowly recover from the crisis correction, and foreign debt will stagnate or even mildly increase in the later years.

A negative international investment position of the domestic sectors during the previous period was to a large extent mitigated by international reserves, which, according to the relevant indicators, can currently be estimated as adequate. Relative indicators of adequacy of international reserves should gradually improve over the medium-term period. Reserves could thus cover about 7 months of the imports of goods and services, or over 90% of the short-term foreign debt (against the remaining maturity), where their level would stabilise at about 25% of the GDP.

Financial sector

At the end of December 2012, total assets of all banks represented a 73.8% of total assets of all financial intermediaries. These shares are a confirmation of the bank-based financial system in the Republic of Croatia. Since the end of 2007, the share of mandatory and voluntary pension funds and insurance companies has grown in the total assets of all financial intermediaries, and the share of open-end and closed-end investment funds decreased due to the decrease in investors' preferences with regard to such investments.

Table 2: Structure of the financial sector (at period-end)

	XII 2009			XII 2010			XII 2011			XII 2012		
	Assets, HRK million	Structure, in %	Number	Assets, HRK million	Structure, in %	Number	Assets, HRK million	Structure, in %	Number	Assets, HRK million	Structure, in %	Number
Banks*	378,726	75.5	32	391,060	75.3	32	407,373	75.8	31	400,230	73.8	30
Open-end investment funds	12,035	2.4	130	13,674	2.6	131	11,929	2.2	128	13,490	2.5	121
Croatian veterans fund**	2,223	0.4	1	2,005	0.4	1	1,446	0.3	1	1,134	0.2	1
Closed-end investment funds	1,841	0.4	10	1,921	0.4	8	1,678	0.3	7	1,632	0.3	7
Insurance and reinsurance companies	27,920	5.6	30	30,115	5.8	27	31,996	6.0	28	34,995	6.5	28
Factoring companies	7,007	1.4	15	5,748	1.1	19	5,801	1.1	17	7,212	1.3	16
Housing savings banks*	6,738	1.3	5	6,881	1.3	5	7,839	1.5	5	7,450	1.4	5
Mandatory pension funds	29,265	5.8	4	36,328	7.0	4	41,067	7.6	4	51,134	9.4	4
Voluntary pension funds	1,363	0.3	21	1,760	0.3	21	1,969	0.4	21	2,429	0.4	23
Leasing companies	33,666	6.7	26	28,988	5.6	26	25,886	4.8	25	22,237	4.1	25
Savings banks	155	0.0	2	11	0.0	1	35	0.0	1	27	0.0	1
Credit unions***	515	0.1	33	530	0.1	23	569	0.1	22	579	0.1	24
Total	501,454	100.0		519,021	100.0		537,587	100.0		542,549	100.0	

Notes:

* Supervisory data (figures may differ from monetary statistics because of consolidation).

** From 14/4/2008 members of the Croatian Veterans Fund can freely withdraw their shares from the fund, which is for this reason excluded from the closed-end investment funds.

*** Data for 2012 refers to June 2012.

Source: CNB, CFSSA

The Croatian banking system is concentrated equally as in other South East European countries (SEE). Two largest banks accounted for 43%, and the ten largest banks for about

93% of the total assets of all banks at the end of 2012. In the ownership structure, the banks in a predominantly foreign ownership prevailed, accounting for a 90.1% of the total assets of all banks, while 4.8% was in the domestic state ownership and 5.2% in the domestic private ownership of the total assets of all banks.

Total bank assets at the end of 2012 were HRK 400.3 billion, or down by 1.6% when compared with the end of 2011. The main reason for the nominal decrease in the bank assets is the already mentioned transaction from the end of the year by which a major bank, with the objective of strengthening the balance sheet, transferred HRK 5.6 billion of nonperforming placements (HRK 3.7 billion in net value) to a separate special-purpose company in foreign ownership. The share of the deposits remained stable when compared with the past three years, and at the end of 2012 it was 69% of the total bank liabilities, which mostly referred to the household sector, while equity share slightly rose to 14.3%. In the same period, households' deposits participated in total bank deposits with 62%, while the majority shareholders' funds accounted for 10% of the received deposits and 50% of the received loans. At the same time, HRK 422.2 billion of placements and off-balance sheet liabilities was exposed to credit risk, of which 10% was distributed to B and C risk categories, which represent partly or fully non-performing placements. A total amount of provisions for placements and off-balance sheet liabilities was about 4.5% of total placements and liabilities, by which the growth of this indicator continued, which began in 2009, and its highest value was reached since 2001. The banks' profit before tax generated in 2012 amounted to HRK 3.5 billion, where 11 smaller banks recorded a loss. The banks' capital adequacy ratio at the end of 2012 was 20.5%, the return on equity (ROAE) was 4.9%, and the return on assets (ROAA) was 0.86%.

Weak credit demand and banks' risk aversion will affect the recovery of the domestic credit activity in 2013, so that even the growth of monetary and credit aggregates could remain suppressed. However, in the forthcoming years, the strengthening of the recovery in the real sector of the economy should reflect on the gradual acceleration of the growth of monetary and credit aggregates. Accordingly, it is foreseen that domestic credit demand will be picking up moderately, which should also have a beneficial effect on the banking sector performances.

2.1.3. Alternative scenarios and risks

Among the risks of the realisation of projections, negative risks prevail. The basic negative external risk includes possible shocks in the international environment. This primarily refers to the intensifying of the crisis in the Eurozone and the worsening of the financial situation of international parent banks owners of the domestic banking system, which would certainly jeopardize the projected dynamics of the economic growth. In addition, a sharp rise of raw materials prices in the world market or the worsening of the conditions of financing would have an additional negative impact on the realisation of the growth projection.

On the internal risks side, the main risk results from the realisation of the assumption of a strong growth of public companies and the recovery of the overall investment climate on which the projected economic growth is based. In this context, a positive risk is present that investments growth will be higher than expected. In addition, the conditions of the business sector financing depend on the domestic commercial banks' appetite to lend to domestic companies, which is linked with the results of the newly opened more favourable credit lines,

with the effects of the Financial Operations and Pre-bankruptcy Settlement Act and with the fiscal consolidation process. The projected exports dynamics, in addition to a stable and growing international market, to a significant extent implies the success of the export-oriented economic strategy, including all reforms directed at the enhancement of competitiveness of the domestic economy, while the imports dynamics is closely related to the results of the domestic energy policy. In taking into consideration the present continuation of the correction of household consumption and the intensity of the household deleveraging process, the assumed slower dynamics of recovery in the labour market implies that the projection of household consumption depends on the extent to which more favourable international and domestic economic movements, and in particular the Croatia's accession to the EU, will change the prevailing pessimistic household expectations. With regard to the positive risks to the economic growth projection, we should separate the possibility of more beneficial macroeconomic trends in the environment from the projected ones, and stronger or earlier rebounded effects of structural reforms than expected.

As to the inflation projection, the risk of the realisation of a higher inflation than projected is primarily represented by a stronger growth of raw materials prices in the global market than expected, while, on the other hand, a weaker recovery of the domestic demand could impact the realisation of a lower inflation than projected.

2.2. General government balance and debt

2.2.1. Policy strategy and medium-term objectives

In the context of greater uncertainty and risks at the global and domestic level, in the forthcoming medium-term period, the key challenge of the economic policy is the preservation of the macroeconomic stability and the creation of conditions for recovery and a stable economic growth. The fiscal policy in the forthcoming medium-term period will be based on two principles. On the one hand, a fast fiscal consolidation is required in considering the growing public debt and the cost of its financing, which is strongly squeezing out the other expenditure categories. On the other hand, it is necessary to adjust the speed of the fiscal consolidation in order not to reverse positive impact of investments and not to discourage growth.

In accordance with the above, fiscal policy medium-term measures will be focused on growth friendly fiscal consolidation which acts within the strong fiscal rules and adjustment both on the revenue and on the expenditure side of the budget. Strong EU governance rules and national fiscal frameworks will contribute to the strengthening of the fiscal adjustment through time. Such rules include the strengthening of the numerical fiscal rules, the strengthening of the independence of the Fiscal Committee and the medium-term budgetary planning in Croatia, but it will also be strengthened by the multilateral dialogue with the EC.

On the expenditure side of the budget, special attention is paid to the improvement of efficiency of public spending. In addition, a differentiated approach is applied in reducing budgetary expenditure to preserve future growth potential. In this context, investments in water and transportation infrastructure, health care and education will be a priority. Attention is drawn to the strengthening of the scope and effectiveness of active measures in the labour

market. The modernization of the social welfare system will also be continued for the purpose of strengthening its quality and sustainability. Pension system reforms will be intensified with the aim of harmonising the retirement age with the life expectancy, a stronger penalisation of early retirement and the prolongation of the years of service. With the view of ensuring a long-term sustainability of public finances in the context of demographic challenges, the structural adjustments of the health care system are also continued.

On the revenue side of the budget, along with the increase in the VAT rate, a redirection of the tax burden from labour towards spending and property is observed, to minimize the negative effect on growth and the creation of jobs as much as possible, in accordance with EC's recommendations. Also, activities are undertaken directed at the suppression of grey economy and the fight against tax evasion and improvement of the efficiency of work of the Tax Administration.

All of the above mentioned objectives and projected fiscal policy trends are determined and depend on the implementation of the key structural reforms in the forthcoming period, which are described in Chapter 3.

2.2.2. Budget implementation in 2012

As parliamentary elections were held at the end of 2011, temporary financing was in force in the first three months of 2012. After the new government was formed, the process of the budget preparation began and the plan for 2012 and the projections for 2013 and 2014 were adopted in February.

During the year some negative risks were realised and international macroeconomic conditions worsened, which resulted in the lowering of macroeconomic projections and amendments to the budget plan in November 2012. With the mentioned changes, the general government balance deficit was maintained at the originally planned level of 4% of the GDP in accordance with the ESA 95 methodology, which was realised by the adequate increase in revenues and by the reallocation of certain categories of expenditure. The data on the budget implementation for 2012 show that revenues were generated at the level of 38.2% of the GDP, and expenditure at the level of 42% of the GDP, consequently, the deficit was 3.8% of the GDP.

Observed from the revenue side, in 2012, tax policy reforms were primarily directed to the strengthening of a long-term fiscal sustainability, improving of the business climate, addressing the problem of illiquidity and financial indiscipline in the economy. Thus from 1 March 2012, the general VAT rate was raised from 23% to 25%, with a simultaneous introduction of a lowered rate of 10% on certain goods and services (edible oils and fats, water supply, sugar and food for children), with the aim of lifting the tax burden for the socially most vulnerable groups of the society. Also, from 1 May 2012, health insurance contributions were reduced from 15% to 13%, reducing the labour cost and stimulating the competitiveness of the economy with the objective of creating new jobs. With the aim of improving fiscal discipline in the area of contributions, the government adopted a Decree preventing the payment of salaries without the paid contributions. The above measure has resulted in an improved collection of these revenues so that despite the negative trends in the labour market and the lower rate of the health insurance contribution, only a modest decrease

in the revenue from contributions was recorded, when compared with the previous year. From 1 March 2012, changes to the system of taxation of income from employment were introduced, which raised the level of the basic personal allowance from HRK 1,800 to HRK 2,200, and for pensioners from HRK 3,200 to HRK 3,400 and tax categories were changed, while tax rates remained unchanged (12%, 25% and 40%). This has enabled a rise of net wages for lower-income groups, i.e. a decrease in net wages for upper-income groups, which also contributes to a progressive taxation.

Observed from the expenditure side, savings have been achieved on all categories, with the exception of paid interests for the debt taken over from the shipyards and interests on bonds issued in the U.S. market, which are paid on a half-yearly basis. In this context, the realised savings in the systems of subsidies to agriculture of 0.3% of the GDP should be especially emphasised. The originally planned reduction on compensation of employees has not been fully realised because of a delay in the process of collective negotiations. For this reason, by amendments to the budget, these expenses increased by 0.5% of the GDP. Despite this, the data for 2012 indicate at the generated savings in the category of compensation of employees of 0.1% of the GDP.

2.2.3. Medium-term budgetary outlook

In comparison to November 2012, when the budget for 2013 was prepared, negative macroeconomic circumstances in the EU intensified, in particular in our immediate surroundings. In the same period, negative trends also continued in the domestic economy, which is also clear from the movements of high-frequency economic indicators. The mentioned trends have also had effect on the slowing-down of the dynamics of the planned investments. As a result, the projections of growth of the gross domestic product were changed, as well as the budget for 2013, which is currently undergoing parliamentary procedure.

Even in the above-mentioned negative circumstances, Croatia continues with the fiscal consolidation, lifting the burden from the real sector, improving of the business climate and strengthening of the development, primarily through the efficient absorption of the EU funds. The closing of fiscal imbalances is necessary to strengthen the sustainability of the public finances, improve the perception about the country in the financial markets, and create conditions for the economic recovery and a long-term sustainable development.

As a result of the changed growth projections, aggregate revenue projections were reduced when compared with the original plan for 2013. The above projections also include a one-off effect of the increase in revenues due to the expected from property income. No additional changes of tax policy have been planned as part of the amendments to the budget, but the preparation of the announced tax reforms continued, with the objective of a further reduction of the tax burden on labour, as well as the activities for the reduction of tax evasion and the equalisation of market conditions for all taxpayers in Croatia.

With the objective of continuing the fiscal consolidation which is necessary for the sustainability of the burden on the society by the existing level of debt and costs of its financing, the reduction of the state budget expenditure is planned, but also of the budget expenditure of extra-budgetary users and the units of local government when compared with

the original plan. In this context, selective cuts and reallocations are planned on the expenditure side of the budget to have as little negative effect as possible on potential growth, and the continuation of investments, although in a reduced volume, in water and transportation infrastructure, health-care and education.

Consolidated general government revenue

The revenue plan of the consolidated general government for 2013 and projections for 2014 – 2016 are based on the expected macroeconomic assumptions for the above period, and they also include expected fiscal effects of the legal changes in the tax policy and further alignment of the Croatian legislation with the EU *acquis communautaire* and the fully-fledged membership of Croatia in the EU from 1 July 2013.

Tax changes in 2013 primarily cover the value added tax and special taxes and excise duties.

By the amendments to the Value Added Tax Act, since 1 January 2013 a provision has been in force prescribing that the reduced rate of 10% will be applied to the services of food preparation and serving of food and drinks in restaurants and bars. Also, since 1 January 2013, the zero rate of the value added tax has been abolished, and products which have so far been taxed by this rate, will be taxed by a 5% rate, as the lowest possible in the EU. The intention is to attempt to avoid a higher rise of prices of such products and to alleviate the effect of the mentioned changes to the categories of the population with a lower income. Also, the Fiscal Cash Register Act has entered into force, under which, since 1 January 2013 fiscal cash registers have been gradually introduced, which represents the adoption of the application solution for the purpose of better collection of tax revenues from cash transactions. The fiscalisation procedure is carried out in three phases. In the first phase, medium-sized and large entrepreneurs, as well as all those performing the services of accommodation and food preparation and serving were under the obligation to install electronic collection devices connected to the Tax Administration. In the second phase, from 1 April 2013, the fiscalisation obligation is introduced for retailers and free-lancers (lawyers, notaries, doctors, translators, auditors, etc.). In the third step, from 1 July 2013, fiscalisation will become obligatory for all other entrepreneurs. The expected annual effect of these changes amounts to about 0.4% of the GDP.

In this year, the biggest changes in taxation are present in the excise duties system. In this context, the most significant changes refer to special taxes on passenger cars, excise duties on energy and electrical energy, and excise duties on tobacco products. Namely, by the new Excise Duty Act a new system of taxation of passenger cars, other motor vehicles, vessels and aircrafts has been adopted, which is based on a combined system of taxation. By such a system, a special tax is determined partly as a value criterion (on the basis of percentage of the selling price), and partly as an environmental criterion (depending on the CO₂ emission). By applying such environmental criteria, the reduction of carbon dioxide emission is promoted, in accordance with the objectives of the Government and obligations towards the EU. In addition to the above, excise duties for new and second-hand cars are equalised. Also, under the new Special Tax on Motor Vehicles Act, airplanes are exempted from taxation by the special tax.

Since 1 January 2013, a special tax on luxury products has been completely abolished, since it has not significantly contributed to the total budget revenues, and its existence in Croatia

makes luxury products non-competitive in terms of price when compared with the markets of other EU states.

The taxation by excise duties on tobacco products in the course of 2013 will be under the influence of a gradual increase in the excise duty on cigarettes and fine-cut smoking tobacco, so that during the granted transition period a full alignment with the EU *acquis* is achieved. Adjustments will be going on at such a pace so that on the date of accession to the EU total excise duty on all cigarettes must be no less than 57% of the average weighted retail price of cigarettes released for consumption and a minimum of EUR 64 on 1,000 pieces of cigarettes.

At the beginning of 2013, excise duties on energy were also raised. Before Croatia's accession to the EU another raise will follow, so that the minimum values of excise duties prescribed by the *acquis* are reached. Also, for the purpose of alignment with the *acquis*, as of the day of accession the excise duty on natural gas and electricity will be introduced. However, parallel with the introduction of the new excise duty, while keeping compulsory ones, optional exemptions will be introduced, for instance in households, in using the energy from natural sources for own use as well as for energy with dual use. The estimated annual effect of the above changes amounts to about 0.4% of the GDP.

Since 2013, the changes of the Corporate Income Tax Act introduced the possibility of non-taxation of re-invested profit. It is estimated that the effects resulting from these changes will ensure a permanence of budget revenues on this basis.

In addition to the changes in the tax system, work is continued on the analysis and assessment of cost-effectiveness of certain non-taxable charges to provide additional incentive to competitiveness and alleviate the burden from entrepreneurs and investors.

On the basis of the above-described tax changes, in 2013, total revenues of the consolidated general government budget are planned at the level of 38.4% of the GDP. Due to the changed GDP real growth from 1.8% to 0.7% in 2013, the projected revenues were reduced by 0.4% of the GDP, when compared with the original plan. However, a one-off increase in property income has been generated in the total amount of 0.4% of the GDP, and the share of the general government budget revenue in the GDP remained unchanged, when compared with the original plan. Towards the end of the medium-term period, general government budget revenues will be determined by a gradual recovery of the economic activity, and in 2014 they will reach the level of 37.9% of the GDP, in 2015 of 37.7% of the GDP, while in 2016 they will be 37.2% of the GDP.

The most important general government budget revenue includes the revenue from value added tax, which in 2013 has been planned at the level of 12.7% of the GDP, and its share towards the end of the medium-term period is slightly decreasing. The movement of revenues from value added tax is under the effect of the expected negative movements of personal consumption in 2013, and its recovery is expected in the following years. The estimated personal income tax revenues will be at an average level of 2.9% of the GDP in 2013 and 2014, and their share will decline by a 0.1 percentage point until the end of the observed period. Corporate income tax revenues are expected at the level of 2.1% of the GDP in 2013, and towards the end of the period their share in the GDP will be gradually reduced. In accordance with the projections, revenues from special taxes and excise duties in 2013 will amount to 3.5% of the GDP, while in the following years their share will be gradually reduced. Revenues from customs and custom duties in 2013 will be collected in the amount of

0.3% of the GDP, while in the following years their stabilisation at the level of 0.2% of the GDP is expected.

The second most important group of general government budget revenues includes social contributions. Their dynamics will be determined by the movements in the labour market as well as by the changes in legislation implemented in 2012 by which the lifting of the burden of the gross labour price has been assured by reducing the contribution for the compulsory health insurance by two percentage points. The estimated effect of this measure is about 0.7% of the GDP, representing the annual level of the decrease in the labour cost in the economy. In addition, the prevention of the payment of salaries without the prior payment of contributions also has effect on the movement of these revenues. On the basis of the above, revenues from social contributions for 2013 have been planned in the amount of 11.5% of the GDP, and their share is reduced in the following years, i.e. to 11.3% of the GDP in 2014, 11% of the GDP in 2015, and 10.9% of the GDP in 2016.

Among other budget revenues, property income should be emphasised, which in 2013 amounts to 0.4% of the GDP. That is, in addition to permanent revenues, in 2013, property income also includes one-off increases on the basis of the government's ownership in certain trade companies, which are assessed at 0.2% of the GDP. Until the end of the observed period, the share of property income is stabilised at an average level of 0.2% of the GDP.

Consolidated general government expenditure

A continued reduction of the share of expenditure of consolidated general government in the GDP is planned in the medium-term period, which will contribute to a long-term sustainability of public finances. The rationalisation of the expenditure side of the budget is a key precondition with regard to the achievement of fiscal sustainability in the conditions of unfavourable economic movements. In 2013, general government budget expenditure is projected at the same level as in 2012, or at 42% of the GDP. However, when compared with the original budget plan for 2013, savings of 0.5% of the GDP have been realised. Such aggregate movements have been realised despite the negative pressures connected with a significant increase in individual expenditure categories by 1.3% of the GDP. This mostly refers to the Croatian contribution to the EU budget, expenses for interests, state aids for the restructuring of shipyards and the inclusion of Croatian Compulsory Oil Stocks Agency (CCOSA) among budgetary users. That is, the increase in the expense for interests is the result of the rise in costs in the servicing of the public debt incurred in the previous period, and the taking over of the debt of the shipyards, with a direct effect on the rise of the costs of interests. The shipyard restructuring plan will also additionally burden the state budget. Furthermore, from 2013, the charges for strategic oil stocks are included in the centralised system of excise duty collection. Thus collected revenues are transferred to CCOSA, resulting in expenditure increase, but with a neutral effect on the budget. With the 2013 budget, Croatia is becoming part of the EU even in fiscal terms. This primarily refers to the Croatian contribution to the EU common budget, which in 2013 will amount to 0.5% of the GDP. Projections for 2014, 2015 and 2016 show a decrease in general government budget expenditure, i.e., from the level of 41.3% in 2014 to 40.8% in 2015 and 39.9% in 2016.

The most important group of general government budget expenditure comprises social benefits, which in the forthcoming period will record a continued reduction of its share in the value of the gross domestic product, i.e. from 13.6% in 2013 to 12% in 2016. The movements of these expenditures, to the largest extent, are determined by the movement of the most

significant categories of social benefits, i.e. expenses for pensions and expenses for health care. In 2013, pensions are growing due to the expected movement of the number of pensioners, and the alignment of pensions in accordance with the consumer price index and gross wages will be carried out as determined by law, but only for pensions from employment, for which an additional expense of about 0.1% of the GDP is foreseen. On the other hand, allocations in health care will be under the influence of a further implementation of reforms in health care (savings on a unified public procurement, recovery of health care institutions, hospital network reform), which are implemented to ensure the financial viability and stability of the health care system. This category of expenditure also covers other types of social benefits such as child allowance, maternity leave allowances, active labour market policy measures, etc.

Compensation of employees in public and civil service, with their share in total expenditure, makes up the second largest group of the general government budget expenditure. The amount of these expenditures will to the largest extent be determined by the movement of the number of civil and public service employees. Also, changes in collective agreements in the field of transportation allowance, vacation allowance, Christmas bonuses, some additions to the salary, per diems, jubilee awards and the reduction of the wage coefficient of civil and public servants as well as the implementation of the central salary system, will contribute to the reduction of this expenditure category in 2013 and in the next three years. Reductions are also expected as a result of the changes of branch collective agreements. The projection of the share of compensation of employees in the GDP ranges from 9.9% of the GDP in 2013 to 9% of the GDP in 2016.

Expenditure for intermediate consumption, which predominantly comprises the expenses for goods and services directed to the compensation of costs to the employees, material, energy and services, will move at an average level of 4.4% of the GDP in the period 2013 – 2016. The dynamics of the movement of expenditure for intermediate consumption to a large extent will be determined by the activities and projects financed from pre-accession and accession programmes as a large share of projects and activities related to the EU is reflected through this group of expenses.

Expenditure for subsidies will increase in 2013, and this increase mostly refers to state aid for the restructuring of shipyards and to the privileged financing programme on CBRD's loan programmes, to strengthen the competitiveness of economic entities by stimulating lending conditions. Also, this increase includes additional funds for the promotion of the development and strengthening of competitiveness of the processing industry. For the purpose of alignment with the EU Common Agricultural Policy, especially in the part of direct payments in agriculture, expenditure for subsidies in agriculture is reduced. In the medium-term period, a reduction of expenditure for subsidies is expected because the highest amount for the programme of shipyards restructuring is planned in 2013. The share of expenditure for subsidies will be reduced in the amount of the gross domestic product, i.e. from the level of 2.1% in 2013 to 1.7% in 2016.

Expenditure for property income will be determined in the forthcoming period by the movement of expenses for interests. Namely, under the impact of movements in the financial markets and total needs for budget financing due to the growth of fiscal deficits, expenses for interests in the previous years recorded continued nominal increases. In 2013 as well, their further growth by about 0.3% of the GDP is forecast. In the forthcoming period, their further

growth is foreseen, but in a much smaller volume and they will move at an average level of 3% of the GDP.

Other current transfers, which include current grants and current donations, are planned at the level of 1.9% of the GDP in 2013, 2.3% of the GDP in 2014 and 2015 and 2.2% of the GDP in 2016. This expenditure category is partly determined by the Croatian contribution to the EU budget, which amounts to about 0.5% of the GDP in 2013 and 1.1% of the GDP in 2014. In the observed medium-term period, capital transfers, which comprise capital grants and capital donations, are projected at an average level of 2.1% of the GDP.

Expenditure for gross fixed capital formation comprises net expenditure for the acquisition of fixed assets, strategic inventories and valuables. These expenditures will range from the level of 1.8% of the GDP in 2013 to 2% of the GDP in 2016, which to the largest extent will be determined by the activities related to capital investments of the general government.

Net lending/borrowing

The planned fiscal consolidation in the forthcoming medium-term period will result in a reduction of the share of budget expenditure in the GDP, reduction of the deficit of the consolidated general government and the stabilisation and reversal in the trend of a continued growth of the share of public debt in the GDP, whose beginning is expected after 2014. In a medium-term period general budget net lending/borrowing is expected to drop from the level of 3.6% of the GDP in 2013 to the level of 3.4% of the GDP in 2014, 3.1% of the GDP in 2015 and 2.6% of the GDP in 2016. This will mostly be contributed by the state budget, which in 2013 records a deficit of 3.2% of the GDP, and in 2014 of 3.1% of the GDP, and in 2015 of 2.7% of the GDP. An additional decrease in the state budget deficit is planned towards the end of 2016 to 2.2% of the GDP. With regard to the movement of net lending/borrowing of other levels of the general government budget, throughout the medium-term period, extra-budgetary users will maintain the same level of deficit i.e. at an average level of 0.4% of the GDP. The units of local government, throughout the medium-term period, will also have a balanced budget.

Table 3: Most important items of revenue, expenditure and net lending/borrowing of the general government in the 2012 – 2016. period

ESA 95	% of GDP	2012	Projection 2013	Projection 2014	Projection 2015	Projection 2016
TR	Total revenue	38.2	38.4	37.9	37.7	37.2
	<i>Main components of total revenue:</i>					
P.11+P.12	Market output and output for own final use	3.1	3.1	2.9	2.9	2.9
D.211	Value-added tax	12.3	12.7	12.7	12.6	12.6
D.61R	Social contributions, receivable	11.7	11.5	11.3	11.0	10.9
D.5R	Current taxes on income, wealth etc., receivable	5.6	5.3	5.1	5.0	4.9
D.51A	- of which personal income tax	3.0	2.9	2.9	2.8	2.8
D.51B	corporate income tax	2.3	2.1	2.0	1.9	1.9
D.212	Taxes and duties on imports excluding VAT	0.5	0.3	0.2	0.2	0.2
D.214	Taxes on products, except VAT and import taxes	3.9	4.0	3.9	3.7	3.5
D.214a	- of which excises	3.4	3.5	3.4	3.2	3.1
D.4R	Property income, receivable	0.5	0.4	0.2	0.2	0.2
TE	Total expenditure	42.0	42.0	41.3	40.8	39.9
	<i>Main components of total expenditure:</i>					
P.2	Intermediate consumption	4.6	4.7	4.4	4.2	4.1
D1.P	Compensation of employees	10.7	9.9	9.5	9.2	9.0
D.3P	Subsidies, payable	2.1	2.1	2.0	1.8	1.7
D.4P	Property income, payable	2.7	3.0	3.1	3.0	3.0
D.62P	Social benefits other than social transfers in kind, payable	13.8	13.6	13.2	12.6	12.0
D.631	Social transfers in kind	3.7	3.1	3.1	2.9	2.8
D.7P	Other current transfers, payable	1.4	1.9	2.3	2.3	2.2
D.9P	Capital transfers, payable	1.4	1.5	1.7	2.4	2.7
P.5	Gross capital formation	1.4	1.8	1.9	2.0	2.0
B.9	Net lending/net borrowing	-3.8	-3.6	-3.4	-3.1	-2.6

Source: MF

2.2.4. Estimate of cyclically adjusted budget balance

The calculation of the potential GDP is based on the production function methodology used by the EC. However, due to the shortness of series and structural breakdowns in the data, as a consequence of the shocks from the recent history, the methodology recommended by the EC has proved not to be fully applicable to Croatia, and the potential GDP has been calculated on the basis of the modification of the above-mentioned methodology. These calculations indicate the closing of the negative output gap in 2015.

The calculation of the cyclically adjusted balance is based on the EC methodology and calculations for the Member States, so that the cyclically sensitive components observed on the revenue side include personal income tax, corporate income tax, indirect taxes, social security contributions and non tax revenue, while unemployment-related expenditure have been observed on the expenditure side. These calculations show that cyclically adjusted budget deficit in 2015 exceeds the actually projected deficit.

2.2.5. Public debt levels and projections of public debt developments and guarantee levels

The institutional framework of public debt and guarantee management and the main characteristics of the existing borrowing policy as well as projections of public debt developments in the medium-term period are presented in the text below.

The Budget Act¹⁷ prescribes the institutional framework of borrowing and public debt management. The main objective of borrowing and debt management is to ensure the financial needs of the state budget by achieving the lowest medium and long-term cost of financing with the assuming of a reasonable degree of risk. The act prescribes that borrowing shall be carried out with the purpose of: financing the budget deficit, financing investment projects and special programmes, subject to Parliament approval, payment of current repayments of government debt, settling due payments associated with state guarantees, budget liquidity management and meeting the needs of the CNB for foreign exchange reserves. Borrowing with the purpose of a premature redemption of government debt shall be carried out with the objective of: lowering the existing costs of the debt repayment, extending the average period of maturity (change in the length of repayment) of the debt and achieving a balanced schedule of debt repayment.

Also, it is worth mentioning that the State Budget Execution Act¹⁸ establishes the total amount of the new government debt and guarantees that may be assumed or issued during the fiscal year and the total amount of government debt at the end of the budget year. The decision on the level of borrowing and the amount of guarantees shall be taken in accordance with the amounts and purposes established by the annual budget and the State Budget Execution Act.

The above Act establishes that in 2013 the total government debt may amount to a maximum of 58% of the GDP, while the annual value of new financial guarantees for 2013 amounts to HRK 4.5 billion, of which the amount of HRK 2.5 billion refers to extra-budgetary users of the state budget.

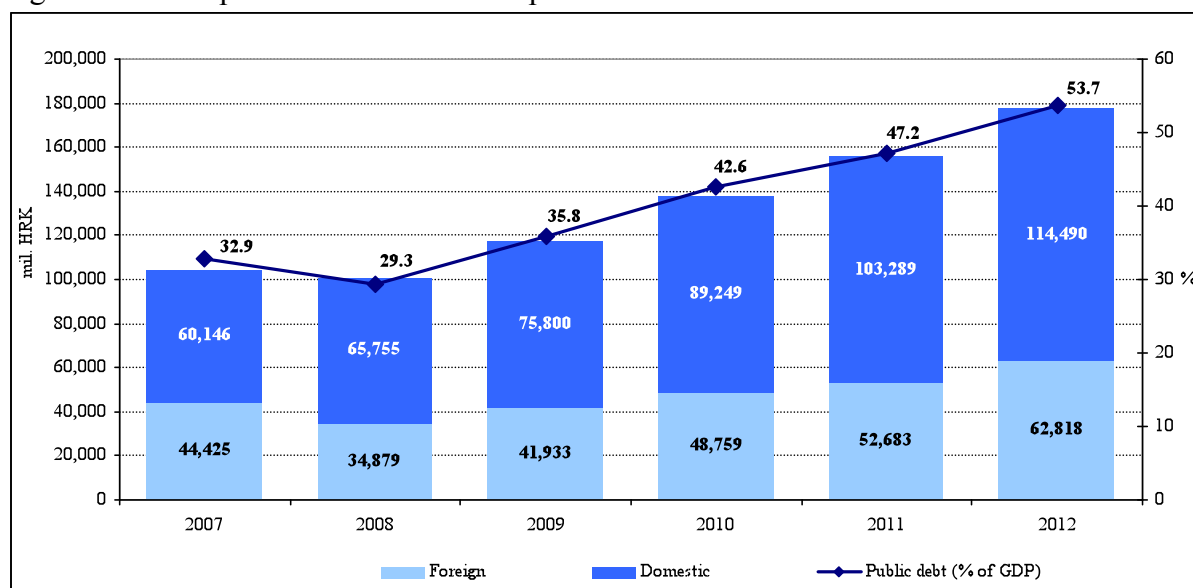
The public debt of the Republic of Croatia at the end of 2012 amounted to HRK 177.3 billion, and increased by HRK 21.3 billion, compared with the end of 2011. The share of public debt in GDP at the end of 2012 stood at the level of 53.7%. Such an increase in the public debt in the observed period is a result of the generated deficit of the consolidated general government in 2012, but also of the fact that the state, in accordance with the restructuring plans of shipyards, has taken over their liabilities in the amount of HRK 9.2 billion into the public debt. Compared with 2011, the foreign component of the public debt increased by HRK 10.1 billion, while the domestic component of the public debt recorded an increase of HRK 11.2 billion in the same period.

As per government level, the majority of the public debt refers to the central government, which recorded the amount of HRK 165.7 billion, while the debt of extra-budgetary users amounted to HRK 9.6 billion, and the debt of local government units was HRK 1.9 billion. In this context, the central government mostly borrows in the domestic market, as a result of which the domestic component of its debt records a share of 63.6% in the central government's total debt. At extra-budgetary users the domestic component of the debt also prevails, accounting for 76.2% of the total debt of extra-budgetary users. Also, the local government borrowed domestically to the largest extent, recording a share of the domestic component in the total debt of the local government of 91.1%.

¹⁷ Official Gazette, No. 136/12, 87/08

¹⁸ Official Gazette, No. 139/12

Figure 2: Developments and structure of public debt



Source: CNB, CBS

In terms of borrowing instruments, the largest share of the public debt was generated by borrowing through long-term securities (62%), followed by the borrowing through loans (27%) and treasury bills (10%).

With regard to the currency structure of the government debt, it should be emphasised that a significant share of the debt is denominated in foreign currency, where debt denominated in the euro accounts for 65%, debt denominated in U.S. dollars accounts for 7%, and debt denominated in the Croatian currency kuna accounts for 28% of the total debt. The debt denominated in euros has gradually increased over the past years and is mostly the result of the issue of bonds denominated in euros, the use of project loans from international financial institutions and borrowing in the domestic market through syndicated loans.

The interest structure of the government debt shows that a share of the debt with fixed interest rate amounts to 81%. It is primarily the consequence of borrowing through the bonds issue, while 19% refers to the debt with a variable interest rate, and results from borrowing through loans.

Total issued guarantees of the Republic of Croatia by the end of 2012 amounted to HRK 38.7 billion, or 11.7% of GDP, which represents a decrease by HRK 7.8 billion when compared with the end of 2011. The biggest share of the decrease in guarantees refers to the above-mentioned re-classification of guarantees for shipyards' liabilities, which in the process of restructuring have become the central government's debt. Foreign guarantees account for the majority, or 60.5% of the total issued guarantees of the Republic of Croatia.

The total CBRD debt by the end of 2012 amounted to HRK 16.3 billion, or 4.9% of GDP. The foreign debt component accounts for the majority, or 65.4% of the total CBRD debt. When compared with the end of 2011, the total CBRD debt increased by HRK 3 billion.

Financing of the general government budget and projection of public debt developments

A total level of the required financing in the forthcoming medium-term period will be determined by the fiscal balance developments, financial assets as well as the general government budget liabilities, which mature in the observed period. The needs for the financing of the total budget deficit and due liabilities will be directed both to the domestic and to the international financial market. With regard to borrowing instruments in the observed period, the focus will be on the instruments with a longer-term due date, i.e. primarily towards bonds. Special attention will be drawn to the adjustment of the future due date by the amount and maturity with a simultaneous release of additional space for the financing of other sectors. With regard to the positive implications on financing and the dynamics of the public debt it should be mentioned that on the financial assets side in 2013, receipts from privatization in the amount of 0.9% of the GDP are also expected, while in the next three years an average of about 0.5% is expected from privatization annually.

The majority of due liabilities in the period of 2013 – 2016 refers to seven bond maturities, where five are domestic and two are foreign. Among the domestic bonds, two are denominated in euros, the first one in the amount of EUR 650 million, and the second one in the amount of EUR 350 million, while the three bonds denominated in the Croatian currency kuna total HRK 13 billion. Foreign maturities refer to two Eurobonds, the first in the amount of EUR 500 million, which is due in 2014, and the second one in the amount of EUR 750 million due in 2015. On the loans side, the biggest maturities in the observed period refer to the maturities of syndicated loans issued in the domestic financial market.

Table 4: Overview of the bonds of the Republic of Croatia maturing in the 2013 – 2016 period

Bond	Date of issue	Amount (in million)	Interest rate	Date of maturity
DOMESTIC BONDS				
Series 11 D-13	11.7.2006	4.000 HRK	4.50%	11.7.2013
Series 05 D-14	10.2.2004	650 EUR	5.50%	10.2.2014
Series 09 D-15	14.7.2005	350 EUR	4.25%	14.7.2015
Series 10 D-15	15.15.2005	5.500 HRK	5.25%	15.12.2015
Series 16 D-16	22.7.2011	3.500 HRK	5.75%	22.7.2016
FOREIGN BONDS				
Euro - EUR VI 2014	15.4.2004	500 EUR	5.00%	15.4.2014
Euro - EUR VII 2015	5.6.2009	750 EUR	6.50%	5.1.2015

Source: MF

In accordance with the planned consolidated general government budget deficit and respectively the financing needs in 2013, it is expected that the public debt at the end of the year will amount to HRK 190.6 billion or 56.2% of GDP. In this context, the domestic component will account for 59.3%, and the foreign component for 40.7% of the total public debt.

The projections of the public debt developments shows that, due to a constant reduction of the general government budget deficit throughout the medium-term period, the public debt growth trend will stabilise in 2014 at the level of 57.5% of GDP, after which its share in the GDP is expected to decline to the level of 57% in 2016.

Table 5: Projection of public debt developments in the 2013 - 2016 period

<i>% of GDP</i>	2012	2013*	2014*	2015*	2016*
Public debt	53.7	56.2	57.5	57.5	57.0
Foreign	19.0	22.9	24.9	25.6	26.0
Domestic	34.7	33.4	32.5	31.8	31.0

* projection

Source: MF

2.3. Sensitivity analysis and comparison with previous programme

Fiscal risks

As mentioned above, fiscal projections have already been revised in accordance with the correction of the projected GDP growth, i.e. due to the intensification of negative macroeconomic developments in the national economy. Therefore, when speaking about fiscal risks, the most significant impact on the movement of fiscal aggregates comes from the changes in macroeconomic variables.

The revenue plan of the consolidated general government for 2013 and the projections for 2014 – 2016 also include the expected fiscal effects of the legislative changes in the tax policy and its alignment with the EU *acquis*. Therefore, failure to achieve the foreseen positive fiscal effects of legislative changes is a risk, which could be reflected on a lower level of revenues than expected. The most important general government's budget revenue, value added tax revenue, is subject to the movements of personal consumption so that a possible risk would also come from the decline of personal consumption when compared with the projected one in the medium-term period. Less favourable trends in the labour market than planned would definitely have an effect on social contributions, which to the largest extent depend on the movement of the number of the employed, i.e. expenditure for salaries, and the growth of the number of the unemployed would be reflected on the increased expenses in the segment of unemployment benefits.

In the forthcoming medium-term period, the share of expenditure in the GDP is expected to decrease, which is subject to a great effect by the implementation of structural reforms as well. Therefore, the risk exists with regard to non-implementation of key structural reforms at the scheduled pace, especially in social benefits systems to which a significant share of the budget expenditure refers.

All mentioned risks would lead to an increase in the general government's budget deficit, which would have effect also with regard to the public debt movements, which would generate growth beyond the projected, due to a higher need for financing and in accordance with the central projection.

In observing possible additional negative effects on the public debt development in the forthcoming period, it is important to highlight the risk of a significant change in the domestic currency exchange rate, since a big share of the total public debt is denominated in foreign currency. As a consequence, the depreciation of the domestic currency would result in a higher level of public debt as well as in its more difficult servicing. Significant fiscal risks, in the case of additional worsening of the conditions in the financial market and reduced availability of capital, would also come from the increase in the burden of debt repayment and

the payment of interests, thus representing a higher pressure on the current government operations.

Net lending/borrowing sensitivity analysis

An analysis is further elaborated of net lending/borrowing developments under the influence of the realisation of certain fiscal risks. The analysis is based on the presumed central macroeconomic projection and fiscal projections for the medium-term period. The results of the carried out tests, i.e. the effects of the changed assumptions when compared with the central projection, are observed in relation to the baseline scenario.

It should be mentioned that the tests have been carried out on the basis of arbitrary assumptions, but they nevertheless give an indication of what effects on the net lending/borrowing can be expected in the medium-term period should undesired developments related to the basic point of reference occur.

By following the movements of the largest budget revenues, a test was carried out of the effect of the realisation of negative risk of decline of personal consumption and negative trends in the labour market on net lending/borrowing. Namely, it has been shown that revenues have significantly reacted in the crisis conditions, and especially tax revenues related to personal consumption. The reduced personal consumption is reflected through the decline of VAT revenues, while negative trends in the labour market are reflected through the lower personal income tax and social security contributions.

In the first test, in value added tax, a growth of nominal personal consumption was assumed by 5% lower than the planned in 2013, i.e. only half of the growth than assumed in accordance with the central projection for 2014. The results show that the fiscal balance, due to such a scenario, would worsen by 0.6 percentage points in 2013 and by 0.8 percentage points in the subsequent medium-term period.

The second test was carried out in such a way that the points of reference of movements of revenues from personal income tax and social security contribution changed in the medium-term period in a way that will generate the worsening of the nominal annual growth rate. In this context, the year-on-year growth rate declined by 2.5% in 2013 and by 1% in 2014. The result of such assumptions shows the worsening of the level of fiscal balance by 0.4 percentage points in 2013 and by 0.5 percentage points in the remaining medium-term period.

The third scenario implies a simultaneous occurrence of the previously described deteriorations on the reference points of the observed revenues. In such conditions, the fiscal balance would show a significant worsening of 1 percentage point in 2013 and on average by 1.3 percentage points by 2016.

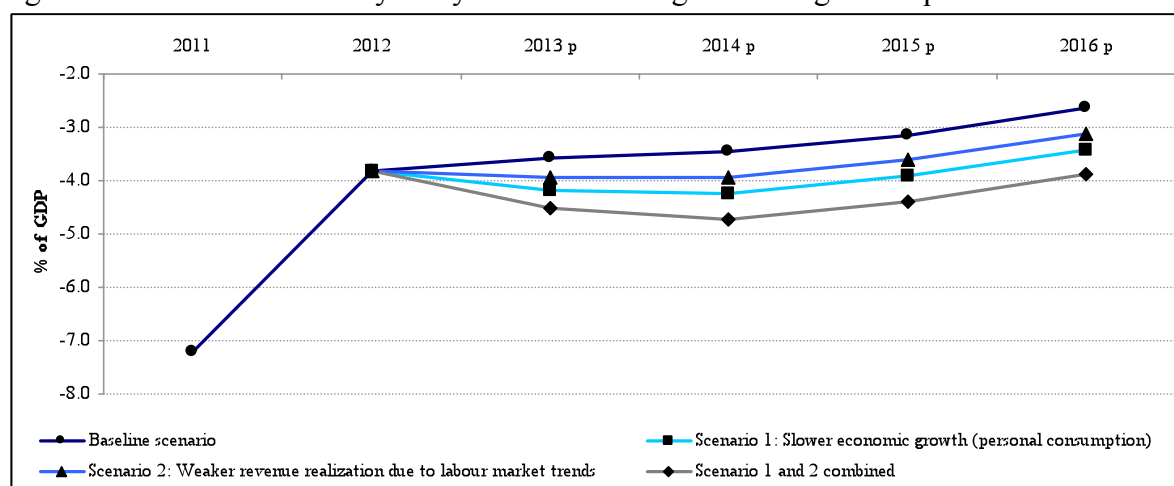
It should also be mentioned that the carried out tests imply a constant amount of the categories on the budget expenditure side although the occurrence of changes in individual reference points of the observed revenues would have implications, to a certain extent, on the expenditure of the general government budget as well.

Table 6: Results of sensitivity analysis of net lending/borrowing developments

% of GDP	2012	2013 p	2014 p	2015 p	2016 p
Net lending (+) / borrowing (-)					
Baseline scenario	-3.8	-3.6	-3.4	-3.1	-2.6
Scenario 1: Slower economic growth (personal consumption)	-3.8	-4.2	-4.2	-3.9	-3.4
Scenario 2: Weaker revenue realization due to labour market trends	-3.8	-3.9	-3.9	-3.6	-3.1
Scenario 1 and 2 combined	-3.8	-4.5	-4.7	-4.4	-3.9

Source: MF

Figure 3: Results of sensitivity analysis of net lending/borrowing developments



Source: MF

Public debt sensitivity analysis

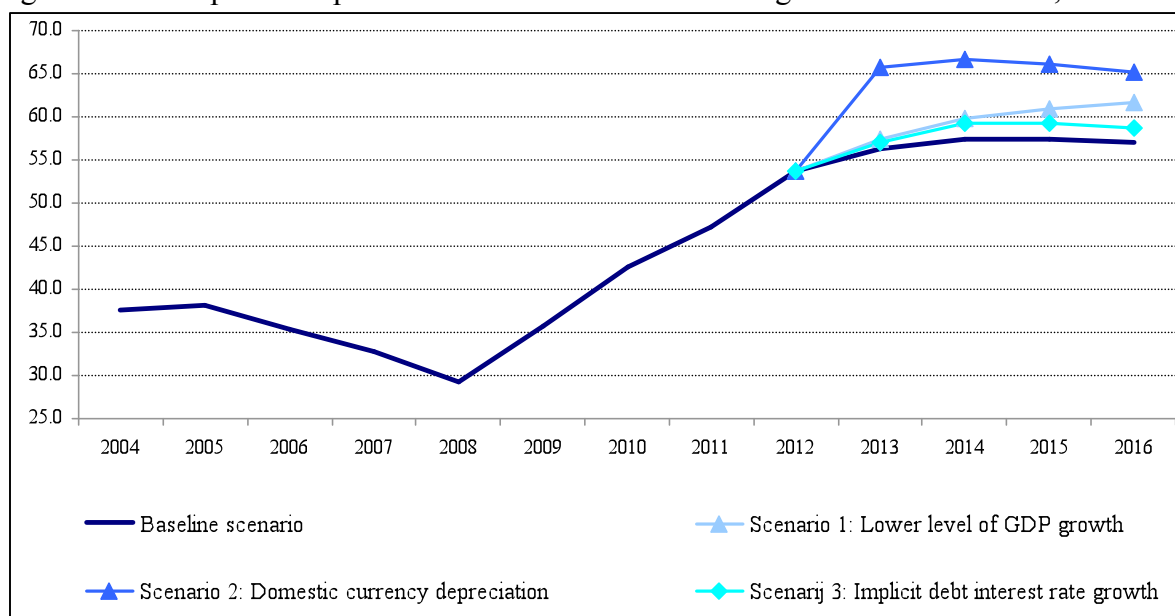
Public debt developments are directly correlated with the macroeconomic conditions and respectively with the results and assumptions of the fiscal policy implementation. For this reason, it is of extreme importance to constantly carry out the tests of public debt sensitivity to different factors to gain a realistic view of all implications of any changes in the assumptions which determine the projection of the public debt developments in the medium-term period and thus present the highest risk, and to ensure the conditions that it is avoided or that its effects are mitigated. The test is carried out by setting a baseline scenario, which is based on the medium-term macroeconomic projections. A series of alternative scenarios are then made whereby the assumed values are subjected to various shocks. The shocks are usually related to the historic values of the observed amounts and their variability, but they can also be arbitrary. For the purpose of this test, three alternative scenarios have been carried out testing the sensitivity of the public debt in the medium-term period.

The carried out public debt sensitivity tests indicate at the fact that the largest effect on its growth would come from the depreciation of the domestic currency, especially towards the euro. The reason for this is in the fact that a high share of the debt is denominated in foreign currency. The conducted sensitivity analysis reflects that arbitrarily determined shock of the depreciation of the Croatian currency kuna by 25% raises the public debt level above 66% of GDP in the 2014 - 2015 period.

Also, the public debt shows an unfavourable medium-term development on the arbitrary assumption of the lower GDP growth rate outcome in the observed period, i.e. by two percentage points less than the expected rate. In this scenario, the public debt increases up to the level of about 61% of GDP by the end of the medium-term period.

On top of the above, further worsening of the conditions in the financial market would affect the interest rate growth and would increase the costs of servicing of the existing, but also of the new debt, i.e. the expenses for interests would record significant increases when compared with the planned ones. For this test's purposes, it has been assumed that the average implicit interest rate on debt increases by two percentage points in 2013 and 2014. This would lead to higher financing costs and a negative impact on the public debt development, which would in turn generate growth above the projected in accordance with the central projection. By the end of the medium-term period it would reach a level of 59% of GDP.

Figure 4: Development of public debt share in GDP according to various scenarios, in %



Source: MF

Comparison of the Economic Programme of the Republic of Croatia 2013 and the Pre-accession Economic Programme 2012 – 2014

Differences can be observed by comparing total revenue, expenditure and net lending/borrowing of the consolidated general government according to the PEP 2012 – 2014 and the Economic Programme of the Republic of Croatia 2013. These differences arise from the different levels of the nominal GDP, which are the result of the changed medium-term macroeconomic assumptions and their effect on budget revenue and expenditure. Namely, the PEP rested on the assumption of real GDP growth of 1.5% in 2013 to 2.5% in 2014. In the Economic Programme, economic growth expectations have been lowered so that in 2013 the projected growth rate is 0.7%, in 2014 it is 2.4%, and in 2015 it is 3.5% and 3.5% in 2016.

The differences of individual fiscal amounts in these two programmes also result from other reasons specific for revenue i.e. expenditure. The prolongation of unfavourable economic movements during 2012, but also certain changes on the revenue and expenditure side of the budget have impacted the realisation of net lending/borrowing in accordance with the plan. In 2013 and 2014, the differences of projected revenue and expenditure amounts result from the changed level of the nominal GDP. Different revenue projections are also the consequence of the legislative changes in the tax system, which entered into force during 2013, which in cumulative terms will effect on a different level of budget revenue. On the other hand, in addition to the nominal GDP level, the projected expenditure side of the budget was also

affected by one-off increases in individual categories, which have been elaborated on in the text above.

Table 7: Comparison of revenue, expenditure and net lending/borrowing of the general government according to the 2012 PEP and the 2013 Economic Programme of Croatia

	2012	2013	2014	2015	2016
EP RoC 2013-2016 (% of GDP)					
Total revenue	38.2	38.4	37.9	37.7	37.2
Total expenditure	42.0	42.0	41.3	40.8	39.9
Net lending/borrowing	-3.8	-3.6	-3.4	-3.1	-2.6
PEP 2012-2014 (% of GDP)					
Total revenue	35.7	35.1	34.6		
Total expenditure	39.5	38.4	37.2		
Net lending/borrowing	-3.8	-3.3	-2.6		
Difference					
Total revenue	2.5	3.3	3.3		
Total expenditure	2.5	3.6	4.1		
Net lending/borrowing	0.0	-0.2	-0.8		

Source: MF

2.4. Quality of public finances

In the observed medium-term period, the implementation of the activities directed towards the strengthening of the quality of public finances is continued both on the revenue and on the expenditure side of the budget.

The activities of the Tax Administration (TA) should be especially highlighted, where changes in the organisational structure have occurred and the Large Taxpayers Office has been established. The Office is responsible for tax collection from companies with the annual income exceeding HRK 150 million, and all companies in the financial and telecommunications industry. In the future, the Office will also deal with all companies implementing major infrastructure projects. In addition, the TA has separated active from inactive taxpayers within the tax register and introduced the possibility of rescheduling and pre-bankruptcy settlements as well as the write-off of obsolete debt. With the aim of strengthening the financial discipline, lists have been published of taxpayers with mature tax obligations. Since 1 May 2012, a Decree has been in force, under which the employers who attempt to pay the salaries without the payment of contributions or who fail to submit the order for the payment of salaries have the account blocked by the TA and further payments are prevented. Since the beginning of June 2012 the full implementation of this Decree has started. All this has resulted in a better collection of tax revenue.

In October 2012 the Financial Operations and Pre-bankruptcy Settlement Act¹⁹ entered into force, with the aim of addressing the problems of illiquidity in the economy. The act introduces more responsible financial operations and shortens the payment periods, and the

¹⁹ Official Gazette, No. 144/12, 108/12

business entities with illiquidity problems are given the chance for restructuring through the pre-bankruptcy settlement process.

By the adoption of the Fiscal Cash Register Act²⁰, which entered into force on 1 January 2013, preconditions have been created for the oversight of cash turnovers and the minimization of the possibility of tax evasion. The implementation of the Act is based on the application solution, which electronically connects the TA with the business entity. A gradual implementation of the Act is foreseen, i.e. from 1 January 2013, and the planned finalisation of the process in terms of the implementation of fiscalisation for all business subject to it is on 1 July 2013.

In addition, it is important to mention the introduction of the centralised salary system (CSS), which will enable a centralised calculation and payment of salaries for all public and civil servants. All ministries are included or are in the process of being included in the CSS. Due to the successful implementation so far, the whole public sector is expected to be finally included in this system by the end of the year.

In the pension system, further promotion of stay in the labour market is planned and stronger penalisation in the case of early retirement. Also, the system of control of awarding disability pensions is being improved, and the possibility of changing the formula for the indexation of pensions as well as the alignment of the age limit for retirement with the demographic movements are under consideration.

In the health care system, the restructuring of hospitals has been planned on the basis of the Public Institutions Restructuring Act²¹ adopted in December 2012. In addition, reforms at the level of the entire system are planned through the reform of the hospital network, merger of public procurement for hospitals, reducing the expenses for sick-leaves, outsourcing of activities unrelated to health care and improving the management of hospitals through monitoring and evaluation.

In the social welfare sector, the plan is to merge social benefits from different systems for the purpose of protection of the most vulnerable groups of the population. In addition to the merger of benefits, a single proprietary census will be set up by which indicators will be established for determining the most vulnerable groups of citizens and in this way rationalize the system of social cash benefits and increase its efficiency. Activities are also intensified to introduce the information system, which will enable administrative savings, better control, a faster and simpler procedure for the exercise of rights and the creation of a single database of the beneficiaries of social benefits.

With regard to the labour market, the amendments to the Labour Act²² are planned and foreseen in two phases. In the first phase, which is on going, provisions on employment contracts for a definite time are being changed, the topic of overtime and termination of employment contract during the trial period. The second phase, which is in preparation, will be directed to the topics such as the notice period, severance payments and the role of agencies for temporary and part-time employment and the strengthening of the adaptability and flexibility of the labour force.

²⁰ Official Gazette, No. 133/12

²¹ Official Gazette, No. 136/12

²² Official Gazzete, No. 61/11, 149/09

In relation to the agriculture sector, the Ministry of Finance (MF) has adopted an ordinance under which subsidies cannot be paid to tax debtors until they settle their obligations towards the state. The Paying Agency for Agriculture, Fisheries and Rural Development checks with the Tax Administration whether someone to whom it intends to pay subsidies is a tax debtor, and if this is the case, the subsidies are suspended up to the amount of the debt, while the remaining amount is disbursed. For those carrying a larger debt, the payment of subsidies will be suspended until the debt is settled. Under the ordinance, no one can receive any subsidy from the state before these subsidies are set off with the tax debt or debt for contributions.

Significant progress has been made in the area of privatisation. On 28 February 2013, a privatisation contract was signed for Brodosplit-Shipyard Inc. between the Ministry of Economy and the Management Board of DIV Shipbuilding Ltd. Also on 6 April 2013, a privatisation contract was signed for Brodotrogir-Shipyard Inc. between the Croatian Government and Kemas Energija Ltd. As to 3. May Shipyard, the buyer have presented the tender and the restructuring plan to the Croatian Government. It is expected that the whole privatisation process will be finalised in May 2013. Kraljevica Shipyard has been in bankruptcy since August 2012. Preparations for the implementation of the privatisation process for Hrvatska poštanska banka and Croatia osiguranje are on going. Namely, consultants for the privatisation and capital increase of these institutions have been selected and their privatisation is expected until the end of 2013. Privatisation is also conducted in the railways sector. Thus Hrvatske željeznice (Croatian Railways) are divided in three associated companies: HŽ Infrastructure, HŽ Passenger Transport and HŽ Cargo. HŽ Cargo is undergoing the privatisation process. Following the published call for the expression of interest, seven offers were received by the end of January 2013. The process included the restructuring programme and the possibility of acquiring its business shares.

2.5. Institutional features of public finances

Budgeting process

Croatia has established an efficient medium-term budget outlook, which enables that budget planning follows a multi-year fiscal planning perspective. The reforms introduced in the management of public finances required making of changes in the legal framework. A new Budget Act was adopted in mid-2008, and entered into force on 1 January 2009. The Act introduced the following:

- The obligation to prepare strategic plans for a three-year period and strategies of government programmes for a three-year period so that strategic priorities and goals of government policy would have a direct effect on the allocation of funds within the budget,
- Multi-year budget framework by which in addition to the budget for one budget year, projections are also adopted for the next two years,
- Bigger flexibility in the budget implementation.

Ministries and other state bodies at the first level of organisational classification prepare strategic plans for a three-year period. Strategic plans for a three-year period contain: vision, mission, strategic goals, the ways of achieving these goals and their link to the organisational and programme classification as well as the measures for result assessment. On the basis of strategic plans the MF in cooperation with the ministry responsible for structural reforms and the coordination of the EU Funds prepares the strategy of government programmes for a

three-year period, which contains joint vision, strategic goal, main strategic areas of Government activities with identified goals, ways of achieving these goals and measures for result assessment, ranked strategic priorities and their link to organisational classification.

In Croatia, the medium-term budget outlook is laid down in the guidelines of the economic and fiscal policy for a three-year period, adopted by the Croatian Government as proposed by the MF. For the mid-term budget outlook to be able to follow the government policies, the guidelines are based on the strategy of government programmes, and contain:

1. Strategic goals of economic and fiscal policy,
2. Basic macroeconomic indicators,
3. Basic indicators of fiscal policy,
4. An estimate of revenues and expenditures and receipts and expenses of all levels of the general budget,
5. A proposal of the financial plan scope by budgetary users for the previous and current budget year, and for the following two years,
6. Projected changes in public debt and a strategy of public debt management.

The 2008 Budget Act has also introduced special mechanisms, which give flexibility to the budget implementation process:

1. With the possibility of reallocation of funds under budget items by budgetary users or between them up to a maximum of 5% (the approval by the Finance Minister required), the flexibility in the budget implementation has been given in such a way that aids, donations and revenues for special purposes that are paid and carried over, but planned at a lower level may be executed above the levels established in the state budget, and up to the amount of paid and/or carried over funds.
2. Also, earmarked receipts from borrowing that are paid and carried over, but planned a lower level may be executed above the planned level established in state budget, and up to the amount of paid and/or carried over funds.
3. Furthermore, the activities and projects financed from EU funds and capital projects, which are not completed by the end of the current year, may be carried over and implemented in the subsequent year, if the basic preconditions prescribed by the State Budget Execution Act are met.

Amendments to the Budget Act were adopted in November 2012. They were motivated by the need to strengthen and more clearly define individual provisions of the Act which in practice have shown to be vague, and with the intention to motivate local units to engage in the energy efficiency projects. This means that they are exempted from the legal limitation of the level of borrowing which is up to 20% of the revenues realised in the preceding year.

Also, amendments to the Budget Act improve the legal framework for a more efficient use of EU funds after entering the fully-fledged membership. Thus, *inter alia*:

- The payment of advances for the obligations in the projects co-financed by EU funds is simplified,
- Preconditions are created for the adoption of subordinate regulations in relation to the suppression of irregularities and fraud in the use of EU funds,
- Flexibility is increased in the making of payments for the Croatian contributions to the EU budget.

The Budget Act prescribes several fiscal rules by which budgetary discipline is promoted:

- The ratio of the unsettled amount of the state debt at the end of the year in relation to the projection of the GDP may be greater than the last year's ratio, provided that the mentioned ratio does not exceed 60% of the GDP;
- Proposals of laws and subordinate amendments must contain a fiscal estimate of the implications for the budget, which must include:
 - Projected budget revenues and expenditures and receipts and expenses for the budget year and for the subsequent two years,
 - Proposals for the covering of increased budget expenditures and expenses,
 - Proposals for the compensation of the reduced budget revenues and receipts,
 - Consent by the MF.

The Instruction on detection, proceedings and reporting on irregularities in the management of budget funds has been adopted, which defines the addressing of irregularities in the management of budget funds. Also, the deadlines of reporting on the observed irregularities are determined.

In the changed economic circumstances with emphasis on the need for a strong fiscal consolidation, the introduction of clear rules of fiscal responsibility and management of budget performance is set as imperative. Fiscal rules are the institutional mechanisms directed at ensuring fiscal credibility and discipline. Thus at the end of 2010, the Fiscal Responsibility Act²³ was adopted, introducing fiscal rules within which the Croatian Government establishes and implements its fiscal policy, with the reduction of government spending as one of its features. The Act entered into force in 2012, which means that the assessment of meeting of fiscal rules for 2012 is expected in May 2013, together with the annual report on the implementation of the state budget.

In the segment of the strengthening of fiscal responsibility this Act complements or strengthens the provisions of the Budget Act, and it particularly introduces the responsibility of each budgetary user for the generation of obligations above the level foreseen by the budget, and the responsibility of their heads for a legal, earmarked and purposeful spending of budget funds, and an efficient and effective functioning of the financial management and control system.

In the part of the Act that refers to fiscal rules, the Act specifies the rules which should be met to achieve the desired direction of the fiscal policy. This direction implies the reduction of government spending and the representation of the government in the economy, which together with the necessary elimination of fiscal imbalances puts a special emphasis on the consolidation of the expenditure side of the budget.

The fiscal rules defined by the Fiscal Responsibility Act are divided in two parts. The rules could be provisionally called as temporary and permanent. A temporary or the first rule which, in accordance with the Act should be met refers to the reduction of expenditures shown by the share in the GDP by at least 1 percentage point per year, i.e. until the moment of achieving the primary balance of the general budget at the zero level or in a positive amount, i.e. in nominal terms. The second, or conditionally called, permanent rule begins from the moment when the first rule has been met, and it refers to the maintenance of the zero or positive cyclically adjusted primary balance of the general budget. The primary balance is the

²³ Official Gazette, No. 139/10

difference between revenues and expenditures without interests, and the scope of the general budget and the method of the calculation of aggregates for the need of these rules are based on the ESA 95 methodology of the EU.

It is worth mentioning that the revision of the Act is planned in the next short-term period in the context of the currently worsened macroeconomic situation, where special attention will be paid to the ensuring of fiscal sustainability. In considering the accession to the EU, the intention is to establish a well-defined, efficient and independent fiscal rule, which would be aligned with the legislative package for the strengthening of the economic management within the EU. In this context, the MF will use the technical assistance of the International Monetary Fund (IMF).

By the Decision of the Croatian Government, in March 2011 a Fiscal Policy Committee was established as an expert and independent body with the following tasks:

- Reviewing and assessment of the implementation of the fiscal rules defined by the Fiscal Responsibility Act,
- Reviewing and assessment of the documents adopted by the Croatian Government, related to the process of preparation of the state budget and projections,
- Reviewing and assessment of measures for the improvement of the efficiency and sustainability of the public finance system.

In the period since its founding until today, the Committee has held nine sessions and three meetings with the representatives of international financial institutions – the World Bank and the IMF. The Committee's standpoints and releases from the Committee's sessions are published on the MF website. It is worth mentioning that in the planned revision of the Fiscal Responsibility Act, among other, the intention is to strengthen the role and independence of this Committee, in such a way that the committee should become a body within the parliamentary Finance and Central Budget Committee.

Fiscal statistics

The fiscal statistics of the Republic of Croatia has been compiled and published according to the IMF's GFS 2001 methodology, by which international comparability of data is enabled. Within the process of the accession of the Republic of Croatia to the EU, the fiscal statistics compilation according to the European System of National Accounts – ESA 95 has been established. Starting from 2006, this methodology has been the basis for the compilation of the Fiscal Notification according to the Excessive Deficit Procedure (EDP), which was annually submitted by the MF under the obligation from the Pre-accession Fiscal Surveillance Procedure. The system of compilation and submission to the Eurostat of non-financial and financial accounts of the government sector according to the ESA 95 methodology has been established (non-financial accounts, under the responsibility of the Croatian Bureau of Statistics (CBS), and financial accounts, under the responsibility of the CNB).

The Fiscal Notification – with minimum differences of the ESA 95 methodology and the specific methodology derived from it according to the Manual on Government Deficit and Debt (MGDD) – must be prepared on the basis of national accounts and aligned with them. Eurostat's requests and recommendations for further improvements in terms of methodology, coverage, etc. have been defined at the pre-accession EDP dialogue visit by the Eurostat's representatives to the Republic of Croatia in May 2012, and improvements in the Fiscal Notification have been made in this sense. Furthermore, in accordance with the European

statistics practice and Eurostat's requests, the responsibility for the Fiscal Notification is transferred from the MF to the CBS. The Fiscal Notification of April 2013 is the first that is prepared and submitted to the Eurostat by the CBS. Cooperation continues between the CBS, the MF as the source of data and the competent body for the preparation of plans and projections, and the CNB for the part of the Notification concerning financial accounts and the debt according to the Maastricht criteria.

The forthcoming development according to the requirements of the European statistics primarily comprises the preparations for the introduction of the new ESA 2010 methodology, which shall be applied for the statistical reporting from September 2014, and the preparations for the reporting according to the EU Council Directive 2011/85 on requirements for budgetary frameworks of the Member States. According to the provisions of the Directive, from the beginning of 2014, each EU Member State has the obligation to publish at least the basic data on total revenue and total expenditure and on overall balance (surplus/deficit), monthly for the central government and social security funds sub-sectors and quarterly for the local government sub-sector. The responsibility of the ministries of finance is mostly foreseen for this. In addition, data on guarantees, public-private partnerships, public companies' liabilities and on non-performing loans will be annually published and submitted to the Eurostat.

With regard to the ECB's reporting requests in the area of fiscal statistics, the CNB has begun with the preparation and test submission of "GFS for ECB" reports in accordance with the European Central Bank's Guidelines 2009/20. With regard to the compilation and submission of financial accounts quarterly statistics (which include the general government sector) for ECB needs in accordance with the ECB Guidelines 2002/7 and 2005/13, the task is in the development stage, although no report request has been received from the ECB.

The overall system of the official statistics of the Republic of Croatia has been aligned with the Code of Practice of European statistics, by the amended Official Statistics Act²⁴. Mutual relations of the competent institutions in the field of general government national accounts and related statistics (CBS, CNB and MF) are regulated, in accordance with the European practice, in the Agreement on Cooperation (Memorandum of Understanding) which was concluded in 2007, and whose adjustment to the new circumstances and statistical requirements is under way.

²⁴ Official Gazette, No. 12/2013 - consolidated text

3. Structural Reforms

3.1. Obstacles to growth and structural reform plan

Table 8 shows the headline targets of the Europe 2020 Strategy and the current position of Croatia in relation to the EU in this respect. The comparison of these data indicates at the areas that represent the main obstacles for growth in the Republic of Croatia.

Table 8: The values of Europe 2020 Strategy headline targets in EU and HR, in 2011

	EU (2011)	HR (2011)
1. Employment (Employment rate)	68.6	57
2. Research and development (% R&D investments in GDP)	2.03	0.75
3. Climate change and energy		
3a. Greenhouse gas emissions (%)	85	95.2
3b. Share of renewable energy in gross final energy consumption (%)	12.5	13.8
3c. Energy efficiency		
4. Education		
4a. Early leavers from education and training (% of population aged 18-24)	35.5	24.5
4b. Tertiary education attainment (% of population aged 30-34)	12.9	4.1
5. Poverty / Social exclusion (Number of persons)	~23	1,382,000

Note: The indicator for energy saving is not listed because in the form applied in the Europe 2020 Strategy, this index is country-specific, therefore the comparison is complicated.

As Table 8 shows, Croatia has a **significant lag** compared to the European averages in the areas of employment, R&D, GHG emissions, tertiary education and poverty. The Croatian position is relatively favourable in comparison with the EU in the area of renewable energy sources, and it is considerably better in the area of early school leaving.

The obstacles to growth in relation to the Europe 2020 Strategy headline targets:

1. **Low participation in the labour market**, in relation to the employment rate, represents a significant obstacle to growth. This is connected with obstacle No. 6 (restructuring) because it is expected that the process of restructuring and privatisation of state-owned enterprises, as well as reform of the state aid system, will contribute to the growth of unemployment in the short term. Gradual and coordinated interventions are necessary to minimise the expected negative effect of these reforms to the employment rate.

2. Croatia is lagging behind in terms of development of knowledge-based growth factors. The obstacle to growth related to the low **expenditure for research and development** is obvious if national and EU indexes are compared and even further when the public and private sector expenditures are compared. From the development policy point of view, research and development are the key preconditions for the development of a more competitive economy, and in this sense, the increase in expenditure for research and development is an important priority of the Croatian government in the forthcoming period.
3. Experience has shown that the decline of **greenhouse gas emissions** is a positive side of the effects of transition and the restructuring of the economy. As a consequence, the correlation with obstacle No. 6 is obvious in this case as well, but here, the correlation is positive and the two bottlenecks can be tackled simultaneously.
4. **An education system that is mismatched to the labour market needs** is an obstacle that is related to the goal of increasing the population with completed tertiary education, but it is also closely related to employment. The increase in the number of people with completed tertiary education in the population should be aligned with the development needs of the labour market, and in this sense, the reform of the education system is also one of the priorities of the Croatian government.
5. A large number of people in Croatia face the **risk of poverty and social exclusion**, which also represents an obstacle for growth. In this respect, Croatia has relatively unfavourable public health-care indicators, and the elderly, children and disabled persons are particularly vulnerable. Similar to employment, poverty is an obstacle closely correlated with obstacle No. 6 (restructuring). The correlation is negative in the short-term. Due to significant costs of the social policy, this obstacle and the reform measures connected with their elimination involve large budgetary effects, too.

Obstacles to growth identified through the 2012 PEP:

6. The correlation of the restructuring and privatisation of state-owned enterprises and the reform of state aid system with other identified obstacles to growth has been pointed out in cases of several obstacles. The elimination of these obstacles is necessary, but in the short term, direct negative effects of the restructuring and privatisation of state-owned enterprises on other identified obstacles to growth should be taken into consideration, in particular in the planning and implementing of related interventions.
7. In Croatia, it is necessary to **increase the participation of individuals in life-long learning**, and in this way, too, appease the imbalance of the supply and demand in the labour market. Life-long learning is one of the basic preconditions for the building of the knowledge-based society and it implies interventions that tackle the economic challenges and growth of unemployment.

Except for the identified obstacles in relation to the targets of the Europe 2020 Strategy and PEP, there are additional factors that hinder the growth and development at the national level and that will be addressed through the EU funds interventions. In the areas closely related to the priorities of the Annual Growth Survey, in particular "**promoting growth and competitiveness**" priority, the following specific obstacles to growth is highlighted.

Specific obstacles connected with the Annual Growth Survey (Priority 3):

8. The obstacle connected with the access and use of information and communication technologies (ICT), has 3 dimensions: broadband access, e-administration and digital literacy. Inadequate coverage, inaccessibility and poor use of the ICT is present especially in Croatian rural areas. E-administration is correlated with obstacle No. 11 concerning public administration, and digital literacy can be addressed under the measures for recommendation 7 (life-long learning).
9. Access to adequate sources of financing is a very important obstacle correlated with the increase in competitiveness and the achievement of economic growth. The lack of adequate sources of financing strongly hinders the growth and competitiveness of key drivers of the economy (e.g. small and medium-sized enterprises - SMEs).

Some of the typical **obstacles to growth for catching-up countries** are also present in Croatia. They include the unbalanced regional development and underdeveloped infrastructure, but are also related to the preservation of natural and cultural resources (e.g. the sea, the areas threatened by fire, brownfield areas, etc.).

10. Unbalanced regional development and underdeveloped infrastructure represent significant obstacles to growth in Croatia. Except for the segment of road infrastructure (motorways), all other transport pathways require improvement and there is a great imbalance of coverage in the different parts of the country and a general disproportion in relation to the EU average.
11. In the area of the preservation of natural and cultural heritage, obstacles are correlated with, i.e. caused by the limiting financial resources for the preservation and the development of such resources, primarily due to the significant investment needs for development in other areas and a limited budget.

Obstacles at the level of the EU:

12. The consequences of the economic crisis on the employment and the economy as a whole in Croatia, as in other EU countries, are obvious. Key challenges in Croatia are related to tackling the negative consequences of the crisis and ensuring conditions for economic recovery in parallel to preserving macroeconomic stability.
13. The inefficiency of public administration in Croatia should be viewed and addressed in the light of the accession to the EU. Beyond the general need for improvement of efficiency of the public administration, the adjustment of the existing public administration structure should be carried out in line with the requirements of the EU membership.

3.2. Reform measures in relation to the Annual Growth Survey reform priorities

3.2.1. Pursuing differentiated, growth-friendly fiscal consolidation

Within the scope of the strategic commitment to the implementation of a differentiated fiscal consolidation which has a minimum negative effect on the recovery and growth, the Croatian Government has been implementing measures both on the revenue and on the expenditure side of the budget, as well as those related to the strengthening of the institutional framework for the fiscal policy management. Detailed measures and their effects are described in chapters 2.2.3 Medium-term budget outlook, 2.4 Quality of public finances and 2.5 Institutional features of public finances. The key highlights are presented below.

The measures that refer to the reforms of the pension and health-care system are described in more detail at the end of this chapter.

1. Measures on the revenue side of the budget

The measures on the revenue side of the budget are primarily defined by the legislative changes and by the strengthening of the institutional capacity.

Following to the tax measures in 2012, in which the general VAT rate was increased from 23% to 25%, health-care contributions rate was reduced from 15% to 13%, and certain non-taxable allowances were abolished or reduced, the directing of tax burden from labour to spending and assets continued in 2013. The aim is to minimise the negative effect on the growth and the creation of jobs. Since the beginning of 2013, the zero VAT rate has been abolished, and reduced rates for specific categories of products have been introduced to appease the effect of the changes on the socially vulnerable groups of the society. The changes in the system of special tax on motor vehicles introduce the environmental criterion, which will contribute to the reduction of the carbon-dioxide emissions. Changes are also implemented in the system of excise duties on tobacco and energy for the purpose of alignment with the EU *acquis* requirements. Changes in the corporate income tax have also been adopted, by which the reinvested profit is exempted from the payment of tax. The expected net fiscal effect of all of the above changes shall amount to HRK 1.2 billion in 2013.

At the same time, measures are implemented for the purpose of strengthening the efficiency of the Tax Administration, the fight against the grey economy and the tax evasion. Organisational changes have been made in the Tax Administration to enable improved supervision, in particular over large taxpayers. Tax debtors' lists have been published, and a regulation has been in force, which prevents the payment of salaries to employers who fail to pay contributions first. The fiscalisation procedure has been introduced for the purpose of control of cash transactions and reducing the possibility of tax evasion.

2. Measures on the expenditure side of the budget

The rationalisation of the expenditure side of the budget is necessary for the maintaining of fiscal sustainability. However, the Government is trying to implement the differentiated approach to maintain the potential growth and the fundamental social security. Thus,

investments are continued, although in a decreased volume, in transportation, water and energy infrastructure and tourism, and further investments are also made in education.

The dynamics of the pensions is determined by demographic trends, as well as by the continuation of the indexing of employment pensions (the expected effect is HRK 475 million in 2013). The incentives to the stay in the labour market continue as well as the reactivation of pensioners. The expenses for the health care will be under the effect of the reform of the hospital network, the unification of the public procurement and the implementation of the rehabilitation of health-care institutions, for which HRK 1.1 billion of budgetary funds has been ensured, all for the purpose of strengthening the cost effectiveness and the sustainability of the system. The centralisation of social benefits is also under way, as well as the creation of a centralised base of their beneficiaries. The introduction of a proprietary census is also being implemented to strengthen the effectiveness and quality of the social welfare.

In the area of compensations of employees in civil and public service, savings have been made by the signing new collective agreements, and further savings are expected after the planned negotiations on branch agreements as well as the completion of the central salary system process. Thus total compensations of employees are down by HRK 1.8 billion when compared with the previous year. The implementation of active employment measures is continued (for which HRK 446 million is ensured, or up by 24% when compared with the previous year). Adaptability of the labour market is continued through the planned amendments to the Labour Act.

The privatisation process of the shipbuilding sector is under way, as well as the privatisation process of the railway cargo transport. The plan is to complete the privatisation of one state-owned bank and an insurance company until the end of the year. Total receipts from privatisation by the end of the year are expected in the amount of HRK 3 billion.

3. Strengthening of the institutional framework for fiscal policy management

Fiscal rules are one of the key mechanisms of strengthening the fiscal credibility and discipline, in particular in the context of the need for fiscal adaptations with regard to the growing pressure by the public debt and its financing, as well as the need to address demographic trends. In this context, the Fiscal Responsibility Act entered into force in 2012, and its revision for the purpose of better alignment with the relevant EU *acquis* and a further strengthening of fiscal sustainability is expected soon.

The quality of medium-term budget planning is strengthened through the recent, but also through further planned changes of the budget regulations, in particular for the purpose of alignment with the EU package for the management of economic policy (six-pack). The setting up of the Fiscal Policy Committee, as an expert and independent body for the monitoring of the implementation of the fiscal rules and improving efficiency of public finances, is also worth mentioning. The anticipated changes will ensure further strengthening of its independence.

Reform measures contributing to the pension system reform

4. Improvement of disability pension and professional rehabilitation systems

The Republic of Croatia has been faced with a large number of disability pension beneficiaries, as a consequence of the economic crisis, unemployment, numerous amendments to the relevant legislative acts and an overall lack of transparency of the system, resulting in deficiencies of the existing disability pension system. It is therefore necessary to regulate the pension system in a new way, with an emphasis on the establishment of the remaining work capacity. The intention of this measure is to reduce the number of disability pension beneficiaries with a total incapacity for work. In addition, it is necessary to review the definition of disability and of the professional rehabilitation system.

The disability insurance system is to be improved primarily by ensuring better conditions for the assessment of disability in the pension insurance system within the Croatian Pension Insurance Fund, as of 1 January 2014. By establishing a single point where forensic expertise will be carried out, the unified forensic expertise criteria will be ensured, and the efficiency of the work of experts will be improved, with the aim to determine the remaining work capacity of persons and their inclusion in the labour market, in line with the remaining capacity to work. At the beginning of 2013, a special unit for the revision of findings and formal opinions on disability was established within the Ministry of Labour and Pension System, with an aim to more effectively control the medical forensic expertise procedure in establishing work capacity.

Furthermore, in order to fight grey economy and ease the related burden on the state budget, it is envisaged to enable the current disability pension beneficiaries, with an established total incapacity to work, to file a request for reassessment of their work capacity. In case an improvement of their health condition or remaining work capacity is established, they will be enabled to enter an employment relationship and to receive a pension at the same time.

5. Broadening the circle of pension beneficiaries who may work while receiving a pension

Due to increased life expectancy, the vitality period has also extended, often exceeding the retirement age. In order to encourage prolonged employment, it is therefore planned to broaden the span of pension beneficiaries who may work while benefitting from a part of the pension.

In accordance with the law currently in force, the beneficiaries of a disability pension due to professional work incapacity, may work and receive a part of the pension, while the payment of the pension is not suspended regarding pension beneficiaries employed at temporary or part-time seasonal jobs in agriculture. However, taking into consideration the need for an improvement of social security of pension beneficiaries, it has been also envisaged to enable old-age pension beneficiaries to work and use a part of the pension, which would increase their standard of living and reduce the overall pension expenditures. In this sense, a revision and amendments of existing legislative framework are foreseen.

6. Revision of the formula for the adjustment of pensions

In order to maintain socially adequate pensions and fiscal sustainability of the pension system based on generation solidarity, the formula for the adjustment of pensions will be reviewed.

Namely, unlike the existing, the so-called “Swiss formula”, which takes into consideration the rate of the change in consumer prices and the average gross salary, on an equal basis (50:50), it is proposed that in the future pensions are adjusted according to a variable model, depending on the share of the rate of change of the average salary and consumer price indexes in the previous half-year in the sum of these rates. This new model of pension adjustment would also take into consideration the growth of the average salary and consumer prices, but in a way that would be more favourable for the pensioners than the existing model of pension adjustment, both in the conditions of economic growth, when salaries grow faster than consumer prices, and economic crisis, when the situation is reversed.

Furthermore, another process underway is separating the pensions acquired on the basis of general regulations from the pensions or parts of pensions acquired in accordance to special regulations, in order to establish which pensions are fully paid from the contributions and which part of all the pensions is paid from the state budget.

7. Change of the penalty system for early-age pension

In order to encourage prolonged employment and retirement at a later age, it is necessary to establish pensions more favourably with regard to insured persons with a longer service. In this sense, a model with stricter penalties is being considered for insured persons with a shorter service, and with smaller penalties for insured persons with a longer service, while insured persons with 42 and more years of service would not be subject to penalties. The biggest deduction of early age pension of 20.4% would remain, as currently stipulated by the Pension Insurance Act. A transitional period by 2029 would be foreseen for women.

The objective of this measure is to lessen the burden on the pension system by encouraging prolonged employment that would reduce the number of early old-age pension beneficiaries and reduce overall pension expenditures. The measure would be realized through the adoption of a new Pension Insurance Act.

8. Change of the basic pension formula

Beneficiaries of the pension insurance, who will acquire a pension from both compulsory pillars, acquire their basic pension within the first pillar. At the moment, the basic pension is low in comparison to the pension that is acquired only in the first pillar and does not sufficiently depend on the salaries of the insured persons. It is thus envisaged to review the formula for determining the basic pension, by taking into account to a larger extent, the amount of the salary and the ratio of contribution rates for the first and the second pillar, with the purpose of ensuring adequate pension levels and maintaining long-term financial stability of the pension system.

9. Change of the existing service insurance system with increased duration

The existing system of insurance service with increased duration (the so-called reduced service retirement) has been set up with the aim of protecting workers employed at especially difficult and health and work capacity detrimental jobs. Since work conditions (safety at work, technology, organisation, etc.) have changed considerably, this institute is no longer adequate for the labour market, and it is incompatible with the pension systems in the EU, and it should therefore be redefined. This measure envisages a differently set system of insurance

service with increased duration that is the introduction of a new institute for persons employed at jobs which are life threatening and difficult, by introducing new funds.

10. Separation of compulsory and voluntary capitalized system

This measure refers to the overall improvement of legislative framework with the objective to intensify investment policies of compulsory pension funds, by introducing the so-called sub-portfolios, further reduction of compulsory pension funds' fee, a more accurate definition of tasks of compulsory and voluntary pension companies, ensuring more efficient control over the work of compulsory and voluntary pension companies.

An introduction of compulsory funds of A, B and C categories, the so-called sub-portfolios, which have different investment strategies and investment limits, is being considered. Operational risks are the lowest in the C fund category intended for investments in short-term securities with the purpose of preserving realized rates of return, as well as to protect from negative rates of return at financial market prior to retirement, while the largest risk is in the pension fund of A category, intended for younger insured persons. The fee reduction is planned for managing a compulsory pension fund, the maximum value of which is currently 0.45% per year, out of the total pension fund assets.

In the forthcoming period, a gradual increase of contributions for the II pension pillar is planned from 2014. The measure will be realized with the amendment to existing legislation through adoption of two separate acts.

11. Introduction of the acknowledgement of the right to a pension supplement in a corresponding percentage for beneficiaries realizing pensions from both compulsory pillars

The introduction of the pension supplement in 2007 significantly improved the material status of pension beneficiaries who realized the pension only in the first pillar in accordance with the Pension Insurance Act as of 1 January 1999, in a way that these beneficiaries are allocated a pension supplement in the amount of 4%-27%, depending on the year of retirement, whereby it has as such been integrated in the total amount of the pension. It is planned through this measure to acknowledge the pension supplement also to beneficiaries from both compulsory pension funds in order to accomplish social adequacy of these pension beneficiaries. In this sense, it is foreseen to amend the act regulating the pension supplement.

12. Informatisation of the generation solidarity system

Further improvement of the efficacy and transparency of the pension system is planned in the part related to a more rational and effective work of relevant institutions, by applying modern information technologies and through direct exchange of data. In accordance with the Labour Act, upon accession of the Republic of Croatia to the EU, the current format of the work record will be replaced by an electronic form of the maintenance of the data contained in the work record, and direct exchange of the data will be ensured between the institutions in the area of social security. Moreover, it is important to emphasise that the Croatian Pension Insurance Fund is being restructured into a more effective and available public institution in which the procedures for the exercise of rights will be shortened, a centralised maintenance of data on the insured persons and beneficiaries will be introduced in the electronic form, and the insured persons/beneficiaries will be able to have an insight into their personal data.

13. Modernization and greater jurisdiction of the institution responsible for keeping the personal accounts of pension insurance fund's members (REGOS) with regard to the exchange of information

The objective of this measure is to strengthen the role of the Central Registry of Affiliates (REGOS) by introducing a single form for the collection of data on all receipts, which will replace all of the existing six forms submitted by employers and payers to the Tax Administration and to the Central Registry of Affiliates.

By introducing a single form, it is planned to speed up the relevant administrative procedures, reduce red tape and increase public administration efficiency. The introduction of this measure will enable REGOS to implement a more precise and efficient distribution of funds to personal accounts of compulsory pension fund members. Via a designated web portal, the insured persons will also be able to have insight into the personal data on receipts and contributions paid by employers.

Reform measures contributing to the healthcare system reform

14. Centralised hospital procurement for hospitals through framework agreements

In 2013, a continuation of the centralisation of hospital procurement is planned. By December 2012, tenders to the value of HRK 1.2 billion were published within this measure. In the first quarter of 2013, new tenders worth an additional HRK 1 billion are expected to be published. The estimate of the fiscal effect for 2013 is HRK 250 – 350 million. Taking into consideration additional reductions of hospital budgets in 2013, the above saving should have a positive effect on the trend of generating of hospital debts.

15. Hospital healthcare system masterplan

This measure refers to the reorganisation of the structure and activity of healthcare institutions. It is planned to complete the masterplan of the hospital healthcare system in the fourth quarter of 2013. The realization of the masterplan will be implemented after 2013, and the results will be the slowing down of the rise of hospital spending through re-modelling of the existing hospital capacities, the introduction of day care hospitals and centralised emergency hospital admittance, reduction of expensive acute capacities, which are currently used for prolonged treatment and the expansion of cheaper chronic capacities in hospitals. The demand for hospital healthcare services is naturally financially growing at a level of 5-8% annually (the aging of population, the advancement of medical technology and the public expectations). The estimated effect of implementation of the masterplan is the reduction of natural increase of hospital health care services from 5-8% to 2-4% annually.

16. Outsourcing of non-medical services in hospitals

This measure also refers to the reorganisation of the structure and activity of healthcare institutions. More than thirty hospitals have individually carried out the programmes of outsourcing of different non-medical services over the past few years, mostly of cleaning and laundry. By the end of 2013, the national recommendations for implementation will be adopted, that will enable the expansion of these activities on a wider range of hospitals and services and ensure efficiency and quality.

17. Healthcare informatization

Healthcare informatization is an administrative measure to set up the information and communication system, which will centralise and integrate the information management in the healthcare system. The objective of this measure is to enhance the effectiveness, accessibility and safety of the healthcare system, the standardisation of business processes and information, and an improved supervision and management of the healthcare system as a whole. The saving of 1.5% of the total annual budget of the healthcare system is to be reallocated to the enhancement of the quality of healthcare, i.e. the treatment of vulnerable groups. The investment in informatization will create preconditions for the monitoring of work, spending and the achievement of objectives, and thus of an efficient management of the healthcare system. Also, better control and guidelines slow down the natural trend of the growth of demand for healthcare services.

18. Control of expenses for sick leave

The measure of control of expenses for sick leave includes the modification of provisions regulating the right to sick leave (the ordinance on the longest duration of sick leave) as well as the administrative (organisational) change. The institutional change is reflected in the reorganisation of the control service, and the administrative change refers to the changed process of the control of sick leaves.

19. New models of contracting healthcare

The measure of the change of the model of contracting healthcare is primarily of administrative nature and includes the changes in contracts with the healthcare providers. The change of the contracting model will be published by the Decision on the bases of entering into contracts on carrying out healthcare from the compulsory healthcare insurance. The New model of contracting primary and hospital healthcare for the contractual period of 2013 - 2015 has been designed and defined, based on the monitoring of the efficiency and quality of healthcare provisions, the implementation of preventive medicine, managing chronic diseases, association of doctors of medicine according to special skills and the provision of additional services to patients, according to the highest European and world standards.

3.2.2. Restoring normal lending to the economy

With regard to the second priority of the Annual Growth Survey – restoring normal lending to the economy – the key measures refer to the development of funds for economic cooperation, the continuation of lending activities of the Croatian Agency for Small Entrepreneurship and Investments (HAMAG INVEST) and the CBRD, the implementation of the Financial Operations and Pre-bankruptcy Settlement Act as well as the participation of the Republic of Croatia in the activities of the European Investment Bank (EIB).

1. Development of funds for economic cooperation (FEC)

This measure promotes the use of new sources of capital in accordance with the recommendations under the second priority of the Annual Growth Survey. FECs are open-end venture capital investment funds with a private offering founded in accordance with the

Investment Funds Act. Their objective is to promote the development of the economy and to preserve the present and create new jobs, through the strengthening of the existing and the launching of new economic entities by ownership restructuring through investment of additional capital. The Croatian Government participates in a specific fund with 25% to 50% of the amount to which the private sector has committed. In 2013, Croatia will participate with HRK 345 million of the budget funds.

The target beneficiaries of the FEC's financing include companies which have products and services with a high growth potential, a comparative advantage over competition, good management, regular and transparent operations and a good business plan, as well as an acceptable rate of return on invested funds by the FECs. The amount of financing and the percentage of co-ownership is not limited, and the exit from ownership of a company by the FEC through the selling of shares will be carried out no later than within 5 years of the investment.

This initiative creates a positive investment climate, sharing of risk with the private sector and the development of the industry of venture capital funds as drivers of new industries (web, media, renewable energy sources, etc.). The activities of FECs in Croatia are directed to the sectors that could be the carriers of employment and new economic growth (wood processing, food processing, metal processing, textile and construction).

2. HAMAG INVEST activities (micro-lending project)

This measure refers to the continuation of HAMAG INVEST activities by which the role of guarantee institutions in the financing of SMEs is strengthened, in accordance with the recommendations under the second priority of the Annual Growth Survey.

HAMAG INVEST has introduced a number of changes into its programmes to correspond as much as possible to the needs of the market – it shortened the administrative procedures for the obtaining of guarantee, and cooperation with the European Bank for Reconstruction and Development is planned in the co-financing of research projects in environment protection and energy efficiency as well as the promotion of new technologies for which HRK 74 million is ensured.

In addition, the programme of micro lending to start-up entrepreneurs is introduced for the first time in 2013, for which HRK 2.1 million has been ensured. The micro-lending programmes should be launched in May 2013. The maximum amount of a loan is HRK 70,000 with a 5-year repayment period and a six-month grace period and the interest rate of 0.99%. It is expected that this measure will provide support for the implementation of a minimum of 30 new business enterprises. The loan will enable the purchase of equipment, devices, the financing of the core herd, projects in vegetable growing, farming and flower growing as well as working capital. The described policy shall speed up and facilitate the financing of the operation of small businesses as a numerous and propulsive segment of the economy.

3. CBRD's lending activities

The objective of this measure is to promote entrepreneurship in Croatia through innovative and favourable lending mechanisms. Thus in 2013, CBRD plans to maintain the enhanced level of the lending activity achieved in the course of 2012 in a total amount of HRK 10.3

billion, of which HRK 4.5 billion for SME investment (within all programmes of CBRD lending).

CBRD will thus, through the existing programmes as well as through new lending programmes introduced in 2013 (lending to new production, the programme of lending to energy reconstruction of buildings, the establishment of venture capital funds), continue to promote the SME lending activity. The key measures in this context include:

- Lower interest rates within all lending programmes by 1 percentage point for new investments in agriculture and fisheries, tourism, industry, environmental protection (interest rates until 30 June 2013 of 2%, 3% and 5%),
- Lending possible in kuna,
- Prolonged repayment and grace periods, where the financing of investments in tourism is separated, with a grace period of up to 4 years and a repayment period of a total of 17 years. Under other programmes, mostly include 3 years grace period and 14 years of total repayment period,
- Refinancing of existing loans for primary agricultural activity,
- New ways of financing through models of sharing risk, both for working capital (through Economic Development Programme) and through investments (risk sharing model for SMEs and risk sharing model for major projects).

4. Implementation of the Financial Operations and Pre-bankruptcy Settlement Act

The Financial Operations and Pre-bankruptcy Settlement Act came into force on 1 October 2012. The objective of the implementation of this Act is to improve the liquidity in the economy, a faster restoration of normal operations and a higher return to the creditors. The implementation of this Act should function as a filter that enables the survival of the economically efficient companies and the redistribution of funds from inefficient companies. The Act also contributes to the improvement of expectations of creditors and debtors concerning the outcome of the procedure, it facilitates the access to financing, contributes to the saving of sustainable companies, and thus to the growth and sustainability in the economy in general.

This act defines the payment deadlines and the settlement procedure in the case of illiquidity or insolvency of business entities. After the expiry of 30 or 60 days, which is the payment deadline between the entrepreneur and the state, or the entrepreneur and another entrepreneur, respectively, a 30-day deadline shall follow, in which the management should agree with the creditors. If it fails to do so, it shall propose the opening of the pre-bankruptcy settlement procedure, which will be conducted as an administrative procedure, and which should be confirmed by the commercial court. The settlement should be completed within 120 days, otherwise, the company shall go bankrupt without the possibility of restructuring.

According to the Financial Agency's data, until 20 February 2013 the pre-bankruptcy settlement procedure for the addressing of the liquidity problem was instituted by 3,250 entrepreneurs with the amount of unsettled liabilities of HRK 32.1 billion. This concerns the entrepreneurs employing 25,082 workers. In a significant number of cases, these are the entrepreneurs in the activity of construction, in which the largest decline in the number of employees and in the gross added value was recorded last year. The first projection of the expected results concerning the open procedures shows a decrease in illiquidity by about HRK 10 billion.

5. Activities of the Republic of Croatia concerning the EIB

With the accession to the EU, Croatia will become a member of the EIB. A total cost of the membership in the period from 1 July 2013 to 31 July 2018 is EUR 207.9 million. This means that upon joining the EIB membership, Croatia should pay the amounts into the EIB's capital and reserves. According to the indicative EIB data, total subscribed capital of the Republic of Croatia to the EIB would amount to EUR 854.4 million. Of this amount, EUR 811.7 million is the callable capital, and EUR 42.7 million is the paid in capital. In addition, Croatia will have the obligation to pay a contribution to the EIB's reserves in the amount of EUR 128.4 million. Additionally, the EIB governors have adopted the decision on an increase in EIB's capital by EUR 10 billion, which has become effective as of 31 December 2012. According to EIB's preliminary calculations, Croatia is committed to pay an additional EUR 36.8 million.

In accordance with the EIB's strategic plan, their activities in the period from 2013 – 2015 will be focused on the addressing of the economic crisis in Europe, the development of innovations, easier access to financing for SMEs, investments in industry, the private sector and strategic infrastructure for the purpose of strengthening the economic sustainability of the Member States.

In Croatia, the cooperation with the EIB in the public sector is mainly directed to major infrastructure projects (reconstruction of infrastructure and modernisation in the railway sector, communal infrastructure in the areas of special government care, reconstruction and building of roads, highways and the construction of pipelines), and the SME financing by lending through CBRD. The participation of the Republic of Croatia as a fully-fledged member in the work of the EIB is expected to provide a strengthened access and use of the EIB's financial instruments.

3.2.3. Promoting growth and competitiveness

Through the implementation of the reform measures in the medium-term period, the Croatian government will work on reducing and eliminating the main barriers to growth identified in Chapter 3.1. With regard to the 3rd priority of the Annual Growth Survey – promoting growth and competitiveness – the main objectives of the Croatian government's reforms are connected to the following areas: enhancing the productivity of small and medium-sized enterprises (SME), strengthening the innovation potential and elimination of administrative barriers for business and investments.

Reform measures contributing to enhancing the productivity of SMEs

1. Strengthening of SMEs competitiveness

The incentive system for SMEs and crafts has been built as a group of measures and instruments, trying to promote faster development of SMEs at the national and regional level, with the objective of new employment, enhancement of competitiveness of the economy, exports and the economic growth as a whole.

The programme of incentives to entrepreneurship and crafts “Entrepreneurship impulse 2013”, for which the grants have been doubled compared to last year and now amount to HRK 730.3 million, includes the following measures and corresponding actions:

- Development of micro-entrepreneurship and crafts (micro-entrepreneurship and crafts, entrepreneurship of creative industries, young people and beginners in entrepreneurship, cooperative entrepreneurship, strengthening of business competitiveness of clusters),
- Strengthening of business competitiveness of entrepreneurs and craftsmen,
- Development of entrepreneurship infrastructure and business environment (business zone, technological parks and business incubators, development agencies and business centres),
- Training for entrepreneurship and crafts and the preservation of traditional and artistic crafts (training for entrepreneurship, training for crafts, preservation of traditional and artistic crafts).

Additional measures of promoting entrepreneurship and strengthening of SME competitiveness in 2013 will continue through the Regional Competitiveness Operational Programme through grants for:

- Investments in new technologies and production processes,
- Implementation of methods for efficient use of energy, environmental norms and testing and certification of products,
- Investments in growth of productivity at all levels,
- Introduction of results of research and development in business and the provision of services,
- Improvement of business activities of the economic entities with the aim of achieving higher standards, quality, productivity, enhancement of competitiveness,
- Strategic marketing with the aim of entry into new and uncharted EU markets,
- Innovative entities as well as fast-growing hiring entities.

Funds are also intended for SMEs in tourism with emphasis on the improvement of the structure and the quality of accommodation in the SME segment in tourism, the creation of additional facilities with accommodation capacities on the destination itself. The objective of these measures are multiple: the operation of SMEs throughout the year and the raising of their competitiveness; enhancement of the quality of accommodation at hotels, apartment-hotels and B&Bs and at camps in particular; the opening of new jobs which will have effect on new employment in tourism as well as in other tourist-induced activities, and the increase in tourist spending in tourism and in tourism-related activities.

Priorities in this area also include additional measures for the development of entrepreneurship in culture and creative industries, as well as investments in preserving cultural heritage with respect to their significant influence in the development of tourist activities, entrepreneurship in general and new job creation.

The new Entrepreneurship Development Strategy 2013-2020 will be completed by mid 2013. Adoption and implementation of the Strategy will have far-reaching impacts on improving the economic activity of small business, improved access to finance, development of new businesses and increasing the number of active businesses, enhancement of entrepreneurial skills and improved business environment.

The **new Act on Improvement of Entrepreneurship Support Infrastructure** is currently in preparation aiming to create a regulatory framework for the development of business support

infrastructure in Croatia, including the type and categories of entrepreneurial zones (EZ) and business support institutions (BSI). The goal is to enable the existing and potential beneficiaries (entrepreneurs) to start and perform business activities in:

- Standardized conditions in highly equipped infrastructure within EZ/BSI
- A competitive and transparent system of incentive measures and benefits both in the initial investment phase and in the phase of expansion of the existing investment activities of entrepreneurs that operate within EZ/BSI.

The Act also defines the preparation of a register of entrepreneurial zones and business support institutions according to specific categories, enables financing of infrastructure supporting entrepreneurship with development potential and potential to attract investment projects, and places emphasis on network cooperation at local, regional and national levels and connecting entrepreneurial projects with universities and research institutions.

2. Service market liberalisation

Through the Internal Market Information system (IMI system), which will be accessible upon accession, electronic exchange of information on services, professional qualifications and workers within the bodies of the countries participating in the European Economic Area (EEA) will take place and thus administrative cooperation will be accelerated and conditions of operation in the internal market will be facilitated.

Simultaneously, administrative simplification of operations will be achieved via the electronic Single contact point for services through a constant increase in the volume of business information for entrepreneurs, in particular about the freedom of cross-border service provision. A fast electronic procedure for the registration of service provider's establishment will soon be developed, which will reduce the number of administrative procedures and the costs of registration of operations in Croatia.

The administrative simplification for a full freedom of service provision in the Croatian service market includes:

- Elimination of all restrictions to the freedom of provision of services concerning the service provider's citizenship, permanent residence or language
- Elimination of all restrictions to the freedom of provision of service concerning equity, business entities' management structures and the selection of the legal form of operations
- Elimination of all restrictions to the freedom of provision of services concerning fixed tariffs for individual professional services
- Elimination of all restrictions by which the provision of services is conditioned by the testing of economic needs, i.e. conditioned by the investigation into the existing market demand, the assessment of economic effects of operations or compliance of a service activity with the plan of a body of state administration
- Elimination of regulations on additional professional insurance of service providers who already have an equally valid insurance in one of the countries partners to the EEA.

Reform measures contributing to the strengthening of the innovation potential

3. Development of a strategic framework for innovation

The measure includes preparation of the National Innovation Strategy of the Republic of

Croatia 2013-2020 with the Action Plan 2013-2014, and the development of a Smart Specialization Strategy for Croatia.

The National Innovation Strategy 2013-2020 and the Action Plan 2013-2014 will be adopted by mid 2013. The strategy envisages strengthening the innovation system in order to strengthen the competitiveness through five strategic objectives:

- Strengthening the innovation potential of the economy,
- Increasing the flow of knowledge and cooperation between industry and the research sector,
- Strengthening the scientific and technological capacity in the public and private sectors,
- Strengthening human resources for innovation,
- Improving the governance of the national innovation system and the creation of the regulatory environment that will encourage innovation.

Development of the Smart Specialization Strategy will determine the targeted niches within the priority sectors in Croatia and identify unique characteristics and comparative advantages of Croatia, to direct investments in research, technological development and commercialization of innovation and application of new technologies. The deadline for the completion and adoption of the Strategy is the end of 2013.

4. Development of a strategic framework for education, science and technology

During 2013 the Strategy for Education, Science and Technology will be adopted, which will, among other things, create conditions for research and innovation focused on excellent science, industrial leadership and societal challenges, and contribute to job creation, prosperity, improved quality of life and general public good. As a part of this measure, instruments will be defined for promotion of research and development as well as foundations of the innovative economy in order to link research, innovation and markets, fostering the creation of innovative companies and fostering cooperation between universities and businesses.

The strategy will achieve its full purpose, through the activities of a unified National Council for Science, Higher Education and Technological Development as the highest expert strategic body in Croatia whose activities will be defined by the amended Act on Science and Higher Education. The National Council shall adopt and clear goals of scientific research and higher education for the public good, sustainable and inclusive social development and economic growth.

Reform measures contributing to the elimination of administrative barriers for business and investments

5. Identification and removal of administrative barriers to investment

The Act on Investment Promotion and Improvement of Investment Environment²⁵ has established a procedure of monitoring the implementation of investment projects. The aim of the procedure is to provide information on identified administrative barriers in the investment environment, which prevent timely realization of each investment project, and propose a final solution for the removal of identified administrative barriers with the ultimate goal of

²⁵ The legislation is in Parliament procedure.

improving the investment environment. Accordingly, business entities shall be able to, through standardized forms that will be provided by HAMAG INVEST, regional development agencies and the Agency for Investment and Competitiveness, submit a request to remove the barriers identified in the laws, regulations and other prescribed procedures and the slow administration. The requests will be dealt with and decided by the Government Working Group for the business climate and private investments which is, responsible for analysis and identification of key determinants and priorities for improving the business and investment climate in Croatia, as well as for proposing of legislative and other solutions which enable improvement of business and investment climate in Croatia particularly through the removal of administrative obstacles.

The agencies will continue to work to provide active support to investors in all stages and activities that affect the realization of the investment project, with the aim of successful and time-predictable realization of the projects, which shall facilitate the implementation of investment projects in Croatia and proactively contribute to attracting investment.

6. Improvement of the regulatory framework for the development of entrepreneurship and investments

The adoption of the new Strategic Investment Projects Act is planned by the end of 2013. The Act will enable creation of necessary preconditions for increased investments in the Croatian economy. The Act defines criteria for identifying strategic investment projects for the Republic of Croatia, procedures and methods of their realization, course of preparation, execution and putting into operation/use. The Act also envisions considerably speeding up the process of obtaining the overall documentation required for the implementation of projects, both public and private, which are of strategic interest to Croatia. The disposal of real estate owned by the Republic of Croatia, giving concessions for the use of the maritime domain and use of immovable cultural property in connection with the implementation of investment projects and issuing administrative decisions related to the implementation of these projects is also regulated by the Act.

It is forecast that in 2013 the project pipeline will be prepared and implementation initiated for projects that will create approximately 3,000 direct new jobs. In this context, each new job created in the major project is linked to the creation of 4 to 8 new jobs in SMEs and crafts in the region.

The Act on Investment Promotion and Improving the Investment Climate has further improved the system of incentive measures for investments in terms of easier access to incentive measures for small businesses. These measures include incentives for micro-entrepreneurs, tax incentives, customs incentives, incentives for eligible costs of new jobs associated with investment projects, for eligible training costs associated with the investment project, for innovation and development activities, business support activities and services with high added value, as well as incentives for the initial infrastructure and capital investment costs of the project and highly labour-intensive investment projects. The Act encourages investments in manufacturing activities, development and innovation activities, business support services and activities with high added value.

At the same time, reduction of the minimum requirements for the use of incentives for investments that will result in a larger number of beneficiaries, but also further attracting foreign direct investments in sectors with high added value is envisioned by the Act.

A large number of investment projects and the increasing number of beneficiaries of incentives for investment will ultimately contribute to the creation of added value in the Croatian economy, job creation and economic growth.

As part of the reform of the free zones system in Croatia, amendments to the Free Zones Act²⁶ are foreseen to enable the transformation of the regime of operations of the free zones system before the EU accession, into the system in compliance with the regime of operations within a common EU economic space.

These amendments will enable the transformation of the existing free zones in such a way that in these special economic areas within the country, a preferential regime of doing business with foreign partners is established (outside of the common areas of the EU). Furthermore, within that system it will be possible to use aid for investment projects with the primary focus on industrial economic zones and logistic distribution zones.

The direct effects of the above measures will be visible through the increase in investment activities within the system, the increase in export activities of the free zones system beneficiaries as well as the increase in the number of newly opened jobs.

3.2.4. Tackling unemployment and the social consequences of the crisis

The priorities of the Government of the Republic of Croatia in the context of reducing unemployment and addressing the social consequences of the crises are: the reform of the labour market, education system reform, social welfare system reform and healthcare system reform.

Reform measures contributing to the labour market reform

1. Changes in labour legislation aimed to facilitate conditions for employment, restructuring and enabling better safety of work and for workers

Due to negative influences of the economic and financial crisis on employment and development trends in the labour market, a need has been identified to reduce existing rigidity of the Labour Act and its application. In order to create a modern labour market, the existing legislative framework will be changed and the implementation of the labour and employment policy will be improved. The change of the labour legislation and of the legislative support, envisaged for 2013, will result in a reduction of the existing segmentation in the labour market, flexibility of labour, improved dynamics of the labour market and relevant institutional stakeholders and the creation of the legal framework and instruments to correspond to the current changes in the labour market.

Amendments to the Labour Act

The first phase of amendment to the Labour Act, comprising consensual proposals by social partners, will be submitted for adoption in the first half of 2013. By adopting the Act, the

²⁶ Official Gazzette, No. 85/08, 92/05, 44/96

alignment of the national labour legislation with Directive 2009/38/EC²⁷ will be achieved. Taking in consideration that certain provisions of the Labour Act currently in force have caused some doubts as well as practical difficulties, changes will be made in parts related to the organization of business processes for some employers, the institutes for alternative daily and weekly rest, fixed-term employment, temporary employment agencies, monthly limitation of the number of working hours, reduction of the minimum number of hours for continuous daily rest duration, trial period, and collective redundancy of workers. The amendments are to improve effectiveness and competitiveness of business performance, fully respecting the objectives of the directives related to these questions, as well as to align them with the EU Court practice.

The objective of the second phase of amendments to the Labour Act, to be made by the end of 2013, is to enable faster restructuring for the employer, through additional normative conclusion or termination of employment contract, as well as periods for notices on employment termination and severance pay, and, through redesign of working hour institute enable flexible labour organization, ensuring at the same time social security of workers.

The public discussion on the assessment of new regulations for safety at work, planned by the end of 2013, is also underway. The regulations will prescribe employers more flexible and organized implementation of safety at work, which is at the same time more cost effective. The procedure for the assessment of hazard will be liberalized in the way to introduce a more simple method enabling more simple and efficient monitoring, evaluation, reporting, as well as exchange of data (*Data Collector*) also with EU Member States. The inspection supervision will also be redefined in the manner to be primarily preventive and informative with guidelines and instructions in the field of safety at work.

Prevention of undeclared work and introducing adaptive labour market institutes

Due to lack of legislation regarding simpler jobs that lack characteristics of classical job or specific occupation, there was a tendency for misuse and illegal work. The Act on Temporary and Part-Time Jobs will provide new legislation and regulate above-mentioned jobs providing three main effects:

- Acting upon legalisation of jobs that have so far been in the “grey economy” with all the negative consequences regarding budgetary incomes, workers’ rights and negative effect on economic growth,
- Influencing unfavourable position of long term unemployed persons in labour market, unemployed youth and low labour market activity rates in the total working age population, as well as the problem of social security of elderly and social inclusion of vulnerable groups
- Simpler work institutes will allow regulation of temporary and part-time jobs, which occasionally occur, and are time limited and of smaller economic value. These jobs due to their special significance and features differ from the jobs whose performance is already regulated by some of the forms of labour or other obligatory relations.

The parliamentary decision on the new Act on Temporary and Part-Time Jobs is expected by mid 2013.

²⁷ Directive 2009/38/EC of the European Parliament and of the Council from 6 May 2009 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees.

Employment of people with disabilities in order to lower the costs of pension insurance and their social inclusion through employment

A large number of inactive and retired persons with disabilities in the last years have resulted in overburdening of the pension system. As a response to the economic crisis and stagnation, as well as unregulated area of vocational rehabilitation and inefficiency of previous employment of people with disabilities, there is a need for a new Act on Vocational Rehabilitation and Employment of Persons with Disabilities, which will provide multiple effects:

- By ensuring equal access to the labour market for persons with disabilities, the state budget will be relieved in relation to pension system and health insurance, there will be less family and disability pensioners which will allow savings in the state budget and increase of state budget revenues through employment i.e. mandatory employer contributions,
- By introducing an unique forensic expertise system, which will determine remaining work capacity with clear standards and criteria for centres for vocational rehabilitation, alignment with European good practice examples for social inclusion of most vulnerable groups of citizens will be enabled,
- By introducing standardised centres for vocational rehabilitation, a good quality vocational rehabilitation system will be enabled providing employment of persons with disabilities, according to their possibilities, knowledge and skills rather than their retirement,
- By introducing quotas for the employment of persons with disabilities in real sector and fees to employers that are not willing to employ a person with disabilities, co-financing will be allowed for workplace adjustments and incentives for the employment of persons with disabilities in order to provide quality system of employment of people with disabilities in a long run,
- By including the abolishment of the payment of compulsory contribution for the employment of persons with disabilities,
- By activating and employing members of this continuously neglected population, social inclusion of people with disabilities will be ensured, as in line with the UN convention on the rights of persons with disabilities²⁸ and European practice.

Ensuring financial and legal protection for craft owners

In order to ensure adequate provision of legal and general protection for craft owners which are due to the negative economic development forced to unregister from craft registry it is envisaged to reach the decision on Amendments to the Act on Employment Mediation and Unemployment Rights by the end of 2013, which envisages that craft owners that will pay the rate of employer's contribution for employment become possible unemployment benefit claimers. This would allow craft owners to equal their rights with the rights of the rest of the workers, which is also EU practice. The main effects are:

- Increased state budget revenues based on employment contributions,
- Ensured social security for craft owners closing down their craft.

The parliamentary decision on Amendments to the Act on Employment Mediation and Unemployment Rights is expected by the 2013.

²⁸ Official Gazzete, International Agreements, No. 6/07 and 5/08

Reform measures contributing to the education system reform

2. Further improvement of links between the education system and labour market

The Croatian labour market is characterised by inadequate alignment of knowledge and skills of the labour force with the needs of employers, as well as a considerable unemployment rate of young people due to a slow adjustment of the education system to the changes in the labour market. With the aim of improving the existing situation, the adjustment of the education policy with the present and future development needs and with the labour market will be intensified in the forthcoming period. The emphasis will be on further development of the *Croatian Qualifications Framework (CROQF)*, through the *Act on the Croatian Qualifications Framework*²⁹, as an instrument for the regulation of the qualifications system in the Republic of Croatia and the building of a more flexible education system which will be able to respond faster to the changes in the labour market and of the society as a whole and on the setting up of a system of monitoring and analysis of labour market needs to provide better analytical basis for the adoption of policies on employment, education and economic development and the adjustment of the curricula to the identified needs.

The relevant line ministries will set up the institutional framework for good quality implementation of the CROQF, *The National Human Resources Development Council and 26 Sectorial Councils*, by the end of 2013. This will ensure an interdisciplinary approach and mechanisms and evaluation instruments necessary for the integration policy of the economic development, the policy of education and employment. The National Council will give recommendations on connecting education with labour market needs, while Sectorial Councils will evaluate the proposals of vocational standards and qualifications standards for the purpose of their entry into the CROQF Register. The Register will provide clear and transparent information about the qualifications standard and about the corresponding training programmes and their connecting with vocational standards based on labour market needs analyses. As such, the Register shall become the key instrument for reducing different forms of gaps between the supply structure and the demand structure in the labour market. For the CROQF, all forms of acquiring competencies are equally important, including non-formal and informal learning or competencies acquired through life, on-the-job or through different other organised or unorganised forms of learning. The implementation of CROQF will result in a higher degree of employability and it will enable the linking and comparing with other education systems in Europe, and facilitate the mobility as well as access to further education to citizens and others who have obtained their qualifications in Croatia.

The Regulation on recognition and evaluation of non-formal and informal learning will be adopted no later than March 2014, while the IT system for the maintenance of the CROQF Register, in which the first qualifications standards and vocational standards will be entered, will be put in place in 2015.

In the context of monitoring and analysis of labour market needs under this measure, a system will be put in place for the collection of information on the present and future labour market needs and the required competencies with the aim to develop the qualifications standard and the vocational standard taking into consideration labour market needs.

²⁹ Official Gazzete, No. 22/13

3. Promotion and improvement of the life-long learning concept

Life-long learning covers all forms of learning (formal, non-formal and informal learning) during the life time (from pre-school to retirement age). Its goal is the acquiring and improving of competencies for personal, social and professional needs. A significant role in the implementation of the life-long learning policy, among others, belongs to adult education, which represents an important component of life-long learning continuity. In Croatia, the share of persons aged 25 – 64 who participate in education and training is only 2.2%, while the European average is 9.1%. The rate of adult participation in non-formal education is higher than formal. In Croatia, this ratio is (18.4%) non-formal to formal (4.5%), while in Europe this ratio is (31.3%) non-formal to (6.6 %) formal. This measure has put special emphasis on adult education since in comparison with younger age groups who are more involved in life-long learning activities the access and participation of adults in life-long learning activities is still not at a satisfactory level.

The measure covers the enabling of higher accessibility and improvement of post-secondary school programmes and study and non-formal programmes, an increase in the number of non-formal learning programmes implemented by education sector institutions in cooperation with employers, and the development of programmes intended for the strengthening of key transversal competencies which reinforce entrepreneurship, creativity and innovativeness to motivate and prepare the adults for further permanent learning and to facilitate the adjustment to the rapidly changing labour market needs.

Reform measures contributing to social welfare system reform

4. Deinstitutionalisation of social welfare system

The proposed measure covers the prevention of institutionalisation, deinstitutionalisation and transformation of social welfare homes and other legal entities performing the social welfare activity. It also covers the development and expansion of a network of sustainable preventive and extra-institutional services with the aim of reducing costs arising from accommodation in social welfare institutions.

The Operating Plan for the transformation and deinstitutionalisation of social welfare homes at national level will be prepared by the end of 2013. The Plan will define the deadlines for the transformation of homes. The process of transformation and deinstitutionalisation of social welfare homes implies the revision of the existing and the preparation of new county social plans, which will establish the real needs for social services at county level. The social welfare services network will be defined, taking into consideration the regional proportional accessibility and quality of social services in the Republic of Croatia.

Furthermore, with the aim of achieving a better control of the use of budget funds in relation to the provided service, the system of financing social services providers will be improved in the forthcoming period. They have so far financed their activity as project activities on the basis of a contract and the cost price by the beneficiary. A standardised system of financing all extra-institutional forms of care in the community will be designed for the equalisation of conditions and raising the quality of services. This will result in equalising the type, quality and price of services for each and individual group of beneficiaries, i.e. ensure a safe access to such services and enhancement of the quality of services, which has a direct impact on the social inclusion of vulnerable groups of beneficiaries.

The measure also foresees further strengthening of competencies of employees in the social welfare system with emphasis on homes for children with behaviour disorders as well as employees of homes for children without adequate parental care.

5. Improvement of the system of awarding social allowances

With the aim of increasing the effectiveness of the social allowances system, a new Social Welfare Act will be prepared until the end of 2013. The Act will prescribe the proprietary census and redefine the award of cash aids/allowances to achieve better targeting, i.e. directing of social aids to those who really need them. The maintenance of the achieved level of social protection with their simultaneous better targeting would be achieved by the integration of social welfares. The new Act will also introduce the institute of guaranteed minimum allowance: this is a new form of social allowance by which the government guarantees that it will, every year and in accordance with available resources, prescribe by the Croatian government regulation the amount which every person with insufficient income and assets for realising basic needs of living will be entitled to receive.

The introduction of the guaranteed minimum fee marks the beginning of integration, and a step in the direction of introducing a single centre for cash allowances, the “one-stop shop“, that would administratively assume control over all allowances currently implemented by social welfare centres, offices of the Croatian Health Insurance Fund, the Croatian Pension Insurance Fund, the Croatian Employment Service (CES) and state administration offices. The informatisation of the social welfare system and its networking with other systems through the Personal Identification Number (PIN) system for the purpose of exchanging data, which will be implemented by the end of 2013, will achieve the reduction of administrative costs and a simplification of the procedure for the exercise of the right itself.

Reform measures which contribute to the healthcare system reform

6. Strengthening of prevention activities and development of palliative care

The Strategic Plan for the Development of Public Health of the Republic of Croatia 2013-2015 will be adopted in the first half of 2013, based on the National Healthcare Development Strategy 2012-2020. The Plan will clearly define and elaborate on preventive activities, expected results and the results of the development of the public health activity from 2013 onward. The Strategic Plan for the Development of Palliative Care in Croatia 2013-2015 in accordance with the above mentioned Strategy, will also be developed with the aim to improve the system of provision of structured and adequately organised palliative care at national level.

3.2.5. Modernizing public administration

Public administration reform with emphasis on rationalisation and informatisation of public administration and judicial reform are the priority reforms in the context of modernizing public administration.

Reform measures contributing to public administration reform

1. Legal regulation of the system of agencies, institutes, funds, centres and other legal entities with public authority

Further public administration reform will continue with the legal regulation of the conditions for establishment and work of agencies, institutes, funds, centres and other legal entities with public authority. The above measure is necessary, as there are considerable differences in the existing system of legal entities with public authority, which burden the structure of the overall public administration. Since most of the existing legal entities with public authority hold a compromise status of public institutions, the measure will enable the setting up of a normative basis for the purpose of an integrated regulation of the overall system. This change of the legal framework is planned for the end of 2014, and it represents an important step towards a modern model of public administration, which is characterised by a high level of professionalization, financial rationality, and increase in transparency, with the maintenance of the necessary control of the legality of work and financial operations.

2. Informatization of public administration

The implementation of the measure foresees the introduction of a number of IT solutions with the aim of improving the functioning of the public administration and the services it provides to the beneficiaries.

With the aim of systemizing and facilitating the access to information of the overall executive power, a central state portal will be put in place as a central Internet solution for information of the authorities at all levels. This measure attempts to increase the level of the transparency of work of the executive power in such a way that the Government's role and structure, the bodies of state administration and the provision of information about other bodies of public administration are simply and systematically presented on the Internet. This will ensure an easily accessible flow of information towards the public on the implementation of policies and programmes, decision-making, the enforcement of laws, administration and supervision over the work of the public administration.

By the setting up of the electronic exchange of data among register in public administration, information on data which the register originally holds, the data taken over from other original registers and about their format, content, purpose, source, manner and right of access and data processing and on the available services which can be used to access and utilize the register. The measure also foresees the introduction of the electronic method of document processing in construction and physical planning procedures, or, more precisely, the introduction of the system of issuing *e-permits*, preparing and management of *e-plans* and the issuing of *e-certificates*, which will make administrative procedures concerning construction and physical planning more transparent and efficient. The introduction of *e-permits* in 109 state administration offices will speed up the issuing of all documents in the area of physical planning and construction. This will raise the quality, coordination and rationalisation of the system for the conducting of procedures for issuing documents. The efficient management of special data will be realised by the process of digitalisation of the physical planning documentation and the development of *e-plans*. The information networking of the *e-permits* and *e-plans* databases will facilitate the users an easier completing of electronic forms, obtaining of information about the validity of individual documents and insight into the course of solving their cases. Those addressing the requests, on the other hand, will be

provided with a more efficient implementation of administrative procedures, faster issuing of documents and transparent proceedings, which will considerably reduce the possibility of corruptive activity. The issuing of *e-certificate* will be made possible through the building of the information system for the management of energy certificates, including the transparent system of issuing energy certificates of buildings, a clear overview of all issued certificates and of all authorised persons issuing energy certificates.

The setting up of a comprehensive register of government assets within the integrated system for central management of government assets, which is based on modern technologies and information systems, represents an important step in the direction of mobilizing the currently insufficiently used national resources with the aim of speeding up the economic and social activities. The setting up of the above register, which will be synchronised with land books, is foreseen by the end of 2014. It will provide for an efficient collection, storing, analysis and use of information on available real property and facilitate their management. At the same time, the communication among the beneficiaries within the state administration system and with external users will be facilitated.

By the introduction of new functionalities in the Register of Employees in the Public Sector, which comprises about 227,000 within 2,000 civil and public service institutions, including the possibility of electronic data exchange, a comprehensive register of employed public and civil servants will be set up, which will result in a better quality data analysis and human resources management in different segments of the public sector. This will also ensure preconditions for a more efficient control over the application of regulations which refer to civil servants and employees and to servants and employees in public services, including the issues related to labour rights status of the employees and payroll. The introduction of the centralised payroll system (CPS) will enable the payroll and payment of salaries for all institutions within the public sector under equal rules. It will also enable a good quality reporting on salaries paid at the level of the whole system, groups of institutions and institutions and employees individually. The completion of the inclusion of the whole public sector into the CPS is expected by the end of 2013.

3. Further strengthening of public administration capacity

Within the implementation of this measure, the plan is to improve human resources management in public administration through the development of competencies framework for the management and non-management servants, the development of the system of employee performance appraisal, the development of the salaries and rewards system, the system of retention and employment of good quality personnel in public administration, enabling the mobility of servants within the system and the career development planning. Public administration will be additionally improved through the development and implementation of the training programme in accordance with the identified needs including the EU-related programmes related, public administration and programmes in the area of public policies.

4. Further reinforcement of capacity for the absorption of EU funds

With the aim of ensuring high rates of absorption of EU funds, in the forthcoming period activities will be continued related to the strengthening of administrative capacities of institutions in the system of management and control and the capacities of potential beneficiaries at national, regional and local level working on project preparation and

implementation, as well as activities of preparing a broad portfolio of mature projects. As a result, the implementation of this measure includes the ensuring of sufficient management and implementation capacities, both by the retention of the existing and by employment of new staff, and their permanent training to develop adequate knowledge and skills. This is also ensured through a continuation of the implementation of the existing training programmes and the development of new ones in accordance with the identified needs at all levels. The strengthening of human resources at regional and local level will focus on the strengthening of capacities of potential beneficiaries in the preparation and implementation of their projects. This will enable them to gradually adapt to the more demanding conditions and criteria, which they will have to meet in applying for and in using the funds.

Project preparation or more precisely, the preparation of project/technical and tender documentation will be financed from the national budget funds as well as from the EU funds. This especially refers to the sectors covered by the 2007-2013 operational programmes. At the same time, part of the funds will be intended for the preparation of projects that will be financed within the 2014 – 2020 Financial Perspective. Apart from the project pipeline, a faster addressing of property rights and the addressing of issues of the share of the national contribution for projects are also important for a timely and high absorption of funds.

The implementation of this measure is constantly monitored by the newly established inter-ministerial Working Group for EU Funds at the Croatian government³⁰. Its activity includes the monitoring and evaluation of the preparation and implementation of projects which are financed and which will be financed from EU funds and the adoption of proposals with the objective of eliminating administrative and other difficulties for the preparation and implementation of projects at all levels as well as the designing of the financial schema for the financing of project preparation and the co-financing of their implementation.

Reform measures contributing to judicial reform

5. Improvement of land book procedure

By the end of 2013, with amendments to the Land Books Act new and redefined existing institutes of land book procedures will be introduced – the establishment, renewal and updating of land books, for the purpose of their simplification, the speeding up and an integrated application of the process and material right. The alignment of court practice and the ensuring of the respect of law will be realised by the establishment of the High Land Book Court of the Republic of Croatia as a unique specialised second instance court for the conducting of land book proceedings. The Act prescribes the maintenance of land books only in electronic form, it introduces the possibility of submitting the electronic report, the issuing of electronic decisions, the maintenance of electronic files and digital archives, which ensures that their number is optimally rationalised through the new network of land book departments. The possibility of issuing land book extracts is introduced, regardless of the local competence for the maintenance of land books. By using the existing land book data, the possibility is opened to establish new land books without the implementation of new cadastral measurements, where land files exist, i.e. where a land book does not exist. The Act also determines the legal framework for the co-financing or financing of the procedure of

³⁰ Established on the Government session of 3 January 2013.

establishment and renewal of a land book at the level of the units of local self-government that will speed up the process of alignment of the land book with the state of facts.

6. Improvement of civil proceedings

The amendments to the Civil Proceedings Act will contribute to further improvement of the quality and efficiency of the judicial system and the implementation of strategic guidelines of the Judiciary Development Strategy. The implementation of this measure foresees the redefining and abolishing of rules which slow down civil proceedings, and the introduction of new solutions to ensure its efficiency, i.e. process discipline, reduction of costs and implementation of proceedings without a delay. The above novelties will be realised primarily by the concentration of the civil proceedings having in mind that the rules, which have so far been applied to the proceedings in small value disputes, will apply to all regular proceedings. Also, the judicial potential will be more efficiently used as the ban of a multiple reversal of first-instance decision is introduced in all types of proceedings, and the authorities of court advisors and second instance judges are increased in deciding on appeals in commercial and other disputes.

By the broadening of the competence of commercial courts to the disputes on the transport of passengers in sailing and air disputes will ensure a higher quality of decisions and balance the judicial practice. The number of “fictitious lawsuits” will be reduced by the introduction of special rules on the burden of proving the non-existence of a claim. By introducing the new rules on delivery, in the proceedings before commercial courts, one of the basic problems in a lawsuit – its duration – will be resolved, and the delivery costs will be reduced. Finally, under this measure, the institute of the stay of proceedings is abandoned, new provisions on procedures concerning complaints and actions are introduced and shorter periods in civil proceedings are defined.

7. Efficient implementation of enforcement proceedings

An important step towards a more efficient judicial system includes the implementation of the new Enforcement Act and the Act on Amendments to the Act on the Execution of Enforcement on Cash Funds. The measure will be implemented continually with the aim of achieving a balance between the execution creditor’s rights to realise the claim and the execution debtor’s right to the protection of dignity, i.e. within the legal framework that enables expedience and efficiency with sensible costs of the procedure.

The new Enforcement Act introduces out of court execution for cash claims (which account for more than 50% of claims), for execution documents (execution decisions) and for the settlements of the domestic court or administrative body, which refer to the fulfilment of a specific cash liability and which have enforcement confirmation. With regard to executions on movable assets, the procedure is adjusted to the efficiency requirements under the normative changes.

8. Introduction of the IT in the judiciary

With this measure, IT solutions are introduced in the justice system in the following way:

- ICMS or e-File (*Integrated Court Case Management System*) is an integrated system for the management of court case files. All the courts which introduced ICMS in

conformity with the Book of Rules of the Court apply the random assignment of cases to judges, while others apply a manual system of randomly assigning cases to judges. Concerning ICMS and other IT systems in judicial bodies, a project of alignment of statistical systems has been initiated in order to establish a standardised, comprehensive system for statistically monitoring court cases, so that these data become available to all relevant persons. Since the statistical data from different courts have been standardised and entered in ICMS, the statistical reports have been defined, which are published on the judicial intranet and are available to all authorised users. By mid-2013, ICMS will have been introduced in the remaining 33 courts, and it is planned that by the end of the year all courts will be part of ICMS. The computerisation of all the procedures, or all the data that have up to now been kept only in written form, will ease the work of judicial officials, allow for an overview of the overall system, for statistical monitoring and, finally, for the better and speedier performance management by the court presidents, and allocation of human resources by the State Judiciary Council and the Ministry of Justice. ICMS enables all the key actors in the judiciary, judges, heads of judicial bodies, parties and the general public, to access data relevant to them. Therefore, some accompanying but important services are also being developed through this system, allowing for the greater transparency of data and the greater efficiency of services, such as e-Case, e-Notice board, the linking of databases, such as the court register, criminal and misdemeanour records, electronic service, etc.

- E-Case will make it possible for all members of the public to view the status of their cases, monitor them, and will greatly help lawyers who will not have to waste time visiting the courts in person.
- The e-Notice board, or publication on the online notice board, will enable everyone who wishes to access information concerning the content of decisions and rulings, which they had not been able to pick up in due time, to do so, without coming to the court.
- The *Case Tracking System* (CTS) is the IT system of the State Attorney's Office. It was developed on the same technological platforms as ICMS, by using the same technology to ensure their interoperability. ICMS and CTS follow the whole life cycle of a case and record all actions on the same *case flow management* system, representing the basis for the further upgrading of the system towards a *document management* system and the complete replacement of paper documents by electronic files. CTS is an integrated management system for state attorney cases. Just like ICMS, CTS is standardised and centralised, ensuring the uniformity of practices and the consolidation of a large number of data. It also provides for the possibility of conducting analyses and makes data available and easy to access. Implementation in the remaining state attorney offices is pending.

The linking of the databases will increase the efficiency and speed up the work of judicial bodies, it will unburden state administration bodies and judicial bodies, depending on the type of business process (linking the Court Register with ICMS, viewing misdemeanour records, viewing the stay and residence database, exchanging data with the Financial Agency with regard to pre-bankruptcy settlement, etc.). The aim is also to implement as soon as possible e-service, e-filing, and e-signature systems, which will complete the software solution and provide the best possible service to users, as well as accelerate individual business processes and boost efficiency.

9. Rationalization of the judicial network

The aim of this measure is to reduce the number of judicial bodies with a view to establishing a network of courts and state attorney offices, which will be economical and, at the same time, offer the public a speedier, more efficient and better administration of justice. Such rationalisation will also create a more balanced workload and allow for the specialisation of judges, whereby account will be taken of the accessibility of courts to the public in order to avoid violations of their right of access to justice.

The drafting of a detailed analysis of the impact of the rationalisation conducted so far is under way, and by the end of 2013 a report will be issued, based on which decisions will be adopted concerning the necessary activities related to the further rationalisation of the judicial network.

3.3. Reform measures in relation to the Europe 2020 targets

Table 9: The values of Europe 2020 Strategy headline targets in EU and HR, in 2020

	EU (2020)	HR (2020)
1. Employment (Employment rate)	75%	59%
2. Research and development (% R&D investments in GDP)	3%	1.4%
3. Climate change and energy		
3a. Greenhouse gas emissions (%)	80%	106%
3b. Share of renewable energy in gross final energy consumption (%)	20%	20%
3c. Energy efficiency	20% (1 474 000 TOE)	20% (9 192 TOE)
4. Education		
4a. Early leavers from education and training (% of population aged 18-24)	10%	4.0%
4b. Tertiary education attainment (% of population aged 30-34)	40%	35%
5. Poverty / Social exclusion (Number of persons)	Reduction by 20 million	1,282,000

3.3.1. Employment

The following measures contribute to the labour market reform and tackle the structural challenges in the labour market in the Republic of Croatia. Their implementation aims to support the achievement of 59% employment rate by 2020.

1. Promotion of employment

During 2013 the implementation of the active labour market policy measures (ALMPs) will be continued. Following the introduction of the new approach in applying ALMPs as well as the new approach toward targeted groups, it is expected that more inactive and unemployed people belonging to vulnerable groups, namely young people, special groups, people with disabilities, the elderly, long-term unemployed, unemployed members of the Roma minority, will be included in the labour market. Consequently this will have positive effects on their social inclusion, competitiveness and mobility on the open labour market, which has been limited due to their education, lack of working experience, age, family and social circumstances. Six sets of measures have been designed for the mentioned target groups and a separate set of measures for employers in difficulties.

They include:

- Incentives for the employment of young people without work experience in the private sector amounting 50% of annual gross salary cost in case SMEs and 30% in case of a large employer; the incentives amount 75% of annual gross salary cost for persons with disabilities and the members of the Roma minority,
- Incentives for self-employment for all groups regardless the work experience, occupation or qualification amounting 50% of the annual gross salary cost; the incentives amount 75% of annual gross salary cost for persons with disabilities,
- Incentive for training of newly employed persons amounting 35% of eligible cost of special training programme in case of SMEs and 25% in case of large employers; the incentives amount 70% of eligible cost of special training programme in case of SMEs and 60% in case of large employers,
- Incentive amounting 100% of education costs for unemployed persons during six months period aiming to provide qualified workforce and reduce skill gaps between the job requirements and skills of the unemployed persons,
- On-the-job training during which the participant is provided with training allowance amounting HRK 1,600 a month and the employer is reimbursed the costs of compulsory contributions for pension and health insurance,
- Public works projects that are mitigating social consequences of unemployment by increasing the employment of vulnerable groups. The measure relies on the enhanced cooperation between local self-government units, public institutions and Non-Governmental Organizations (NGOs) and includes standard public works programmes, namely community work; communal public works implemented by public communal companies and performed by long-term unemployed persons; co-financing of 85%-100% of annual gross salary costs depending on the type of individual public work for employment of the members of special groups of persons and unemployed persons with vocational education background in the work of NGOs and institutions implementing programmes for special groups,
- Incentives for job preservation aiming to encourage employment and reduce new unemployment, with special emphasis on tourism related jobs; the incentives depends on the type of measure and amount 50% of annual gross salary cost in case of SMEs, 30% in case of large employers and 75% when employing persons with disabilities.

In order to increase the social effect of active labour market policies and enhance competitiveness of unemployed persons until the end of 2013, additional measures will be implemented:

- Preparatory activities for the implementation of the Youth Guarantee Scheme,

- New forms of public works including financing public works that provide not only income, but also support social inclusion, training and apprenticeship leading to development of new skills and specialization. Stronger emphasis will be put on the inclusion of the children with disabilities into education system by providing them with trained school assistants, employing project managers/coordinators in NGOs providing care and nursing to elderly, dependent persons and women, enhancing the capacities of NGOs related to preparation and implementation of EU funded projects. Additionally new forms of public works are envisaged in cooperation with local community,
- Co-financing the costs of compulsory contributions for health insurance and costs arising from collective agreements (Christmas bonus, compensation during annual leave) when employing workers whose full work time is shorter than 40 hours per week, including women and other vulnerable groups had limited access to labour market,
- Co-financing three monthly gross salaries for employing a person that was participating in on-the-job training with the aim of keeping young people in employment, keeping the continuity of training and avoiding inactivity and loss of gained skills and knowledge if becoming un-employed,
- Training and education that will enhance employability of: (i) persons which are hard to employ by focusing on literacy trainings for persons without elementary school education, providing possibilities for on-the-job training in the private sector for unemployed persons with high school education, (ii) persons lacking specific skills and knowledge relevant for the eco industry, energy management, ICT/digital services, health and social care including children care, care and nursing for elderly and dependent persons, assistants to persons with disabilities, (iii) persons participating in self-employment programmes by including them in programmes of informal entrepreneurship learning where under the mentoring of a selected entrepreneur they develop their business idea,
- Co-financing of training for unemployed namely economists and lawyers, to manage bankruptcy procedures in order to enhance the implementation of pre-bankruptcy proceedings,
- Incentives for employing unemployed persons in companies in the sector of social entrepreneurship with the aim to develop the social entrepreneurship promote social responsibility and enhance the general quality of life in the community, which is in line with Croatian Strategy for social entrepreneurship.

Council for work, active ageing and employment and Council for proposing measures supporting youth employment play an important role in further development of measures and activities related to the implementation of employment policies,

Additional support for youth employment comes from the Council for proposing measures supporting youth employment having the creation of new measures for increasing the youth employment as the main task. Croatian Youth Network as an alliance of 61 non-governmental youth organizations participates in the work of the Council. This partnership-based approach is in line with Council Recommendation on Establishing a Youth Guarantee Scheme.

Through the Council for work, active ageing and employment (SRAZ) civil society organisations work together with the with relevant ministries on the improvement of future employment policies in order to include unemployed persons in the labour market, as well as

on the preparation of projects, initiatives and measures related to work and active aging eligible for EU funding.

Programme of professional training and employment of Croatian war veterans and the children of dead, detained and missing Croatian war veterans will continue to be implemented as part of the National Plan for the promotion of employment as well as the Joint Memorandum on the priorities of the employment policy of the Republic of Croatia with the aim to of increasing the employability for these especially vulnerable groups in the labour market. The Programme focuses on activities related to training, employment and self-employment, incentives for the establishment and development of cooperatives of Croatian war veterans as a special form of small business which enables an organised and professionally guided activities and a joint presentation in the market. Also, a special attention is given to the development of the social entrepreneurship targeting the war veterans' population that will require the extension of the Programme to additional measures.

In the long term, the plan is to build and develop four business centres/business incubators (Osijek, Zagreb, Rijeka, Split) to provide the target group beneficiaries with the incentives ensuring better start-up conditions and which would facilitate their entry in the global EU market. This also includes comprehensive promotional campaigns that would have a positive effect on a public perception of the war veterans' population.

Furthermore, this measure foresees the implementation of Transition programme and management of separated (allocated) staff from the Ministry of Defence and Croatian Army³¹ and Programme for management of civil servants and employees in the Ministry of Defence and Croatian Army. Their objective is to facilitate successful reintegration of allocated staff and their inclusion in an open labour market as part of Croatian economic recovery.

2. Enhancing administrative capacities and ensuring provision of good quality service in Croatian Employment Service

In order to increase the participation of larger number of vulnerable and hardly employable people and to ensure the provision of provide better, quality and comprehensive assistance to the beneficiaries, further improvement and adjustment of Croatian Employment Service (CES) will be continued.

Redistribution of jurisdictions and responsibilities, as well as financial and other resources for public services at different administration levels of CES, will enable better performing implementation of policies and provision of more suitable services targeting specific regional and local problems and needs and will help to reduce existing significant regional disparities. Further improvement will come from restructuring of both, organization and business processes, strengthening of the capacity for the provision of services at national and international level, improvement of the existing and the development of new services available to beneficiaries, including specialization of CES advisors for work with employable job-seekers and for work with clients who should prepare for the labour market through different forms of activation, education and other measures to enhance their employability. Furthermore, improvements will be visible in development of key competences for the analysis of the local labour demand, elaboration and objective setting, strategic planning,

³¹ Government decision on 3rd October 2012

monitoring and assessing the impact of implemented measures, of CES staff but also at the level of Local Partnerships for Employment.

3. Further development and institutional support to Local Partnerships for Employment

In parallel with the ongoing activities related to matching the educational system with present and future needs of the labour market, Local Partnerships for Employment (LPEs) will be attributed with an active role in addressing unemployment on local and regional levels and thus employment rates at the local level especially of persons coming from vulnerable and hardly employable groups. LPEs are currently active in all counties. Through the network of local stakeholders including representatives from public and private sector, as well as civil society, the development and implementation of Human Resources Development Strategies at the local level will be continued, together with further identification of the actual needs of the local labour market.

The measure foresees the development of the legal and institutional framework by which the LPEs will be recognised as a competent partner, the aspects of its activity will be defined, the issue of financial support will be addressed and the role in the work of other bodies dealing with labour market issues will be determined. Also, additional support to the work of LPEs will be provided through the establishment of the National Coordinating Body having the monitoring role over the activities of LPEs.

3.3.2. Investment in research and development

Investments directed to research and development in the Republic of Croatia in 2011 amounted to 0.75% of the GDP, of which 0.42% of the GDP was invested from public sources and 0.34% of the GDP from the private sector.

The main objectives of the measures envisaged in this area are the increase in the share of total domestic expenses for research and development to 1.4% of the GDP by 2020, creating greater interaction between research and development activities and industry and enhancing the innovation potential.

1. Promotion of scientific excellence, strengthening of national innovation system and support to scientific and research activities in the public sector

With investments in science and research of only 0.75% of the GDP, when compared with 2.03% of the GDP in the EU-27, the Republic of Croatia is considerably lagging behind the EU Member States. Apart from being insufficient, investments in science and research in the public sector are insufficiently effective and are inadequately linked with the economic activities. The amount of investments in science and research will increase by a combination of national investments with investments through international programmes, including EU funds. The focusing of investments towards sustainable economic growth and development and their effectiveness will improve through a group of activities that will:

- Develop infrastructure for research, development and innovation available to public and private sector,
- Promote scientific excellence in research,
- Strengthen the national innovation system by funding research focused on the needs of the society,

- Implement the preconditions for the introduction of a comprehensive programme financing of scientific activity, planned from 2016, which will further promote the efficiency of research results and transfer of technologies in public science and research institutions, improve the interaction between science and industry, promote the commercialisation of research, support the development of innovative programmes of collaboration between higher education institutions and research organisation and/or industry,
- Strengthen human resources in the field of research, development and innovation.

During 2013 Croatian Science Foundation will implement new calls for proposals based on project type of financing of scientific activity. Further profiling of public research system through the accreditation of public research organisation supported by a detailed analysis of the system will be implemented in 2013 and 2014.

2. Strengthening the innovation potential and support to scientific and research activities and the development of new products and services in the private sector

In addition to the ongoing activities supporting research and development in the private sector, including reduction of the tax base of corporate income tax for R&D expenditures, this measure will focus on:

- Verification of technical and commercial viability of research results and enabling access to instruments allowing their further commercialisation,
- Provision of support for R&D activities to small and medium enterprises as well as for the sustainable increase in number of small and medium enterprises based on knowledge,
- Support to R&D activities performed by small and medium enterprises in collaboration with public science and research institutions,
- Project based collaboration of the private sector, science and research institutions and universities,
- Support to academic entrepreneurship including the financial support to knowledge based spin-off companies established by the technology transfer offices and emerging from public research institutes and higher education institutions.

3. Establishing high technology network for industry and development of sectoral technological platforms

With the aim of creating more dynamic interaction between the science and research and the business sector and enabling successful commercialisation of scientific research and the application of new technologies in industry, this measure foresees the continuation of activities related to the establishment of high technology network for industry, development of technological platforms and centres of competence. Activities designed within the framework of high technology network for industry focus on creating the critical mass for industrial research, technology transfer and commercialisation of innovations; development of innovation processes including social innovation, development and implementation of education programmes for researchers in both, science and research and the business sector, exchange of knowledge and experience through intersectoral and international networking and the application of key enabling technologies in traditional sectors.

Twelve priority sectors of Croatian manufacturing industry have been identified including food processing industry, wood processing industry, car industry, maritime industry

(shipbuilding and small shipbuilding), military industry, creative industry, ICT industry, textile industry and manufacture of leather and footwear, construction, health care industry (manufacture of pharmaceutical products and medical equipment), chemical industry, manufacture of electrical equipment, machinery and equipment). Their competitive development as well as the development of new goods and services will be enabled by Key Enabling Technologies (KET), even more in traditional sectors where the transition to innovative manufacturing processes becomes crucial for added value production. Eight sectoral technological platforms as well as four KET technologic platforms have been identified and their establishment will follow in the forthcoming period.

4. Networking of public, private and scientific sector through clusters of competitiveness

The setting up of clusters of competitiveness and the promotion of cluster initiatives will enable raising the sectoral and regional competitiveness, internationalisation of the sectors and the creation of a new added value, as well as the establishment of inter-sectoral networks, the promotion of the selected sectors and their branding. Clusters of competitiveness will be established in the twelve priority sectors, among which the priority is given to the food processing industry, wood processing industry and car industry. They will include the institutions from the public, private and science and research sector and will use to the largest extend possible the existing business and research infrastructures.

3.3.3. Climate change and energy

1. Further harmonization of the institutional and legal framework for the development of the energy market

Further alignment of Croatian energy market regulations with those of the EU and the development of the Croatian Energy Regulatory Agency as an independent and autonomous institution in the energy market, will enable additional opening of the market, better control and protection of all entities in the market and, finally, more favourable prices of electricity and gas for the end users. The changes introduced in the Croatian energy market are based on the implementation of the third package of legislative proposals for electricity and gas markets and include the adoption of the Heat Energy Market Act, Renewable Energy Sources Act, and the transposition of Directive 2012/27 /EU on energy efficiency.

More significant changes of the legal and institutional framework introduced under this measure include:

- Guaranteed energy supply in the area of public service ensuring its availability to all customers if their supplier ceases to work,
- Universal service for the households ensuring equal prices of electricity throughout Croatia,
- Separation of transfer and transport of gas and electricity from their production and supply, which can be achieved by selecting one of the three models of separation; independent transfer or transport operator (ITO), independent transfer or transport system operator (ISO) and transfer or transport system operator (TSO),
- Developing programmes of smart measuring device application, namely smart networks, aiming to support the development of renewable energy sources and market,
- Elaboration of development plans by the actors on the energy market including the plans for infrastructure development on the European and national market,

- Special protection mechanism including particular form of social aid for households where limited supply of electricity or gas represents a threat for life and health.

Apart from the changes of the legal and institutional framework, Croatia is committed to supporting the energy sector development through the promotion of investments in specific energy sector areas, with emphasis on the building of competitive basic energy facilities, integrated in the regional infrastructure. To achieve the objective assumed by the Kyoto Protocol, but also the obligations of the future international agreement on greenhouse gas emissions, Croatia will promote investments in the energy efficiency, renewable energy sources and technologies with a low CO₂ and other greenhouse gas emissions. In this context, special attention will be given to promotion of investments related to development of heating systems, as well as a wider inclusion of solar collectors, heat pumps and biomass and gas cogeneration plants. The use of “clean” technologies should be promoted especially in the production of heat and electrical energy as well as energy for motor drives. Higher energy efficiency will be achieved by the promotion of investments in the building sector and industry, while higher production of electricity from renewable energy sources will be achieved through models of guaranteed buy-out, defined by the tariff system.

2. Energy renovation of buildings, including the increase in the number of nearly-zero energy consumption buildings

In accordance with the second National Energy Efficiency Action Plan of the Republic of Croatia for the period until the end of 2013 this measure will focus on: energy renovation of public sector buildings, energy renovation of residential buildings, energy renovation of commercial non-residential buildings and increase in the number of nearly-zero energy consumption buildings.

It foresees the drafting the implementation of the National Programme for Energy Renovation Public Sector Buildings, the National Programme for Energy Renovation of residential buildings and the National Programme for Energy Renovation of commercial non-residential buildings. These Programmes will focus primarily on buildings constructed before 1987, namely their renovation to a low-energy standard and the achievement of energy grades B, A or A+. The adoption of the Programmes is planned for Q3 2013. The measure also foresees the development of energy audits and the display of the energy certificates of buildings before and after energy renovation.

Nearly-zero energy buildings will be defined within the National Plan for increasing the number of nearly-zero energy buildings setting the goals for improving energy performance in accordance with the requirements of Directive 2010/31/EU on the energy performance of buildings. A special system of incentives is envisaged in case of new buildings construction where their energy performance is higher than the one required by the regulations. The adoption of the Plan and the beginning of implementation are expected by the end of 2013.

3. Setting up of a legal framework for adaptation to climate changes, reduction of greenhouse gas emissions and air protection

The measure is implemented with the aim of reducing the impact and the risk from the adverse effects of climate change on the sectors that will be affected due to the expected rise in temperatures, the sea level and the disruption of the seasonal precipitation cycle. A Climate Change Adaptation Strategy and the related Action Plan which will determine the measures

for the prevention of adverse effects in the sectors recognised as the most sensitive to climate change, namely hydrology and water resources, agriculture, forestry, biodiversity and preserved land ecosystems, the coast and the coastal zone, tourism, marine ecosystem and fish stock and human health, will be prepared in the forthcoming period.

Apart of the drafting process of the Climate Change Adaptation Strategy is setting up an expert body which will contribute to the inter-institutional networking and the strengthening of cooperation with the national and international expert staff in the fields relevant for defining the measures of adaptation and monitoring the effect of the implementation of these measures

At the same time, the Low carbon-dioxide development strategy which will determine long-term objectives for reduction of emissions and the measures by which these objectives will be achieved, as well as sources of their financing, is under preparation. The Strategy is planned to be adopted by the end of 2014, and will be the main instrument of steering the Croatian economy towards a low-carbon and competitive development in accordance with the EU policy.

The measure also foresees the adoption of the Plan for air and ozone layer protection and mitigating climate change. The Plan will determine the framework for the implementation of projects and investments aiming to reduce greenhouse gas emissions in the period until 2016, and support the fulfilment of the objectives defined under the Treaty concerning the accession of the Republic of Croatia to the EU, more specifically the requirement to limit the greenhouse gas emissions by sectors. Furthermore, the Plan will define additional measures of protection and long-term improvement of air quality and measures to mitigate climate change with established deadlines for the implementation of the designed measures but also designated bodies responsible for their implementation.

4. Harmonization of the legal framework for waste management

In 2013, the new Sustainable Waste Management Act, which will be aligned with Directive 2008/98/EC on waste, will be adopted. The adoption of the secondary legislation will follow together with the development of the new waste management plan and programme for waste generation prevention compliant with the requirements of the respective Directive. Changes that will be introduced by the updated legal framework will facilitate the achievement of the objectives defined under the Treaty concerning the accession of the Republic of Croatia to the EU, more specifically the requirement to reduce the amount of biodegradable municipal waste deposited on landfills. Furthermore, they will provide the ground for the elimination of administrative barriers in the waste management system including the obstacles to obtaining the necessary licences, contribute to a more efficient exploitation of raw materials by introducing the term of a by-product where a substance under specific conditions is not necessary treated as waste and by developing the mechanism which will be applied in such cases. The reduction of deposited quantities of waste will also reduce the concentration of landfill gases as well as the negative effect on health and environment.

3.3.4. Education

The education system in Croatia aspires towards improvement, and thus also to the achievement of the headline target of the Europe 2020 Strategy in the field of education. More

specifically, the population aged from 18 to 24 leaving early from education and training shall be retained at level of 4.0% while the share of the population aged 30 to 34 having completed tertiary education will be increased from the present 25% to 35%. In the context of the education system reform, which will contribute to the achievement of the set objectives, the measure for a further improvement of the quality of education and increasing access to education will be implemented from 2013 to 2015.

1. Improvement of quality of education and increasing access to education at all levels

The improvement in the quality and efficiency of the education system, better matching to the labour market needs and easier access to education at all levels, are important preconditions for ensuring a highly qualified and flexible labour force and making full use of the human resources. The activities related to the achievement of this objective, and in particular the improvement of quality and efficiency of the education system, foreseen by this measure include:

- Implementation of the Croatian Qualifications Framework (CROQF)
- Setting up of a comprehensive and efficient system of ensuring the quality of education at all levels, including external evaluation and self-evaluation of educational institutions,
- Promoting the adaptability of the curricula to the labour market needs,
- Setting up of an efficient network of education institutions and qualifications/programmes/curricula in line with the labour market needs and human resources development,
- Improvement of the VET system through development of new vocational curricula adjusted to the modern needs of the society, especially with regard to the development of key competences (functional literacy, numerical literacy, digital competences, foreign languages, entrepreneurship, maths and natural sciences, interpersonal and social competences, learning how to learn, general knowledge),
- Curricula alignments of faculties for teachers with the needs of modern schools,
- Enhancing the competences of teachers through their continuous professional training,
- Improvement of infrastructure in educations,
- Management of school capacities in accordance with the National Pedagogical Standard,
- Increasing the number of schools working in one shift which will enable the implementation of additional educational contents and life-long learning programmes,
- The adoption and implementation of new programmes and curricula based on learning outcomes,
- Further improvement of the implementation of the State Matura and national examination and other forms of external evaluation of education,
- Implementation of support programme to non-formal learning,
- Further development of informatisation of business processes in schools including e-attendance log, e-register, e-enrolment, as well as learning and teaching processes namely e-learning, and connecting schools to ultra-fast Internet.

The introduction of electronic applications and enrolments in secondary schools will have direct impact on the access to education, the increase in the number of enrolled students and the retention of young people within the education system. Through e-enrolments students will be able to apply to more than one school, which will result with increased transparency, positive financial and time-consuming effect. Also, the registered data will enable a better

planning of the enrolment in the coming years and consequently a better adjustment of the curricula with the actual needs of the society.

The measure comprises the improvement of the quality and access to higher education in Croatia regardless of the social status. In this context, activities related to the functional integration of universities, taking into consideration the autonomy and tradition of certain higher education institutions in the Republic of Croatia, will be executed as follows:

- The review of study programmes at universities and professional studies based on of learning outcomes with ECTS credits estimated on the basis of students' workload necessary for obtaining of the envisaged learning outcomes;
- Acquiring qualifications within the period foreseen by the curricula;
- Reducing the number of early school leavers and facilitating access to students over the age of 25, which is especially important in the context of increasing the percentage of citizens with obtained higher education degree.

With this aim, free education at higher education public institutions is ensured for successful and regular students in the 2012/2013, 2013/2014 and 2014/2015 academic years. The subsidising of the costs of studies for regular students will facilitate access to university level even to lower-income students, as well as to students with disabilities. Special priority in the development of higher education is given to the increase in the number of persons with completed studies in technical, biomedical, biotechnical and science (STEM) fields, information and communications area and in interdisciplinary studies related to these fields. This calls for the implementation of additional activities that attract students into these fields of education. The implementation of the measure improving the quality of education and increasing access to education at all levels foresees the development of the National Information System for Science and Higher Education which will ensure availability of relevant statistical data in quality assurance and accreditation procedures, and that the adoption of public policies in the overall system of higher education and science is based on relevant empirical indicators.

The implementation of this measure will have effect on the reduction of social exclusion and poverty of individual groups of the society, by investing in education of disadvantaged groups, such as children with disabilities, children with special educational needs and members of the Roma ethnic minority.

With the aim of improving the education of children with disabilities and children with special educational needs, in the forthcoming period the capacities of expert services of education and training institutions will be enhanced. These capacities are necessary for the development and implementation of adjusted curricula and individualised teaching methods. The number of hired assistants in classes and personal assistants in schools will also be raised. In addition, material conditions in schools will be improved by the purchase of specialized equipment and furniture.

Free textbooks, transportation, accommodation in boarding homes and scholarships for students in secondary schools and at higher education institutions for members of the Roma ethnic minority will be ensured and thus increasing currently low level of their participation in pre-school education programmes, prep-school programmes, primary schools and higher level programmes. The implementation of day care programmes in primary schools will be continued as well as the in-service teacher training and other staff included in the work with the members of the Roma ethnic minority.

3.3.5. Poverty and social exclusion

1. Ensuring support to persons with disabilities

For the purpose of realising adequate support and simplification of the procedure of exercise of rights of persons with disabilities, a new Inclusive Allowance Act that would enter into force in 2014, is being prepared. . The act should integrate the rights of persons with disabilities they are now exercising in different systems. The objective is to ensure the necessary support to persons with disabilities and children with difficulties under a single right. In this way, the procedure would be simplified and the possibility would be given to a person with a disability to define his/her own priorities. The amount of the inclusive allowance would be more appropriate for the needs of the targeted groups, and this cash allowance would be aimed at equalising the possibilities of persons with disabilities in social inclusion.

Furthermore, by the end of 2013, activities related to the defining of a unique method of determining disabilities including the drafting of the Unique list of impairments, the overview of the applicable legal regulations and the list of regulations that need to be changed, the drafting of the Act on a single forensic expertise body and the method of determining the disabilities, would be continued. After the setting up of equalised criteria in the process of forensic expertise by the introduction of the unique list and a single forensic expertise body, the quality of the collection of data in the Croatian register of persons with disabilities will be enhanced on the basis of the unique definition of disabilities in Croatia. Beneficiaries will exercise more easily their rights on the basis of disabilities because they will be able to use one finding in all systems. By the introduction of a single forensic expertise body, the criteria in the forensic expertise procedure will be equalised, and the costs of the forensic expertise procedure will be reduced in such a way that a single forensic expertise body will be working for all systems (or at least for the majority of them).

2. Development of the system of care for the veterans and the suffering population and the members of their families

The measure foresees continuous and long-term development of the system of care for veterans and the suffering population (Croatian war veterans and their family members, military and civilian victims of war, as well as World War II, casualties in the performance of military and police duties within the peacekeeping missions and injured pyrotechnics), through three separate or combined forms: veterans' centres, extra-institutional forms of care and programmes providing services to the community.

The priorities in the fight against poverty and social exclusion of the targeted population include the broadening of the provision of health care, psychological and social services and the provision of services in the communities in which the beneficiaries live, including the accommodation, care and rehabilitation. They also include developing the concept of social housing, aid to households with poor social and housing situation, the housing for the homeless.

By the setting up of veterans' centres, which are designed as residential-hospice type centres, the existing state institutions would no longer be the only providers of social services available to the this population. The stay at the centre to one extent would be temporary (e.g. until the recovery after a health condition or improvement of socio-economic situation), and

to another extent it would be permanent, while the local character of the centre would prevent the detachment of the beneficiaries from a familiar social environment. The county centres for psychological and social aid which provide social, legal, psychological and advisory assistance would be included in the activities of the veterans' centres. Additional services including education for the target population (workshops, trainings, and lectures), work therapy and the provision of assistance to unemployed while seeking employment (entrepreneurship, project management, computer literacy, etc.) will also be available at the premises of the centres. This concept enables the access to comprehensive set of services on a single location for the targeted population.

Further development of extra-institutional services and programmes providing services to the community will include health care and nursing care, assistance in households and provision of support services through specialised programmes of support. Moreover, services to the community will be extended to implementation of projects at local level for the targeted population and the community. These activities are implemented with a view of supporting the psychological and social integration of the veterans and the suffering population and the raising of the general quality of living.

The recently developed system for the employment of children of the target population would also be implemented in veterans' centres where they would be provided with education and professional training for work in the centres, and ensured employment.

3. Development of the housing for rent model

Since there is a relatively high number of unsold, empty apartments in the market, and since a certain number of such residential units is in state ownership, the development of a housing for rent model is planned, which on the one hand would regulate the rental system and the provision of business services in this segment, and on the other hand would help to reduce the number of empty apartments, which depreciate in value. The housing for rent model will be developed according to the best and most efficient practices applied within the EU. The model will be defined and regulated by the Act on Renting. Access to housing for rent will be enabled to a broader public not able to get and repay housing loans due to relatively low income or job insecurity, and with additional subsidies from the state for special social groups such as children without proper parental care who after turning 18 must leave the accommodation in social welfare institutions. The prices of rent would be regulated by law and the situation in the market.

The concrete investment activities foreseen under this measure refer to the possible purchase of the existing empty and available apartments in the real estate market at favourable prices below the current market prices and/or building of new residential units, which after the purchase/building would be intended for rent.

The plan is to implement the measure in all units of local and regional self-government that have previously expressed the need and interest for such a form of housing.

4. Improvement of the quality of life of young people

The measure envisages the adoption of the new Youth Act and amendments to the Youth Advisory Boards Act, both by the end of 2013. The implementation of the measure will provide the ground for more active participation of young people in decision making process

related to issues of importance for this target group, their involvement in the creation of public policies at the local and regional level, their self-organisation and, finally, will lead to higher level of social empowerment of young people in general.

The Youth Act will define the levels of organisation of young people (central, national, local), define the work with young people, introduce and ensure a sustainable framework for the financing of projects and programmes of youth associations and associations for young people, provide a framework for regular surveys about young people and provide a legal basis for the promotion and implementation of inter-sectoral cooperation on the issues of young people and a structured dialogue with youth representatives in Croatia. Defining the work with young people will enable the evaluation of work and non-formal education present in a large number of youth associations and associations for young people, while the implementation of regular surveys about young people will allow better evaluation of implemented public policies and the formulation of new ones based on previously achieved results.

The amendments to the Youth Advisory Boards Act represent the enhancement of the counselling system on the issues of importance for young people at the local and regional level. The aim of these amendments is to update the Act adopted in 2007, which has been partially successful, both with regard to the number of established advisory boards in the units of local and regional self-government, and with regard to the activities, relevance and the scope of work of the advisory board as such. The aim is to make the Act more enforceable, to facilitate the performance of the basic function of the board – advising local and regional communities on issues of importance for young people, and eliminate any ambiguities which have in the past resulted in undesired consequences in the functioning of the boards, such as project activity, managing large budgets and their use for project activity which by law is not characteristic for this type of the body. Also, the aim is to facilitate the flow of the boards and their contact and cooperation with the local and regional community.

3.4. Other specific reform measures concerning identified barriers to growth

Additional reform measures concerning the privatisation and restructuring of public companies, the award of state subsidies, further infrastructure development, the strengthening of the competitiveness of the agricultural sector, physical planning and urban development and the protection of the environment and nature, which will be implemented in the future short-term and medium-term period, are also part of the reform agenda of the Economic Programme with regard to its importance for the sustainable economic growth, promotion of investments, creation of new jobs, improvement of the standard of living and the development of the society as a whole.

Reform measures related privatisation and restructuring of public companies

1. Privatisation and restructuring of Croatian shipbuilding industry

The Republic of Croatia has fully met its obligations concerning the restructuring of the Croatian shipbuilding industry resulting from the Accession Agreement. Kraljevica Shipyard for construction and overhaul of ships has been in bankruptcy since August 2012. On 28

February 2013, the Croatian Government and the Management Board of DIV Shipbuilding Ltd. signed the Agreement on the sale and transfer of shares of Brodosplit-Shipyard Inc., while on 6 April 2013, the Croatian Government and Kermas Energija Ltd. signed the Agreement on the sale and transfer of shares of Brodotrogir-Shipyard Inc. Closing negotiations for the privatisation of 3. May Shipyard are under way, and the finalisation of the overall privatisation process is expected in May 2013.

As a result, over the next five years, the emphasis will be on the implementation of the accepted plans for the restructuring of the mentioned shipyards whose implementation is necessary in the context of long-term sustainable operations of the shipyards that complies with the conditions compatible with the EU policy and the state subsidies rules.

2. Privatisation and restructuring of other state-owned enterprises

The preparations for the implementation of the process of privatisation of Hrvatska poštanska banka and Croatia osiguranje are under way. Consultants for the privatisation and capital increase of these institutions have been selected, and their privatisation is expected by the end of 2013.

Restructuring program is also being implemented in the railways sector, i.e. companies HŽ Infrastructure and HŽ Passenger Transport. The company HŽ Cargo is also in the process of restructuring with the possibility of being privatised, but with emphasis on keeping the core business. Restructuring aims at preparing the companies for the liberalisation of the railway services market, as well as improving their operational efficiency, given that the companies, in relation to companies operating in the EU, are showing significantly worse results.

Restructuring program is also being implemented in the field of road transportation, companies Croatian Roads Ltd. and Rijeka-Zagreb Motorway PLC. Until now, the process of selecting the consultants who will suggest some form of monetisation has finished. Parallel to this process, these companies are going through operational and financial restructuring.

The main objective of the Program for restructuring of the Croatia Airlines company is to ensure the existence of the company and its further positive operation and stability, which will result in increasing its competitiveness in the single European transport market. The Program for restructuring program includes operational, financial and strategic restructuring of the company, made on the basis of the analysis of the causes of the current situation and the analysis of the current situation and the potential for future development. The restructuring of the company was executed by increasing its capital by the owner.

3. Liberalisation of railway services market

For the purpose of creating preconditions for a liberalised market of railway services, by mid-2013 a new Railway Act will be adopted, by which the EU *acquis* in the area of railway transportation will be fully transposed. At the same time, the adoption of the new Act on the Rail Market Regulatory Agency (ARTZU) is under way, by which the authorities of the autonomous and independent regulatory body will be increased and it will have impact on the development of the liberalised railway service market.

4. Reorganisation of the water utility sector

With the aim of amalgamation (integration) of the water utility sector, its reorganisation and making the operation of all utility companies effective, efficient and purposeful according to the principle of full return of costs, activities have been initiated which are implemented for the purpose of the reorganisation of the water utility sector. Since the water utility sector is currently fragmented, its amalgamation and consolidation will eventually result in the lowering of the price of water supply when compared with the conditions without the amalgamation and consolidation. By the end of 2013, the institutional reorganisation of the water utility sector will be implemented by adopting the ordinance of the Croatian government. The next phase will be the alignment of other national regulations concerning communal water supply and sewerage activities after which the alignment of utility companies with the above regulations will follow. The planned period for the implementation of the reorganisation of the water utility sector is 2016.

Reform measures related to state aid

5. Monitoring the amounts of state aid awarded in Croatia

This measure foresees the setting up of an efficient system of economic incentives oriented towards the needs of the economy through the improvement of the system of awarding, monitoring the infringement and the effects of the awarded state subsidies in the Republic of Croatia. The aim is to achieve a higher efficiency of the financial resources directed through the subsidies into the economy, and in this way achieve that the subsidies actually contribute to the economic growth and the strengthening of the competitiveness of the Croatian economy. This will be achieved by a larger directing of subsidies towards horizontal objectives such as investments in research and development and innovations, environmental protection and greater energy efficiency, new investments and accompanying new employment, professional development, SMEs, etc. The reduction of the share of state subsidies in the GDP and the change of the structure of subsidies from predominantly sectoral to horizontal subsidies is foreseen in the period from 2013 to 2016. For this reason, parallel with the restructuring and privatisation processes in the shipbuilding and transportation sectors, the policy of a continued abandoning of the awarding of subsidies to specific economic sectors will be implemented, and the measures to promote those activities of entrepreneurs enabled by the EU *acquis* on the awarding of horizontal subsidies, which generate economic development and new employment will be strengthened.

In this sense, the monitoring and coordination of the activities of subsidies grantors will be ensured through the competent bodies, especially through the Competition Agency, as an independent body with a long-term experience and knowledge in the area of state subsidies. The consulting role of this Agency in the designing and preparation of state subsidies programmes and in the selection of objectives for which state subsidies will be granted and the preparation of reports on state subsidies are the main instruments for the supervision and monitoring of this measure, i.e. for the improvement and advancement in the area of state subsidies policy.

Reform measures related to infrastructure development

6. Railway infrastructure development

With the aim of creating a single interoperable railway system and the improvement of the railway transport in the Republic of Croatia, significant investments in the development of railway infrastructure will continue in the forthcoming period. They are aligned with the technical and operating standards of the EU, including infrastructure that will facilitate the inclusion of the Croatian railway system in the trans-European railway network and the connection with the European transport networks. It will also strengthen the role of the railway in the suburban and city transportation of large cities in the Republic of Croatia by respecting the principles of safety, functionality, sustainable development and environmental protection. The project pipeline as well as a large share of total investments will be financed from the EU funds.

7. Development of infrastructure in maritime and harbour transport

The building and development of infrastructure of sea ports has been planned with an aim to achieve an efficient transport connection with the main road and railroad corridors for better integration with the economic hinterland and increase in transportation, i.e. the creation of preconditions for the development of intermodal transport. In the forthcoming three-year period, the started projects on the building and modernisation of infrastructure in sea ports of state importance will continue: Rijeka increase in transit cargo, Zadar – building of passenger and Ro-Ro terminal, Šibenik – building of operative coastline for the receipt of passenger ships, Split – modernisation of the port infrastructure, Ploče – building of the terminal for bulk cargo for the needs of the gravitation area and Dubrovnik – completion of infrastructure for passenger coast in Gruž. Also, the situation in the maritime transport will be additionally improved by the setting up of the Croatian Integrated Maritime Information System (CIMIS) and the strengthening of the safety of maritime sailing and the security protection in the Croatian part of the Adriatic, including the supervision and control of the safety of sailing of ships in the Adriatic, the maintenance of the existing and the setting up of new mechanisms of environmental protection, as well as further development of safety protection measures for our ships and ports. The implementation of this measure will improve the conditions for the intensive economic and touristic activity of islands and coastal areas, but also of Croatia as a whole.

8. Infrastructure development of inland waterways

With the aim of ensuring a better positioning of inland waterways and their integration in the intermodal transport network, it is necessary to regulate inland waterways in accordance with their international qualification requirements, ensure the technical and technological modernisation of inland waterway ports, the networking of ports with the economic and business zones and main transport corridors, their integration in the logistics and distribution chains, and to stimulate their development cycles through investments. The project pipeline, as well as a large share of total investments will be financed from the EU funds.

9. Development of broadband access infrastructure

With the aim of creating the preconditions for an accelerated development of broadband infrastructure and services which are needed for high-speed access, as a basis which will

enable a further development of the information and knowledge-based society, with the ensuring of access of broadband access services under equal conditions throughout the territory of the Republic of Croatia, the following measures will be implemented:

- Measures to ensure efficient competition,
- Measures to ensure accessibility of broadband access to the Internet, including the enabling physical planning preconditions which do not limit further development of the new generation communication networks in compliance with the Regulation on benchmarks of the development of electronic communications and other associated facilities (OG No. 131/12.)
- Measures for the promotion of demand for broadband services and the use of broadband access for citizens and economic entities.

At the same time, the preparation of the Framework National Programmes for the Development of Broadband Access Infrastructure in the areas in which there is no sufficient commercial interest for investment (critical the so-called “white areas”) is under way, for the purpose of optimizing the overall process of planning the construction and financing of communication infrastructure. The Framework National Programmes will contain a detailed process of delegation of implementation to the lower, county level, with the application of standardised investment and business solutions for the projects of the building of access electronic communication network or electronic communications infrastructure throughout Croatia to optimize the need for the administrative capacities of the bodies of public authority.

10. Sustainability of water management development

The measure covers the implementation of the activities in water supply, sewerage, protection from adverse water activity and amelioration through:

- Construction/reconstruction of water supply network and construction /reconstruction of conditioning of drinkable water,
- Construction/reconstruction of sewerage network and construction/reconstruction of wastewater treatment plants,
- Construction/reconstruction of infrastructure for defence from adverse impact of waters,
- Construction of large systems for amelioration to plots of land.

The implementation of the above measures contributes to the development of investments in the public sector, but it is also implemented for the alignment with the water utility EU directives in accordance with the Plan for the implementation of water utility directives and in compliance with the Water Management Strategy.

11. Improvement and development of the rural infrastructure

The improvement and development of the rural infrastructure, as a precondition for the economic growth and development of rural areas has been focusing on the implementation of the Common Agricultural Policy and other related policies that form part of the framework of development and improvement of the basic rural infrastructure. This measure is made up of activities that include the development and improvement of basic infrastructure, the improvement of rural working and living conditions, and measures aimed at preventing further rural depopulation. The above-mentioned activities are co-funded from the EU funds.

Strengthening of the competitiveness of agricultural sector and rural development

12. Amalgamation of average agricultural property

The objective of the agricultural land policy is the amalgamation of agricultural property used by farms for agricultural production. Croatian farms amalgamate agricultural property mostly through purchase or renting of state-owned or privately owned agricultural land. The amalgamation of farms implies the increase in the used agricultural lands and the putting in use so-far unused agricultural land. The measure is used in accordance with the Agricultural Land Amalgamation Programme in the Republic of Croatia 2009- 2021 and in the long-term it will contribute to sustainable development.

13. Further development of agricultural holdings

The further development of agricultural holdings implies investment with the aim of restructuring and modernising agricultural holdings and achieving EU standards. This measure consists of activities that involve investments aimed at protecting the environment and safeguarding public health (food safety and food quality), preserving the health of animals and plants and animal welfare, and health and safety at work. Investments have also been planned for the modernisation of the production system with the aim of reducing pollution through agricultural production and activities in order to improve general conditions in the production of primary agricultural goods, and improve the quality of agricultural goods in general.

This measure will also promote the diversification of economic activities of the existing agricultural holdings to supplementary agricultural activities and non-agricultural activities, and the initiation or broadening of non-agricultural economic activities of enterprises in rural areas, with a view to increasing economic activities in rural environments.

14. Organisation of the market of agricultural products

The harmonisation of measures for organising the market of agricultural and food products in the Republic of Croatia with the framework in force in the EU has been conducted steadily since the beginning of 2013 with the aim of achieving the seamless transfer to the operating conditions and the available mechanisms within the common organisation of the market of agricultural products.

The Act on the Organisation of Agricultural Products has been implemented for this purpose³² and, by 1 July 2013, the process of aligning and implementing the measures for the organisation of the market will be completed, and the producers of agricultural products will be able, after joining the EU, to use regulatory public intervention measures, special aid in the fruit and vegetables, apiculture and wine sectors, and the system of trade mechanisms through which the market of agricultural products in the Republic of Croatia will be integrated in the common customs policy system.

³² Official Gazette, No. 120/12, 22/11, 149/09)

15. Preparation and implementation of local rural development strategies

The preparation and implementation of local rural strategies will take place through the implementation of the LEADER approach, which aims at promoting rural development through local initiatives and partnerships. The Local Rural Strategy will define relevant socio-economic and social problems that will arise from a previously conducted situation analysis. This will include quantitative goals and a description of the expected activities, as well as the types of projects that will be promoted. It will be aligned with other relevant strategies and national/regional policies.

The main goals of the LEADER approach within the Agriculture and Rural Development Plan 2007 – 2013 (IPARD) are to improve the conditions of life and work in rural areas, including wellbeing, the creation of new, sustainable earning opportunities, the preservation of old and the creation of new jobs, and the diversification of economic activities.

Physical planning and urban development

16. Integrated physical planning and reconstruction of space

Due to the lack of continued monitoring of physical planning and construction, as well as due to insufficient exchange of knowledge and experience between the academic community, the central and local government, the spatial development of Croatia in the past two decades was not planned in the best, sustainable and the most advanced way. The current amendments to the Physical Planning Strategy and Programme of the Republic of Croatia ensure a sustainable development of the space to 2020. In the second half of 2013, intensified work on the new long-term Physical Planning Strategy and Programme of the Republic of Croatia until 2030, is planned, whose adoption is expected in the first half of 2014. Together with the other relevant sector strategies, it will serve as a basis for the adoption of the Physical Plan of the Republic of Croatia.

The above strategy and programme will also clearly define the procedures for the alignment of lower-tier physical plans with the higher-tier plans for the purpose of an easier implementation of investment interventions in the space, as well as the implementation of the building of communal, energy, transport and other infrastructure.

The measure also implies the application of the tools such as the territorial impact assessment, which will ensure the monitoring of the specific, clearly defined indicators, comparable at the level of the EU, and the strategic planning of the Croatian territory, which will be aligned with the spatial development of the EU.

The measure covers the preparation of physical plans of the legalised areas, as well as the reconstruction of the space itself by the adequate adjustment of communal and transport infrastructure after the finalisation of the procedure of legalisation in compliance with the Act on Procedures with Illegally Built Buildings³³ so that the situation on-site is aligned with the existing physical planning documentation.

³³ Official Gazette, No. 86/12

17. Sustainable urban development and urban reconstruction

With the aim of enhancing the economic activity in the urban environment, the improvement of living conditions and the standard of living in urban centres, the promotion of healthy and active life of the inhabitants, improving the position of socially vulnerable groups and improvement of urban-rural links (connection of surrounding rural areas with the urban centre to which they gravitate), the Urban Reconstruction Programme will be adopted in 2013. The Programme foresees:

- Reconstruction of neglected/abandoned/old city blocks to enhance the quality of living,
- Building of adequate facilities, improvement of communal infrastructure, etc.
- Reconstruction of areas within cities and in city access areas devastated by industry, currently abandoned and out of function (brownfield areas),
- Changing the use of donated military complexes in urban centres,
- Creation of green oases in cities,
- Reconstruction, connecting and redevelopment of back yards of old city blocks,
- Reconstruction of cultural heritage buildings,
- Construction of free parking lots in town peripheries, where users who commute every day for work/school, etc. could park their vehicle and continue travelling by public transport.

The units of local and regional self-government will take part in the implementation of the above in accordance with the EU principle of '*multi-level governance*'.

Protection of the environment and nature

18. Achievement and maintenance of good condition of marine environment and the coastal area

The measure implies the development and implementation of the Marine Environment and Coastal Zone Management Strategy that combines the obligation to prepare a Marine Strategy (under the EU Marine Strategy Framework Directive – MSFD) and the Integrated Coastal Zone Management Strategy (on the basis of the ICZM Protocol to the Barcelona Convention). The objectives to be achieved include:

- Protection, preservation and enabling the recovery of marine and coastal ecosystems and sustainable use of ecosystem services,
- Preservation of protected areas and environmentally significant areas of EU Natura 2000,
- Reduction of pollution in marine and coastal environment with the aim of preserving human health, the ecosystem and enabling the use of the sea and the coast,
- Establishment and maintenance of balance between human activities and natural resources by applying the ecosystem approach.

The above strategy will be used as one of the bases for the development of the Physical Plan of the Republic of Croatia and the Physical Plan of areas with special features for the protected coastal zone of the Republic of Croatia (physical plan of the marine and coastal zone of the Republic of Croatia), which will define the manners and conditions of use and protection of space, including, *inter alia*, the exploitation of resources in the Adriatic Sea and on the coast, having in mind the preservation of the Adriatic as a tourist destination. This will ensure the adequate use of the resources of the Croatian coastline and the Adriatic Sea, taking into consideration the existing infrastructure, construction, inhabitants, economic

opportunities and potential, environmental protection and cultural heritage. As action programmes of the strategy, by 15 July 2014 the System for Monitoring and Observation of the Marine Environment will be developed, and the National and Regional Level Implementing Measures Programme will be adopted by 2015.

19. Setting up of areas important for the preservation of endangered and rare species and habitat types EU Natura 2000 and sustainable management mechanisms

The EU ecological network Natura 2000 represents the most important obligation of the protection of nature of the Republic of Croatia in the process of EU accession. For the Natura 2000 ecological network Croatia will propose areas important for the preservation of more than 508 species and 74 habitat types which are considered as important for the European Community. The proposal of Natura 2000 network (www.natura2000.hr) covers 36.92% of land surface and 16.60% of sea surface (total percentage: 29.64%). By the day of accession to the EU, Croatia will prepare a list of proposed Areas of Importance for the Community and determine the list of Areas of Special Protection, as well as adopt the regulation on internationally important ecological areas (Natura 2000). The ecological network preservation mechanisms include the adoption of plans for the management of Natura 2000 network areas, integration of conditions and measures of the protection of nature in the plans for the management of natural goods and in the spatial development documents, as well as in the implementation of the assessment of acceptability, of the plan, programme and interventions for the ecological network. The inventory of species and the mapping of habitats important for the setting up of the Natura 2000 network on land and in the sea, the defining of its scope and the setting up of sustainable management mechanisms will ensure the stability of the Natura 2000 network. This will contribute to the preservation of rare and endangered species and habitats at the European level. After the EC accepts the list of Areas of Importance for the Community at bio-geographic seminars, Croatia should set up a framework for the management of these areas within 6 years, after which they are adopted as Special Preservation Areas.

ANNEX

Table 1a. Macroeconomic prospects

	ESA Code	2012 (level)	2012 (rate of change)	2013 (rate of change)	2014 (rate of change)	2015 (rate of change)	2016 (rate of change)
1. Real GDP	B1*g	323,648	-2.0	0.7	2.4	3.5	3.5
2. Nominal GDP	B1*g	330,232	0.0	2.6	4.6	5.6	5.6
Components of real GDP							
3. Private consumption expenditure [1]	P.3	192,022	-2.9	-0.7	1.5	3.7	3.6
4. Government consumption expenditure	P.3	64,762	-0.8	-1.7	-0.9	0.7	1.0
5. Gross fixed capital formation	P.51	60,372	-4.6	6.3	9.9	7.3	6.4
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	1.0	1.0	1.0	1.1	1.4	1.6
7. Exports of goods and services	P.6	140,147	0.4	1.6	3.2	4.5	5.1
8. Imports of goods and services	P.7	136,782	-2.1	1.2	4.3	6.2	6.2
Contribution to real GDP growth							
9. Final domestic demand			-2.8	0.4	2.7	3.9	3.8
10. Changes in inventories and net acquisition of valuables	P.52 + P.53		-0.3	0.0	0.1	0.3	0.2
11. External balance of goods and services	B.11		1.1	0.2	-0.4	-0.7	-0.5

Note: GDP and all of its components expressed in real terms are in constant previous year prices, HRK million.

[1]: Including non-profit institutions serving households.

Source: CBS, MF

Table 1b. Price developments

	ESA Code	2012 (level)	2012 (rate of change)	2013 (rate of change)	2014 (rate of change)	2015 (rate of change)	2016 (rate of change)
1. GDP deflator			2.0	2.0	2.1	2.0	2.0
2. Private consumption deflator [1]			3.5	3.3	2.4	2.1	2.1
3. HICP [2]			n.a.	n.a.	n.a.	n.a.	n.a.
4. Public consumption deflator			0.8	-1.9	1.7	1.8	1.8
5. Investment deflator			0.6	2.1	2.1	2.0	2.0
6. Export price deflator (goods and services)			2.2	2.4	2.1	2.0	2.0
7. Import price deflator (goods and services)			3.1	2.6	2.2	2.0	2.0

[1]: Including non-profit institutions serving households.

[2]: Optional for stability programmes

Source: CBS, MF

Table 1c. Labour market developments

	ESA Code	2012 (level)	2012 (rate of change)	2013 (rate of change)	2014 (rate of change)	2015 (rate of change)	2016 (rate of change)
1. Employment, persons [1]		1,454,143	-2.2	-1.0	0.9	1.6	1.8
2. Employment, hours worked [2]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%) [3]		15.5	15.5	16.0	15.2	14.1	13.0
4. Labour productivity, persons [4]		222,569	0.3	1.6	1.4	1.8	1.6
5. Labour productivity, hours worked [5]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees [6]	D.1	162,380	1.0	-0.1	3.7	5.3	5.8
7. Compensation per employee		111,667	3.3	0.8	2.8	3.6	3.9

[1]: Occupied population, domestic concept national accounts definition.

[2]: National accounts definition.

[3]: Unemployment rate is calculated as share of ILO definition unemployed in labour force calculated as sum of ILO definition unemployed and national accounts definition employed.

[4]: Real GDP in constant previous year prices per person employed.

[5]: Real GDP per hour worked.

[6]: Data for 2012 is preliminary CBS estimate.

Source: CBS, MF

Table 1d. Sectoral balances

	ESA Code	2012 (% of GDP)	2013 (% of GDP)	2014 (% of GDP)	2015 (% of GDP)	2016 (% of GDP)
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	0.1	0.7	-0.1	-0.8	-1.3
<i>of which:</i>						
- Balance on goods and services		0.8	1.0	0.5	-0.2	-0.7
- Balance of primary incomes and transfers		-0.8	-0.4	-0.9	-1.0	-1.1
- Capital account		0.0	0.1	0.3	0.4	0.5
2. Net lending/borrowing of the private sector	B.9	2.9	2.6	2.0	1.0	0.1
3. Net lending/borrowing of general government	EDP B.9	-3.8	-3.6	-3.4	-3.1	-2.6
4. Statistical discrepancy		1.0	1.6	1.4	1.3	1.2

Source: CNB, MF

Table 2a. General government budgetary prospects

	ESA Code	2012 (level, HRK billion)	2012 (% of GDP)	2013 (% of GDP)	2014 (% of GDP)	2015 (% of GDP)	2016 (% of GDP)
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-12.6	-3.8	-3.6	-3.4	-3.1	-2.6
2. Central government	S.1311	-11.3	-3.4	-3.2	-3.1	-2.7	-2.2
3. State government	S.1312	0.0	0.0	0.0	0.0	0.0	0.0
4. Local government	S.1313	0.3	0.1	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	0.0	0.0	0.0	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	126.1	38.2	38.4	37.9	37.7	37.2
7. Total expenditure	TE	138.7	42.0	42.0	41.3	40.8	39.9
8. Net lending/borrowing	EDP B.9	-12.6	-3.8	-3.6	-3.4	-3.1	-2.6
9. Interest expenditure	EDP D.41	8.9	2.7	3.0	3.1	3.0	3.0
10. Primary balance [1]		-3.7	-1.1	-0.5	-0.4	-0.1	0.4
11. One-off and other temporary measures [2]		0.0	0.0	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		73.7	22.3	22.4	22.0	21.6	21.3
12a. Taxes on production and imports	D.2	55.3	16.8	17.0	16.8	16.6	16.4
12b. Current taxes on income, wealth, etc	D.5	18.4	5.6	5.3	5.1	5.0	4.9
12c. Capital taxes	D.91	0.0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	38.8	11.7	11.5	11.3	11.0	10.9
14. Property income	D.4	1.5	0.5	0.4	0.2	0.2	0.2
15. Other [3]		12.1	3.7	4.1	4.4	4.9	4.8
16=6. Total revenue	TR	126.1	38.2	38.4	37.9	37.7	37.2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) [4]		112.5	34.1	33.8	33.3	32.6	32.2
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	50.5	15.3	14.6	13.9	13.5	13.2
17a. Compensation of employees	D.1	35.2	10.7	9.9	9.5	9.2	9.0
17b. Intermediate consumption	P.2	15.2	4.6	4.7	4.4	4.2	4.1
18. Social payments (18=18a+18b)		58.1	17.6	16.8	16.2	15.5	14.8
of which Unemployment benefits [5]		1.5	0.4	0.4	0.4	0.3	0.0
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	12.3	3.7	3.1	3.1	2.9	2.8
18b. Social transfers other than in kind	D.62	45.7	13.8	13.6	13.2	12.6	12.0
19=9. Interest expenditure							
20. Subsidies	D.3	6.8	2.1	2.1	2.0	1.8	1.7
21. Gross fixed capital formation	P.51	4.7	1.4	1.7	1.9	2.0	1.9
22. Capital transfers	D.9	4.5	1.4	1.5	1.7	2.4	2.7
23. Other [6]		5.3	1.6	2.3	2.6	2.5	2.5
24=7. Total expenditure [7]	TE	138.7	42.0	42.0	41.3	40.8	39.9
p.m.: Government consumption (nominal)	P.3	53.9	16.3	15.0	14.4	13.9	13.4

[1]: The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[2]: A plus sign means deficit-reducing one-off measures.

[3]: P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[4]: Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[5]: Includes cash benefits (D.621 and D.624) and in kind benefits (D.631) related to unemployment benefits.

[6]: D.29+D.4 (other than D.41) +D.5+D.7+P.52+P.53+K.2+D.8.

[7]: Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Source: CBS, MF

Table 2b. No-policy change projections*

	2012 (level, HRK billion)	2012 (% of GDP)	2013 (% of GDP)	2014 (% of GDP)	2015 (% of GDP)	2016 (% of GDP)
1. Total revenue at unchanged policies	126.1	38.2	38.5	38.2	37.9	37.6
2. Total expenditure at unchanged policies	138.7	42.0	42.5	41.8	41.0	40.2

* The cut-off date is middle of March 2013.

Source: CBS, MF

Table 2c. Amounts to be excluded from the expenditure benchmark

	2012 (level, HRK billion)	2012 (% of GDP)	2013 (% of GDP)	2014 (% of GDP)	2015 (% of GDP)	2016 (% of GDP)
1. Expenditure on EU programmes fully matched by EU funds revenue	0.8	0.3	0.5	0.8	1.0	1.5
2. Cyclical unemployment benefit expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Effect of discretionary revenue measures	1.0	0.3	0.4	n.a.	n.a.	n.a.
4. Revenue increases mandated by law	1.7	0.5	0.7	0.2	n.a.	n.a.

Source: CBS, MF

Table 3. General government expenditure by function

	COFOG Code	2011 (% of GDP)	2016 (% of GDP)
1. General public services	1	5.2	n.a.
2. Defence	2	1.5	n.a.
3. Public order and safety	3	2.5	n.a.
4. Economic affairs	4	6.7	n.a.
5. Environmental protection	5	0.3	n.a.
6. Housing and community amenities	6	1.2	n.a.
7. Health	7	6.2	n.a.
8. Recreation, culture and religion	8	1.1	n.a.
9. Education	9	4.2	n.a.
10. Social protection	10	15.0	n.a.
11. Total expenditure (=item 7=23 in Table 2) [1]	TE	44.5	39.9

[1]: Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Source: CBS, MF

Table 4. General government debt developments

	ESA Code	2012 (% of GDP)	2013 (% of GDP)	2014 (% of GDP)	2015 (% of GDP)	2016 (% of GDP)
1. Gross debt [1]						
		53.7	56.2	57.5	57.5	57.0
2. Change in gross debt ratio						
		6.5	2.5	1.3	0.0	-0.5
Contributions to changes in gross debt						
3. Primary balance [2]						
		1.1	0.5	0.4	0.1	-0.4
4. Interest expenditure [3]						
	EDP D.41	2.7	3.0	3.1	3.0	3.0
5. Stock-flow adjustment*						
		2.6	-1.0	-2.2	-3.2	-3.1
<i>of which:</i>						
- Differences between cash and accruals [4]						
- Net accumulation of financial assets [5]						
		-0.2	-0.3	-0.2	0.2	0.1
<i>of which:</i>						
- Privatisation proceeds						
		0.0	0.9	0.6	0.6	0.5
- Valuation effects and other [6]						
p.m.: Implicit interest rate on debt [7]						
		5.7	5.8	5.7	5.5	5.6
Other relevant variables						
6. Liquid financial assets [8]						
		0	0	0	0	0
7. Net financial debt (7 = 1 - 6)						
		53.7	56.2	57.5	57.5	57.0
8. Debt amortization (existing bonds) since the end of the previous year						
9. Percentage of debt denominated in foreign currency						
10. Average maturity						

* In 2012 the Government has taken over the shipyards guaranteed debt into public debt.

[1]: As defined in Regulation 479/2009 (not an ESA concept).

[2]: Cf. item 10 in Table 2.

[3]: Cf. item 9 in Table 2.

[4]: The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

[5]: Liquid assets (currency), government securities, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

[6]: Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

[7]: Proxied by interest expenditure divided by the debt level of the previous year.

[8]: AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Source: CNB, CBS, MF

Table 5. Cyclical developments

	ESA Code	2012 (% of GDP)	2013 (% of GDP)	2014 (% of GDP)	2015 (% of GDP)	2016 (% of GDP)
1. Real GDP Growth (%)		-2.0	0.7	2.4	3.5	3.5
2. Net Lending of general government	EDP B.9	-3.8	-3.6	-3.4	-3.1	-2.6
3. Interest expenditure	EDP D.41	2.7	3.0	3.1	3.0	3.0
4. One-off and other temporary measures [1]		0.3	0.4	0.0	0.0	0.0
5. Potential GDP growth (%)		-0.6	-0.4	0.1	0.6	0.8
contributions:						
- labour		-0.6	-0.6	-0.5	-0.2	-0.1
- capital		0.3	0.4	0.6	0.7	0.8
- total factor productivity		-0.3	-0.1	0.0	0.1	0.2
6. Output gap		-4.1	-3.1	-0.9	1.9	4.6
7. Cyclical budgetary component		-1.7	-1.3	-0.4	0.8	1.9
8. Cyclically-adjusted balance (8 = 2 - 7)		-2.1	-2.3	-3.1	-3.9	-4.5
9. Cyclically-adjusted primary balance (9 = 8 + 3)		0.6	0.7	0.0	-0.9	-1.5
10. Structural balance (10 = 8 - 4)		-2.4	-2.7	-3.1	-3.9	-4.5

[1]: A plus sign means deficit-reducing one-off measures.

Source: CBS, MF

Table 6. Divergence from previous update*

	ESA Code	2012	2013	2014	2015	2016
Real GDP growth (%)						
Previous update		0.8	1.5	2.5	n.a.	n.a.
Current update		-2.0	0.7	2.4	3.5	3.5
Difference		-2.8	-0.8	-0.1	n.a.	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-3.8	-3.3	-2.6	n.a.	n.a.
Current update		-3.8	-3.6	-3.4	-3.1	-2.6
Difference		0.0	-0.3	-0.8	n.a.	n.a.
General government gross debt (% of GDP)						
Previous update		47.2	48.9	49.4	n.a.	n.a.
Current update		53.7	56.2	57.5	57.5	57.0
Difference		6.5	7.3	8.1	n.a.	n.a.

* Previous update is the 2012 PEP.

Source: CBS, MF

Table 7a. Contingent liabilities

	2012 (% of GDP)	2013 (% of GDP)
Public guarantees	11.7	n.a.
<i>Of which: linked to the financial sector</i>	n.a.	n.a.

Source: CBS, MF

Table 8. Basic assumptions

	2012	2013	2014	2015	2016
Short-term interest rate (annual average) [1]	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
USD/EUR exchange rate (annual average)	1.28	1.35	1.35	1.35	1.35
Nominal effective exchange rate (for countries not in euro area or ERM II) exchange rate vis-à-vis the EUR (annual average)	7.52	7.52	7.52	7.52	7.52
World excluding EU, GDP growth	3.9	4.0	4.5	n.a.	n.a.
EU GDP growth	-0.3	0.1	1.6	n.a.	n.a.
Growth of relevant foreign markets	-0.4	2.3	5.2	5.9	6.3
World import volumes	2.5	3.3	5.5	6.1	6.3
Oil prices (Brent, USD/barrel)	111.8	113.7	106.4	106.4	106.4

[1]: If necessary, purely technical assumptions.

Source: EC, IMF, MF

Table 9. Structural reform agenda and achievements

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Product and capital markets			
Establishment of a system aligned with EU practice in the energy sector	YES	14 February 2013	Synchronization with Third Energy Package of EU law by adoption of the Second National Energy Efficiency Action Plan for the period until the end of 2013 (NAPEnU). NAPEnU was adopted by the Government on 14 February 2013.
	YES	2012	Adjustment of the internal market to European conditions; The measure Encouraging investments in the energy sector is achieved through the development of the Programme for Energy Renovation of Buildings of the public sector - increase of the number of energy-efficient buildings.
Alignment of legislation with the <i>acquis</i> in the railway sector	YES	Continuously	Drawing up subordinate legislation in order to align legislation with the <i>acquis</i> in the railway sector.
	YES	2012	Establishing an independent body for traffic accident inquests in order to align legislation with the <i>acquis</i> in the railway sector.
Liberalisation of the rail transport market	YES		Liberalisation of the rail transport market is achieved through the following measures: Drawing up a network report, Allocation of routes to operators, Activities of the Rail Market Regulatory Agency and Activities of the Railway Transport Safety Agency.
Restructuring and modernisation of railway companies	YES	Continuously	Restructuring program is being implemented in the railways sector, i.e. companies HŽ Infrastructure and HŽ Passenger Transport. The company HŽ Cargo is also in the process of restructuring with the possibility of being privatised.
Labour market			
Development of cooperatives		2012	Development of cooperatives for war veterans; the program for vocational training and employment of Homeland war veterans and children of killed, imprisoned or missing war veterans is a part of the National Plan for Employment 2011-2012 and a part of the Joint Assessment of the Employment Policy Priorities of the Republic of Croatia (JAP). It contains incentives aimed at veterans' cooperatives, which promote social entrepreneurship and the establishment and development of veterans' cooperatives as a special form of small entrepreneurship that enables an organized and professional management of businesses and joint entrance on the market. Special attention is given on cooperative values like self-help, responsibility, democracy, equality, equity, solidarity and concern for others.

³⁴ The date when the measure was adopted or will be adopted

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Focusing the measures of active employment policy on particularly sensitive groups on the labour market (young and long time unemployed persons)		2012	Continued implementation of the National Employment Stimulation Plan 2011 – 2012; The measures contained in the National Plan for Employment in 2011 involve 2,351 war veterans. The payment for the measures amounts to HRK 24,437,456.25. The biggest part of the amount is related to the employment in public works (1,208 people) and education of unemployed war veterans (814 people), followed by support for employment and self-employment (267 people), support for training (52 people), and support for the preservation of jobs (10 people). Program for vocational training and employment of Homeland war veterans and children of killed, imprisoned or missing Homeland War veterans is a part of the National Employment Stimulation Plan 2011 – 2012.
Increasing employment and employability through alignment of supply and demand on the labour market	YES	2011	Analysis and independent evaluation of annual employment stimulation plans is carried out continuously.
Systematic protection of the rights and interests of children and vulnerable groups, and alignment with international standards	YES	2012	The draft of the National Strategy for the protection and promotion of children's rights in Croatia from 2013 to 2020 is expected to be completed in 2013.
Preparation and implementation of pre-accession and accession activities in the field of social inclusion	YES	Continuously	The measures Encouraging providers of social services to increase their usage of pre-accession funds of the EU, and to have a stronger role in future use of structural funds and EU programmes and Strengthening capacity of social service providers for the implementation of projects financed from IPA, structural funds, and EU programmes are carried out continuously.
Administrative reform			
Adjustment of the competition policy to the requirements for membership in the EU	YES	II Quarter of 2012	Submitting the proposal for introduction of analysis of regulatory impact on competition; At the proposal of the Agency for the Protection, the Competition Legislation Office of the Government included in assessing the impact of legislation (Regulatory Impact Assessment), which is produced when passing new legislation, the test of the effect on competition (Competition assessment) in order to identify the provisions of the regulations that could lead to the restriction of competition. Although not included in the mandatory and integral part of the Regulation on the implementation of regulatory impact assessment process, this test, meaning the Agency's opinion is included in the accompanying document - Guidelines for Civil Servants.
Adjustment of the state aid system to the requirements for membership in the EU	NO	IV Quarter of 2013	Due to delays in the preparatory phase of the project, the implementation of the measure Establishing the advisory contact point for rules on state aid in the context of structural fund projects has been postponed until the legal definition of jurisdiction over matters of state aid after accession to the EU.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Strengthening the independence of the judiciary	YES	2011	The measure Selection and education of candidates at the National school for judicial officials is carried out continuously from 2011.
Improve efficiency of the judicial system	YES	2013	The measure Carrying out activities for the establishment of two-instance administrative court procedures is carried out continuously in 2013.
	YES	2012	Implementation of the activities required for the establishment of a more efficient public enforcement system.
	YES	2011	Implementation of the activities required for full establishment of the probation system.
	YES	2019	Further rationalisation of municipal and misdemeanour courts and state attorney's offices.
	YES	2019	Rationalisation of the network of county and commercial courts.
	YES	2012	Introduction of ICMS and CTS in courts and state attorney's offices.
	YES	Continuously	The measure Further strengthening of the free legal aid system is carried out continuously.
	YES/NO	2012	Construction of the Justice Square in Zagreb is completed. Construction of the Justice Square in Split was cancelled due to limitations in budget planning for the next three years.
	YES	2009	Strengthening administrative and accommodation capacity of the prison system.
	NO	2012	The measure Construction and remodelling works at the Municipal Court in Karlovac was withdrawn due to limitations in budget planning for the next three years, and because of the new strategic direction of the Ministry of Justice.
	YES	July 2010	Construction and remodelling works at the premises of the State Attorney's Office/Office for the Suppression of Corruption and Organised Crime (USKOK) in Zagreb.
	YES	September 2010	Remodelling works at the Municipal State Attorney's Office in Pula.
	YES	September 2011	Reconstruction and remodelling works at the Municipal Court in Daruvar.
	NO	September 2012	The measure Construction and remodelling works at the Municipal Court in Virovitica was withdrawn due to budget constraints.
	NO	September 2012	Construction and remodelling works at the Municipal Court in Slatina (it was given up from construction and remodelling works due to budget constraints).
	YES	2011	Reconstruction and extension works at the County Court in Osijek and Sisak, and the Municipal Courts in Ivanić Grad, Benkovac and Valpovo.
YES	2011	Purchasing IT equipment for judicial bodies.	
Prevention of corruption	YES	15 November 2012	The measure Implementation of the Action Plan accompanying the Corruption Prevention Strategy is carried out continuously from 15 November 2012.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Improve efficiency and rationalisation, and lower costs of the administrative apparatus	NO		The Public Administration Reform Strategy for the period 2008 – 2011 expired in 2011.
	YES	Continuously	Drafting the new Public Administration Modernisation Strategy for the period 2013-2018.
	YES	Continuously	Adjustment of the system of public agencies in accordance with EU standards 2012; In the framework of the measures of the Strategic Plan of the Ministry of Administration for the period 2012 - 2014, the improvement of agencies, institutes, foundations, centres and other legal persons with public authorities, in order to rationalize, increase efficiency, transparency and accountability in the work and better cohesion in the work of legal entities and ministries is under way.
	YES	Continuously	Implementation of territorial reorganisation and decentralisation of regional and local self-government units; Croatian Government Programme for the period 2011 - 2015 as one of the prerequisites for the decentralization of government and public affairs is representing the new regional and local structure, which will meet the requirement of economic efficiency, local democracy and identity.
Uniform application of the new General Administrative Procedure Act and improved protection of citizens' rights in administrative procedures	YES	Continuously	Establishing the Reporting methodology for the purposes of monitoring the implementation of the General Administrative Procedure Act, and further strengthening of administrative capacity of the Ministry of Public Administration in relation to the implementation of the General Administrative Procedure Act. In the framework of the IPA 2008 project: "Support to the Implementation of the Law on Administrative Procedure" the methodology for monitoring the implementation of the Law on Administrative Procedure, as well as conducting training officers who conduct administrative proceedings are in the draft.
	YES	Continuously	Alignment of procedural acts and subordinate regulations with the new General Administrative Procedure Act, and providing education to civil servants for proper application of the General Administrative Procedure Act Croatian Government at its session on 5 July 2012 adopted the conclusion that central government authorities have not completed the process of harmonization of specific laws to the Law on Administrative Procedure undertake the urgent drafting of amendments to the law of the administrative areas within the defined scope. The process of matching specific legislation is in progress, as well as conducting training officers who conduct administrative proceedings.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Increase motivation of civil servants for quality work and reduced drain of quality personnel from the civil service	YES	Continuously	Implementation of the Action plan for the implementation of the Development Strategy for Human Resources in Civil Service for the period 2010 - 2013 and preparation of the new Development Strategy for Human Resources in Civil Service and the Action Plan for the period 2014 - 2016. It is scheduled the continuation of implementation of the Action Plan for the implementation of the Strategy for the Development of Human Resources in the civil service for a period of 2010th-2013 Further to the amendments of the Action Plan for the implementation of HRD strategy in the civil service for the period of 2010-2013, for year 2012 and 2013 which was adopted by the Croatian government in a conclusion in 26 July 2012 year. The plan is to build a new strategy with its Action Plan for the next period of 2014 onwards during the 2013.
	YES	Continuously	Continued education in the Centre for professional education and training of civil servants and the State School for Public Administration; National School of Public Administration took over the training of civil servants due to termination of the Centre for Education and Training officers.
Optimal utilisation of resources from EU structural funds	NO		Setting up the management body for the Operational Programme: Building of administrative capacity for use of funding from the EU structural funds; The Operational Programme: Development of administrative capacity will not be implemented in the period 2013 - 2014, and projects that were intended with this programme will be co-financed from the Transition Facility.
Establishment of an IT-supported central register of civil servants	YES	Continuously	Unification of data on employees in the public sector (including public administration) in the Register of employees in the public sector; Law on Registry of employees in the public sector was implemented on 31 March 2011 and represents the basis for the collection and further processing of personal data of employees in the public sector. During the 2012 it is continued with data entry into the Registry of employees in the public sector.
Improve coordination of public administration bodies in the planning and implementation of informatisation			Implementation of the Decision of the Government of the Republic of Croatia on establishing electronic administration development goals for the period 2011 – 2015; Croatian Government at its session on the 2nd February 2012 adopted the Decision on the establishment of the Commission for Coordination of computerization of the public sector, whose task is to guide the development and coordination of all activities and projects of the application of ICT in the public sector with the aim of streamlining the system while increasing the quality of public services.
Improve availability of health care	YES	2012	Implementing the measure Purchasing medical equipment and furnishing hospital premises through merged hospital procurement for hospitals owned by the state through framework agreements
Further financial stabilisation of the healthcare system	YES	2012	Drawing up and implementation of the "Master Plan" for health care institutions

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Additional reform areas			
Improve the control of the health care expenditures system	YES	1August 2012	Informatisation of the primary health care system; Continuing the informatisation of hospitals
Further financial stabilisation of the health care system	YES	1November 2012.	Supervision of sick leave expenditure
Privatisation and restructuring with the aim of ensuring conditions for long-term sustainable operation of shipyards under conditions compatible with EU policy, and rules on state aid in the shipbuilding sector	YES	Continuously	Measures Completion of the privatisation process (depending on the investors' acceptance of the terms and conditions) and conclusion of privatisation contracts and Implementation of the restructuring programme (depending on the completion of privatisation, and the approval of final drafts of the privatisation contracts by the Croatian Competition Agency and the EC) are carried out continuously.
Competitiveness and innovation	YES	2012	The measures: Strengthening competitive ability of small businesses; Innovation and new products; Stimulating fast-growing small business entities; Women entrepreneurs; Young, beginner and disabled entrepreneurs; Entrepreneurship in culture and culture-related industries; Clusters; Development of crafts and trades; Development of cooperatives; Use of new technologies and technological procedures; Introduction of EU standards; Linking SMEs and R&D; Marketing and advertising of small business entities; Promotion of entrepreneurship; Coordination of activities in the e-Croatia project, e-trade and e-business enhancement, public portals for small businesses are carried out through IMPULS 2012.
Improvement of financing	YES	2012	The measures Low-cost loans; Financial instruments for regional development of entrepreneurship; Guarantees; Development of the fund industry; EU projects and grants for SMEs, use of the Competitiveness and Innovation Framework Programme are carried out through the new warranty programs HAMAG INVEST 2012.
Development of entrepreneurial support structure	YES	2012	The measures Stimulating the development of the Croatian Agency for Small Business; Stimulating regional development agencies; Training and development of a network of consultants; Support to the development of regional development agencies, entrepreneurial centres, technological parks and business incubators are carried out through IMPULS 2012.
Lifelong education for entrepreneurship	YES	2012	The projects: Project for the National entrepreneurial learning programme in formal and informal education; South East European Centre for Entrepreneurial Learning (SEECCEL); Students' entrepreneurial incubators; Education for crafts and trades and cooperatives; Children's entrepreneurship week; Co-financing of universities with specialist entrepreneurial programmes; Pupils' cooperatives and pupils' enterprises are carried out through IMPULS 2012.
Strengthening expertise and capacity for the EU	YES	2012	The measure Implementation of projects financed from EU IPA funds under the Regional Competitiveness Operational Programme, component IIIc is carried out through forming the Board for EU Programmes, bilateral assistance programs and projects of other international institutions under the Ministry of Entrepreneurship and Crafts.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Stimulating the development of tourism	YES	Continuously	Programme of new product development of sustainable tourism is carried out continuously.
	YES	Continuously	Programmes of subsidizing credit programmes in tourism are carried out continuously.
	YES	Continuously	Programme to encourage the development of tourism in the undeveloped tourist areas is carried out continuously.
	YES	Continuously	Programme to improve the offer of the tourist sector is carried out continuously.
Improvement of the system of integrated water management	NO	2012.	Preparation and adoption of the Water Areas Management Plan for the first plan cycle (2012 - 2015); The draft of the Water management plan has been drafted and the strategic environmental assessment is currently underway. A procedure of trans boundary consultations in accordance with the provisions of the Espoo Convention has been started. Adoption of WAMP is expected by the end of quarter II of 2013.
	NO	2013.	Monitoring the implementation of the Water Areas Management Plan (2012 - 2015) and preparing the draft Water Areas Management Plan for the second plan cycle (2016 - 2021) After the adoption of WAMP, environmental monitoring program in relation to the implementation of the Plan will be prepared. By the end of the first quarter of 2013 program of create a Plan for the second cycle will be published.
	YES	Continuously	Development and setting up of the Water Information System related to reporting on the quality, quantity and use of waters and waste water in accordance with WISE (Water Information System for Europe) requirements and integration into the Environmental Protection Information System Croatian Environment Agency (CEA) will, within a period of 2012-2014, continue the activities on the establishment, operation and maintenance of the national Environmental Information System (EIS), in which the development of the Water Information System is included for which Croatian waters are in charge and thus ensure the development of a comprehensive information system by the standards of the information system of the European Agency for environment - Shared Environmental Information System (SEIS).
	YES	2012	The project Training for the establishment of reporting as part of the G2G project "Reporting in accordance with the Framework Directive and the Urban Waste Water Treatment Directive" was completed on 9 November 2012 with the recommendations from the institutions responsible for the information on the obligations from the Accession Treaty. By adopting of amendments to the Water Act and the new Environmental Protection Act, the final structure of the relevant institutions and their liability will ultimately be defined.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Development of the public water supply and drainage system	NO	2012	Restructuring of the water supply sector and building capacity at the national, regional and local levels; A study of the institutional structure of the water utility sector of Croatia is made, and the results obtained will serve as a basis for institutional reform of the sector, and the development of a Regulation establishing the service areas and determining their boundaries, which the Croatian Government will adopt pursuant to Article 199 Of the Water Act (OG 153/09, 130/11). The deadline for the adoption of the Regulation on the establishment of service areas is quarter IV of 2013.
	YES	Continuously	Improvement of the water protection system, in particular in relation to the preparation and implementation of infrastructure projects for the drainage and purification of waste waters; investment in the reconstruction of the existing and construction of new public drainage facilities; Projects of drainage and wastewater treatment are carried out in accordance with the Water Management Plan of Croatian waters and Implementation Plan for water municipal directives. In addition to national funding, for the preparation and implementation of projects the pre-accession funds, EIB, Central European Bank (CEB), and the World Bank funds are being used. The activities in the intensive preparation of drainage projects whose implementation is planned to be co-financed from EU funds are on going.
	YES	Continuously	Reduction in losses in the existing water supply systems and an increase in connections to the public water supply systems (regional water supply systems), through connection of low-volume water supply systems outside the control system to the public water supply system so as to ensure the safety of drinking water; investment in the reconstruction of the existing and construction of new public water supply facilities; Water supply projects are implemented in accordance with the Water Management Plan of Croatian waters and Implementation Plan for water municipal directives. In addition to national funding, for the preparation and implementation of projects the pre-accession funds, EIB, CEB and the World Bank funds are being used. The activities in the intensive preparation of drainage projects whose implementation is planned to be co-financed from EU funds are on going.
Development of the system for the protection against harmful effects of waters and melioration systems	YES	Continuously	Increasing investment into the construction of water regulation and safety structures and structures for basic melioration drainage; Projects for the protection from the harmful effects of water are carried out in accordance with the Water Management Plan of Croatian waters. Activities are also being carried out to use CEB loan (EUR 100 million) with EUR 100 million from national funding for projects of constructing regulating and protective of buildings and structures for primary amelioration drainage. Current activities related to preparations for the next programming period are on-going and the activities for the protection from the harmful effects of water will be proposed as one of the measures for co-financing from the EU funds. The activities related to the preparation of hazard maps and flood risk maps prescribed by Art. 111 Of the Water Act (OG 153/09, 130/11) are on going.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
	YES	Continuously	Increasing the volume of agricultural land covered by irrigation systems through rehabilitation and reconstruction of existing, and construction of new irrigation systems; On-going activities in the preparation of the novelations of the National Project for irrigation and agricultural soil and water management in the Republic of Croatia (NAPNAV). Investments related to irrigation are carried out in accordance with the Water Management Plan of Croatian waters, and resources for irrigation projects are secured in the state budget. With regard to the preparations for the next programming period, the plan is to propose irrigation as a measure that will be co-financed from EU funds.
Establishment of a system of continuous forest supervision	YES	Continuously	The measure Programme of measures for data collection and establishment of the registry of forest damage is carried out continuously
	YES	Continuously	The measure Establishing and maintaining a unique information system and registry of forest fires is carried out continuously
Enhancing the integral system for air quality management and ensuring conditions for systematic resolution of problems related to climate change	YES	Continuously	The measure Development and upgrading of the Air Quality Information System (as part of the Environmental Protection Information system) is carried out continuously
	YES	17 January 2013	The measure Maintaining the greenhouse gas emission registry is carried out continuously
	YES	17 January 2013	Maintaining the system for EU ETS (registering and opening user accounts, establishing the payment system, preparing instructions, etc)
	YES	1 January 2013.	Involvement in the EU emission trading scheme, and trading in emission units under the EU ETS system upon accession to the EU; The EU ETS is required in Croatia since 1 January 2013., before accession to the EU
	YES	2012	Inclusion of airplane activity in the system of greenhouse gas emission and tonne kilometres reporting system (drawing up the monitoring plan, emission monitoring, drawing up emission reports); Monitoring plans for tonne kilometres were delivered in 2012. The first reports of tonne kilometres will be delivered in 2013. Monitoring plans for emissions will be granted in 2013.
	YES	2012	Annual assessment of air quality in designated zones and agglomerations on the territory of the state
	YES	2012	Report on the implementation of the Plan for air quality protection and improvement for the period 2008 - 2011
	YES	2013	Establishing the institutional framework for auctions in the greenhouse gas emission trading scheme
	YES	2014	Full implementation of greenhouse gas emission trading for airplane operators will be applicable from 1 January 2014.
	YES	2013	Drawing up the draft Plan for the protection of air and the ozone layer and mitigation of climate change in the Republic of Croatia for the period 2012 - 2017
YES	2012 / Continuously	The measure Establishing the Greenhouse Gas Inventory is carried out continuously since 2012.	

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Integration of environmental protection objectives in planning and implementation of other sectoral policies, with the aim of promoting sustainable growth	YES	2011	The measure International reporting in accordance with the assumed obligations and reporting to the Republic of Croatia in accordance with national legislation and international obligations is carried out continuously.
	YES	2009	Maintaining the Environmental Protection Information System in accordance with the Programme for maintaining the Environmental Protection Information System in the Republic of Croatia for the period 2009 - 2012
	YES	2011	Implementation, control and certification of the information security system in accordance with the ISO 27001 : 2005 standard (the Agency)
	YES	2011	The measure Maintaining the database of projects in the field of environmental protection is carried out continuously.
	YES	2013	Establishing the Agency's reference centres for individual theme areas; By Government decree (NN 34/2012) RC for Marine Environmental Protection Agency was established - Establishment of Water Agency reference centre - approved by EPA work plan 2013 / tender documentation in preparation - Establishment of Nature Agency reference centre - approved by EPA work plan 2013 / tender documentation in preparation
	YES	2011	Review of the national list of indicators and its publication in the Official Gazette after receiving the opinion of the Ministry of Environmental and Nature Protection
Establishment of industrial pollution control system	YES	2011	The measure Further development and upgrading of the Environmental Pollution Register and the Register of installations containing hazardous materials within the Information System of Installations and Emissions as part of the Environmental Protection Information System is carried out continuously
	YES	2011	The measure Reporting in accordance with data in the Environmental Pollution Register and the Register of installations containing hazardous materials is carried out continuously
Protection of natural values	YES	Continuously	The measure Reporting to the EEA on protected areas (CDDA) is carried out continuously
Efficient and harmonised implementation of the national policy in the field of chemical safety	YES	2012	Participation in the project "Chemical Safety – strengthening the legal and institutional framework for the protection against hazardous chemicals"; Implementing measures under the policy objective: Efficient and coordinated implementation of national policy in the field of chemical safety
Integration of environmental protection objectives in planning and implementation of other sectoral policies, with the aim of promoting sustainable growth	YES	Continuously	International reporting in accordance with the assumed obligations and reporting to the Republic of Croatia in accordance with national legislation and international obligations is carried out continuously
Establishment of a comprehensive waste management system	YES	2012	The measure Further development of the waste management information system is carried out continuously
	YES	2012	The implementation of the measure Improving waste reporting - the project "Improving waste reporting in Croatia" has not yet started.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
	NO	2012	The project Improving reporting on biodegradable waste - applied project "Environmentally sustainable and economical sound approach to municipal solid waste disposal practices in SEE countries" was not accepted by Monitoring Committee (MC) of the South East Europe (SEE).
	YES	Continuously	Establishment of county/regional waste management centres; Two large infrastructure projects are in the implementation (Marišćina and Kaštijun), which are co-financed from IPA. Other projects of construction of county/regional waste management centres will be co-financed from the EU funds.
	YES	Continuously	The measure Rehabilitation of municipal landfill sites and "hot spots" through transformation for other use, continued use or shutdown is carried out continuously.
	YES	2012	The measure Improving the system for national and international reporting in the field of waste management is carried out continuously.
Establishment of the legal framework in the field of noise protection	YES		Drawing up the National Noise Protection Strategy and the framework for the noise protection programme - the project entitled "Strengthening capacity for the implementation of environmental acquis in the fields of waste management, integrated prevention and control of pollution, and noise protection" National Noise Protection Strategy Draft has been developed.
	YES		The measure "Technical assistance for the development of a National Environmental Noise Strategy for the Republic of Croatia" officially ended on 9 October 2012.
Protection of human health and the environment against direct and indirect effects of noise	YES	Continuously	The measure Implementation of the legislative provisions in the field of noise protection measures is carried out continuously.
	YES	Continuously	The measure Inspection control is carried out continuously.
Establishment of the legal framework in the field of GMO	YES	Continuously	The measure Transposition of EU legislation into Croatian legislation is carried out continuously.
	YES	Continuously	Authorisation of legal entities to carry out risk assessments for the purpose of placing on the market GMOs or products containing and/or composed of or derived from GMOs; Two legal entities were authorised in 2012. Procedure has ended.
	NO		Appointment of the national reference laboratory for the detection of GMO by adopting legal provision for establishing NRL for GMO
Establishment of the legal framework for chemical safety in the Republic of Croatia	YES	May 2012	Implementation of the IPA 2007 project "Chemical Safety" ended in May 2012.
	YES	July 2012	Implementation of the G2G Matra Project ended in July 2012.
	YES	June 2013	Project entitled "Synergy of the Three Conventions" (Stockholm, Basel and Rotterdam) with the Regional centre for the Basel Convention in Bratislava ended in June 2012.
	YES	Continuously	Implementation of the ECHA-IPA 2012-2013 is carried out continuously.
	YES	Continuously	Transposition of EU legislation into Croatian legislation is carried out continuously.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
Sea and marine environment protection	NO		Drawing up the annual National Report on Monitoring of the Adriatic Sea; The last report was prepared in 2009. Since 2010, funding from the UNEP MAP/MED POL is no longer received for the preparation of this report.
	YES	Continuously	Drawing up the annual report, brochure and chart on the quality of beach seawater; Brochure and map of the sea quality is not produced/printed since 2009 due to the reduction of funding in this budget line.
	DA	Continuously	Establishing and maintaining the national Database for input, processing and valorisation of data on the quality of sea bathing water, reporting and providing information to the public; The database was made in 2009-2010, and its maintenance and upgrading is done through the CEA, given that the database is part of the Marine Referral Centre and is a part of the Sea Information System (located at the Institute of Oceanography and Fisheries, Split).
	YES	2011	Drawing up the implementing regulation on the establishment of the framework for action in the Republic of Croatia related to the protection of the marine environment was done in 2011.
	YES	2012	Drawing up the assessment of environmental status and the pressures on the marine Environment was done in 2012.
	YES	2013	The measure Determining the good environmental status of the marine environment, in accordance with the Regulation on the establishment of a framework for the operation of the Republic of Croatia on marine environmental OG136/11, should have been completed by the 15 July 2012 and the funds have been provided in the budget for 2012. However, the funds were subsequently removed.
	YES	2013	The measure Establishing the series of environmental targets and associated indicators, in accordance with the Regulation on the establishment of a framework for the operation of the Republic of Croatia on marine environmental OG136/11, should have been completed by the 15 July 2012 and the funds have been provided in the budget for 2012. However, the funds were subsequently removed.
YES	Continuously	Establishment and further development of the Sea Information System; Database and indicators of the environmental status of the marine environment, mariculture and fisheries; reports on the environmental status of the sea; upgrading of IT support for the purposes of implementation of the Marine Strategy Framework Directive, i.e. the national implementing regulation; The work is scheduled on the database through activities of the Sea referral centre. Upgrade of the Database for the Framework Directive on Marine Strategy foresees the realization of the component II of the Project protection against water pollution in the Coastal Zone 2 IBRD 7640/HR - Programme for the monitoring of the Adriatic Sea, for which the Republic of Croatia received a loan from the International Bank for Reconstruction and Development. Component II of the Contract provides: "Consultancy services for the development of integrated programming platform IPP in the implementation of the Framework Directive on Marine Strategy".	

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
	YES	2014	Adjustment of software support and the modelling and monitoring data from Phase I of the Project for protection against seaside water pollution for use by expert institutions and the interested public Existing numerical models will be upgraded through the realization of the component I of the Project protection against water pollution in the Coastal Zone 2 IBRD 7640/HR - Programme for the monitoring of the Adriatic Sea, for which the Republic of Croatia received a loan from the International Bank for Reconstruction and Development. Realization of this Contract ("Consulting Services for defining the system of monitoring and observation for continuous assessment of the Adriatic Sea") is conducted via MENP from February 2013 to September 2014.
	YES	2013 - 2014	Strengthening the monitoring system for the quality of seaside water (Project for protection against seaside water pollution); For the realization of the Project for protection against water pollution in coastal area of Croatia, is used loan from the International Bank for Reconstruction and Development in the amount of 50% the total amount. It is anticipated that a portion of the Project of monitoring of the Adriatic Sea, will be implemented through the three components in the period from 2013 to 2014. The implementation of the Treaty and components: "Defining the observation system and monitoring system for continuous assessment of the Adriatic Sea, in the within the implementation of the Framework Directive on Marine Strategy", is in progress.
Improvement of student standard and availability of higher education to a larger number of students in the Republic of Croatia	YES	Continuously	The measure Providing state scholarships to full-time students enrolled in university, vocational and postgraduate courses is carried out continuously every year.
	YES	Continuously	The measure Subsidising transportation costs for full-time students and disabled students is carried out continuously every year.
	YES	Continuously	The measure Subsidising meals and accommodation of students in students' and pupils' halls of residence in the Republic of Croatia is carried out continuously every year.
Improve quality of primary and secondary education	YES	Continuously	The measure Increasing the number of children and youth in the educational system is carried out continuously each calendar year.
	YES	Continuously	The measure Developing and implementing subject and inter-subject curricula is carried out continuously.
	YES	Continuously	The measure Implementing the national pedagogic standards in accordance with feasibility coefficients is carried out continuously each calendar year.
	YES	Continuously	Developing the Croatian Qualifications Framework is carried out Continuously through legislative changes from 2012.
	YES	Continuously	The measure Increasing the number of participants in adult education programmes in accordance with the demands of the economy is carried out continuously each calendar year.

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date ³⁴	Comments
	YES	2009/2010	The measure Developing a quality assurance system (state graduation) was carried out in school year 2009/2010.
Continue implementation of the Bologna process	YES	Continuously	The measure Developing professional and university programmes in line with the demands of the economy and the labour market is conducted continuously through the pilot project of program contracts concluded in December 2012 and through the implementation of CQF.
	YES	Continuously	The measure Strengthening the cooperation between the higher education system and the private sector is conducted continuously through a partnership in the development of qualification standard and study programs, and institutionalized through sectoral councils and the National Council for Human Resources Development.
	YES	Continuously	The measure Encouraging and strengthening the integration of universities is conducted continuously through the pilot project of program contracts concluded in December 2012.
	YES	Continuously	Developing a quality assurance system is conducted continuously through the pilot project of program contracts concluded in December 2012 and through the implementation of CQF.
Strengthening the connection between science and research in the service of economic development	YES	Continuously	Encourage the development of technological and scientific infrastructure; In order to foster the continuous development of science and technology scientific and technology infrastructure is systematically funded through the budget, and EU funds will significantly contribute to the national co-financing.
	YES	Continuously	Encourage the commercial application of research findings, and the transfer of knowledge and technology, to ensure development of the economy; Ministry of Science, Education and Sport continuously implements measures to foster the transfer of knowledge and technologies and the commercialization of research projects. The ministry will continue to implement these measures through a series of national and international programs (second technology development project 2012-2017, EU funds).
	NO	III/IV quarter 2013	Networking of existing scientific capacities; Law on Amendments to the Law on the Croatian Science Foundation was adopted only in July 2012. (NN 78/12), and is currently waiting for the Croatian Parliament appoints members of the Board After the Board adopts an Action Plan will be able to invite tenders for a new competitive projects. Part of the required funds is in the State Budget for 2013 directed from projects MZOS on projects MZOS in the fourth quarter of 2012 started with the process of defining criteria and performance indicators for the multiannual institutional funding of science in public research institutes and public universities. There is a decision to prepare a multiannual institutional funding for 2013-2015, which should be adopted by the Croatian Government. Also, in the parliamentary procedure and the Law on Amendments to the Law on Science and Higher Education, which more explicitly defines the ability to be part of the activities in public research institutes and public universities be funded under the agreement. Stated reasons for delays in the implementation of this measure.

Table 10. EU reform priorities

	List of the key measures related to achievement of Annual Growth Survey priorities and main objectives of the Europe 2020 Strategy	The estimated effects of the measures (quantitative and/or qualitative)
1. Pursuing differentiated, growth-friendly fiscal consolidation	1. Measures on the revenue side of the budget	Directing the tax burden from labour to consumption and asset will reduce the negative impact on growth and will have a positive impact on job creation. Changes in the VAT system will abate the consequences of the changes for the socially vulnerable groups of population. Changes in excise duties system, which refer to special tax on motor vehicles, contribute to reducing CO2 emissions. Changes in the income tax system will contribute to increase investments. Expected net fiscal effect amounts to HRK 1.2 billion. The efficiency of tax administration will increase, the possibility of tax evasion will be reduced and a greater financial discipline and better collection of tax revenue will be achieved.
	2. Measures on the expenditure side of the budget	The dynamics of pension is determined by demographic trends, as well as by continuation of indexation of pension gained from the employment system. The expected effect amounts to 475 million in 2013. Enhancing the cost – effectiveness and sustainability of the public health system. Healthcare expenditure will be influenced by the reforms of the hospital network, centralized hospital procurement and remediation of health institutions for which is insured HRK 1.1 billion. Total compensation of employees decreased by HRK 1.8 billion, compared to the previous year. The implementation of active employment measures continues, for which is insured HRK 446 billion, i.e. 24 % more than previous year. It is expected that the total receipts from privatization will amount to HRK 3 billion by the end of the year.
	3. Strengthening of the institutional framework for fiscal policy management	Strengthening fiscal discipline and sustainability and quality of medium-term budget planning. Better compliance with EU legislation.
	4. Improvement of disability pension and professional rehabilitation systems	Reducing the number of disability pension beneficiaries with general inability to work. Increasing the efficiency and transparency of the disability pension system, vocational rehabilitation and medical expertise. The reduction of the shadow economy.
	5. Broadening the circle of pension beneficiaries who may work while receiving a pension	Improving living standards of pension beneficiaries. Encouraging longer participation in the labour market. Reduction of pension expenditures.
	6. Revision of the formula for the adjustment of pensions	Preservation of social adequacy of pensions and long-term financial sustainability of the pension system.
	7. Change of the penalty system for early-age pension	Relieving the pension system by prolonged stay in the work system. Reduction in pension expenses.
	8. Change of the basic pension formula	Maintenance of social adequacy of pensions and long-term financial sustainability of the pension system.
	9. Change of the existing service insurance system with increased duration	Greater financial security workers employed within particularly difficult and dangerous jobs, which represent an increased risk to the health and work ability
	10. Separation of compulsory and voluntary capitalized system	Intensifying investment policy of mandatory pension funds, a more precise definition of their jobs and ensuring a more efficient control of their business.
	11. Introduction of the acknowledgement of the right to a pension supplement in a corresponding percentage for beneficiaries realizing pensions from both compulsory pillars	Recognition of pension supplement to users from both pillars to achieve social adequacy of pensions of those users.
	12. Informatisation of generation solidarity system	Improve the efficiency and transparency of the pension system
	13. Modernization and greater jurisdiction of the institution responsible for keeping the personal accounts of pension insurance fund's members (REGOS) with regard to the exchange of information	Accelerating administrative procedures, reducing red tape and more efficient deployment of funds to personal accounts for mandatory pension funds.

	14. Centralised hospital procurement for hospitals through framework agreements	Preserving financial stability of the health care system through a positive impact on the trend of generation debts of hospitals. Fiscal impact assessment in 2013 amounts to HRK 250 - 350 billion.
	15. Hospital healthcare system master plan	Effective organization and activities of health care institutions. Reduction of natural increase spending on hospital services from 5 – 8 % to 2 – 4 % per year.
	16. Outsourcing of non-medical services in hospitals	Increasing the efficiency and quality of the performance of non – medical services in hospitals. Reducing the costs of non-health workers by 5 – 10 %.
	17. Healthcare informatisation	Improving the efficiency, accessibility and safety of the health system, standardization of business processes and information. Redirecting savings of 1.5 % of the total annual budget of the healthcare system to improve the quality of health care.
	18. Control of expenses for sick leave	Reducing the rate charged to sick leave at the expense of Croatian Institute for Health Insurance by 10 % and the number of unjustified sick level. Increasing the number of people who are able to work. Relieved planning of business processes for employers.
	19. New models of contracting healthcare	Redirecting savings of 5 % of the annual funding of primary health care and 2 % of hospital health care in improving the efficiency of health care. Load Reduction Hospital efficacious treatment of patients at the primary care level.
2. Restoring normal lending to the economy	1. Development of funds for economic cooperation (FEC)	Encouraging economic development and the preservation of existing and creation of new jobs. In 2013 Croatia will participate with HRK 345 million of budget funds.
	2. HAMAG INVEST activities (micro-lending project)	Stronger role of guarantee institutions in financing SMEs. Faster and easier financing of small business. Co-funding research projects in environmental protection and energy efficiency in the amount of 74 million. Micro – credit program for businesses in 2013. Has secured HRK 2.1 million.
	3.CBRD's lending activities	The total amount of the credit is equal to 10.3 billion Euros of which 4. 5 billion for investment of small and medium entrepreneurs. Improved access to finance for small and medium businesses.
	4.Implementation of the Financial Operations and Pre-bankruptcy Settlement Act	Improving liquidity in the economy and a faster return to normal operations and a greater return to creditors. The first projection of expected results compared to open procedures talking about reducing the liquidity of around 10 billion.
	5. Activities of the Republic of Croatia concerning the EIB	The total cost of membership of the EIB, in the period from 1 July 2013 to 31 July 2018 amounts to EUR 207.9 million. Investment in large infrastructure projects and financing for SMEs through credit lines by CBRD.
3. Promoting growth and competitiveness	1. Strengthening of SME competitiveness	Further development of micro-entrepreneurship, entrepreneurship and crafts. Increased number of innovations and commercialised innovations. Growth of export. Increased transfer of new technologies. Increased share of subjects implementing quality norms in the economy. Increased TEA index. Contributing to preservation of cultural heritage. The grants for the programme of incentives to entrepreneurship and crafts (Entrepreneurship impulse for 2013) have been doubled when compared to 2012 and amount to HRK 730.3 million.
	2. Service market liberalisation	Contribution to free and competitive service market. IPA programme project for Croatian administrative capacities development amounts to EUR 222,222 while the co-financing from the state budget amounts to EUR 22,222.
	3. Development of a strategic framework for innovation	Contribution to strengthening the innovation potential of the economy, increased flow of knowledge and cooperation between the business sector and the scientific research community, and contribution to strengthening scientific and technological capacities in both private and public sectors.
	4. Development of strategic framework for education, science and technology	Defined instruments for supporting research and development, and prerequisites for the development of innovative economy.

	5. Identification and removal of administrative barriers to investment	Set-up procedures for efficient identification and removal of specific administrative barriers in realisation of individual projects which will enable the timely realisation of each investment project and whilst impact the improvement of the investment climate in Croatia.
	6. Improvement of the regulatory framework for the development of entrepreneurship and investments	The Strategic Investment Projects Act adopted. Speeding up the processes of obtaining total documentation necessary for the implementation of projects, both governmental and private ones that are of strategic interest for the Republic of Croatia. Increased number of investment projects and increased number of users of incentive measures for investment..
4. Tackling unemployment and the social consequences of the crisis	1. Changes in labour legislation aimed to facilitate conditions for employment, restructuring and enabling better safety of work and for workers.	Support to higher competitiveness and modernisation labour market. Reduction of the existing segmentation in the labour market, dynamisation of the relevant institutional stakeholders and the creation of the legal framework and instruments to correspond to the current changes in the labour market. Support to combating undeclared work. Higher number of employed persons with disabilities and reduced costs in the pension insurance. Insured improved material and legal protection of artisans.
	2. Further improvement of link between the education system and labour market	Creating a high quality replacement for existing employees who retire. Increasing employability and social inclusion, which will be reflected in a reduction in youth unemployment, and increasing the share of people aged between 30 and 34 years who acquire tertiary education to 30 % by 2020. Financing this measure from EU funds in the amount of EUR 18,865,882 and from the state budget in the amount of HRK 5,563,527.
	3. Promotion and improvement of life-long learning concept	Greater flexibility of the labour force in the circumstances on the labour market and an increased number of adults involved in lifelong learning. Increase the percentage of people aged 26 – 64 years participating in education and training. Enabled greater access and contribute to the improvement of post- secondary programs, curricula and programs of non-formal learning. Increasing the number of informal learning institutions that implement the educational sector in cooperation with employers, and the development of programs designed to strengthen key transversal competences. Financing for EU funds in the amount of EUR 7,529,412 and the funds from the budget in the amount of HRK 1,242,422
	4. Deinstitutionalisation of social welfare system	Improving the quality of life of recipients from welfare homes and a better quality of social services in the community. Long-term savings are expected in the budget, as it is placed in an institution expensive form of care.
	5. Improvement of the system of awarding social allowances	Reducing the number of social benefits and consolidating them into one fee. Achieved target assistance to those who need it most. Reducing administration and simplifying the procedure. At the beginning of the introduction of integrated benefits are expected increased costs of reorganization and subsequently reduced administrative costs, and thus saving resources.
	6. Strengthening of preventive activities and development of palliative care	Expected positive effects of improved prevention activities by 2015 are as follows: - Decreased 5-year (2003 to 2008) cumulative incidence of improper nutrition index from 14.4% among men and 9.1% among women by at least 10% - Decreased 5-year (2003 to 2008).cumulative incidence of physical inactivity at leisure with 27.2% among men and 31.1% among women by at least 10% - Decreased 5-year (2003 to 2008) cumulative incidence of smoking from 1.1% among men and 2.3% among women by at least 5% - Reduced total consumption of pure alcohol per capita aged 15 years and over from 12.7 to 11.7 litres - Decreased 5-year (2003 to 2008) cumulative incidence of obesity from 8.7% in men and 20.5% in women by at least 30%) - Expanding the coverage of the target population of the national programs of early detection of breast cancer by 70%, and colon cancer in 45% of the people invited to test and begin a program of early detection of cervical cancer. Improving the delivery system structured and organized appropriate palliative care at the state level.

5. Modernizing public administration	1. Legal regulation of the system of agencies, institutes, funds, centres and other legal entities with public authority	Modern and professional public administration system. Better financial management of public bodies, reducing political influence on operations and enhancing transparency.
	2. Informatisation of public administration	Efficient and transparent functioning of public administration and improving services to customers. Higher quality flow and processing of information, management of ICT policies in one place. The cost of informatisation is estimated at HRK 9,726,000. Development of an information system in construction procedures will shorten the time needed to issue regulations and improve transparency of the process. The cost of introducing ICT systems in construction is estimated at HRK 30,430,000. Establishing a registry of state assets will enable the efficient and transparent management of all state assets and data consistency. The cost of introducing the registry is estimated at HRK 7 million. New functionality in the registry of employees in the public sector and new system of central payroll for employees in the public sector will enable more effective management of human resources and expenditures for employees.
	3. Further strengthening of public administration capacity	Efficient management of human resources, professionalization of state administration. In the next three-year period, the cost of the measure is estimated at HRK 13.8 million.
	4. Further reinforcement of capacity for the absorption of EU funds	Regional and local projects prepared for submission to the calls for co-financing from EU funds. Co-financed projects in the implementation. Trained staff at the regional and national level.
	5. Improvement of land book procedure	Simplified and accelerated land book procedures. Uniform application of procedural and substantive law and standardization of court practices.
	6. Improvement of civil proceedings	Accelerated and more efficient litigation, increased procedural discipline, reducing litigation costs. The cost of informatisation of the judicial authorities in 2013 estimated at HRK 200,000.
	7. Efficient implementation of enforcement proceedings	Achieved a balance between the rights of execution creditor in collection of claims and rights of debtor to maintain their dignity in the legal framework that allows the speed and efficiency at reasonable costs.
	8. Introduction of the IT in the judiciary	Enhancing judicial efficiency, simplifying access to justice system, data transparency and greater efficiency of services.
	9. Rationalization of the judicial network	Rationalization of costs of judicial bodies and faster, more efficient and better services for citizens.
1. Employment	1. Promotion of employment	Increasing employment rate and decreasing unemployment rate. Increasing employment of target groups: young people, persons with disabilities, special groups, long term unemployed, the unemployed Roma minority, the elderly, veterans and employers in difficulties. Mitigate the social consequences of unemployment and the preservation of existing jobs. Improving social entrepreneurship.
	2. Enhancing administrative capacities and ensuring provision of good quality service in Croatian Employment Service	More quality CES service for the unemployed and employers. The cost of the measure in the period 2013-2015 estimated at HRK 9 million.
	3. Further development and institutional support to the Local Partnerships for Employment (LPE)	Quality and innovative services provided by organizations linked to local labour market. Improved employability at local and regional level, especially vulnerable and persons hardly employable in the labour market.
2. Research and development	1. Promotion of scientific excellence, strengthening of national innovation system and support to scientific and research activities in the public sector	Quality and modernized system of science and innovation in public sector. Developed infrastructure in R&D, science and innovation available to public and private sector. Strengthening of human resources in research, science and innovation. Established the system of programme financing founded on the results of each scientific institution.
	2. Strengthening the innovation potential and support to scientific and research activities and the development of new products and services in the private sector	Quality and modernized system of science and innovation in private sector. Better support for R&D in small and medium enterprises. Encouraging higher quality project cooperation between economic sector, R&D centres and universities.

	3. Establishing high technology network for industry and development of sectoral technological platforms	More quality application of new technologies in industry and more successful commercialization of innovations with the aim to strengthen competitiveness.
	4. Networking of public, private and scientific sector through clusters of competitiveness	Contribution to raising sectoral and regional competitiveness and internationalization of individual sectors.
3. Climate change and energy sustainability	1. Further harmonization of the institutional and legal framework for the development of the energy market	Establishing conditions for all consumers that ensure greater availability of energy at the realistic price. Increased security of energy supply and ensuring stable and quality supply with realistic prices for all customers. Higher energy efficiency and higher production of electricity from renewable energy sources.
	2. Energy renovation of buildings, including the increase in the number of nearly-zero energy consumption buildings	Final energy savings from the energy renovation of buildings is estimated: the public sector buildings in 2016. at 148.00 GWh (0.533 BU), and in 2020. 275.00 GWh (0.991 PJ), for residential buildings in 2016. at 2,114 GWh (7.61 PJ), and in 2020. 3554 GWh (12.79 PJ) for commercial the public sector building in 2016. at 413.00 GWh (1.48 PJ), and in 2020. 756.00 GWh (2.72 PJ). By increasing the number of buildings with almost zero energy consumption, the energy savings are expected to be in 2016. around 0.044 PJ (12 GWh) for households and 0.062 PJ (17 GWh) for the service sector (public and commercial buildings), and the expected impact on the energy savings for 2020. PJ is 0.064 (18 GWh) for households and 0.089 PJ (25 GWh) for the service sector. The planned funding on an annual basis for a total cost of reconstruction of building for a period of 4 years amounts to HRK 19,736,400,000.
	3. Setting up of a legal framework for adaptation to climate changes, reduction of greenhouse gas emissions and air protection	The measure aims to support the compliance with the greenhouse gas limit in 2020 compared to 2005 greenhouse gas emissions levels. Preventing or gradually reducing air pollution in order to protect human health, quality of life and the environment in general. The establishment, maintenance and improvement of an integrated air quality management in the territory of Croatia. Ensured public access to information related to air quality, emissions and pollutant emissions projections and the implementation of policies and measures to improve air quality through the information system of air protection.
	4. Harmonization of the legal framework for waste management	Contribution to efficient waste management. Reduced amount of waste disposed in landfills. Reduced the negative impact of waste on human health and the environment.
4. Education	1. Improvement of quality of education and increasing access to education at all levels	Contribution to the creation of highly skilled and adaptable workforce. Establishing a comprehensive and efficient system of ensuring the quality of education at all levels (including the external evaluation and self-assessment). Improving the quality of educational programs, teacher and students competences and increased access of education to adults. Increased percentage of people aged between 30 and 34 years who acquire tertiary education to 30% by year 2020.
5. Fighting poverty and social exclusion	1. Ensuring support to persons with disabilities	Insuring social inclusion of persons with disabilities. Unifying all rights that persons with disabilities attain through more than one system. Homogenising the criteria for forensic expertise, conducting expertise in one place and lowering the cost of expertise.
	2. Development of the system of care for the veterans and the suffering population and the members of their families	Improving services and raising standard of Homeland War veterans and victims and the members of their families.
	3. Development of the housing for rent model	More favourable rental housing for citizens.
	4. Improvement of the quality of life of young people	Enabling young people to participate actively in issues of importance to young people. Increased number and implementation of projects and programs for young people at the national and regional levels.

	List of the key measures in relation to other obstacles to growth	The estimated effects of the measures (qualitative and/or quantitative)
Other Measures	1. Privatisation and restructuring of Croatian shipbuilding industry	More competitive shipbuilding industry. Rationalisation of state budget expenditures. The total receipts from privatization by the end of the year are expected to be in the amount of HRK 3 billion.
	2. Privatisation and restructuring of other state-owned companies	Lowering subsidies from state budget, rationalisation of expenditures. Enhanced competitiveness of companies.
	3. Liberalisation of railway services market	More competitive railroad sector.
	4. Reorganisation of the water utility sector	Improving the quality of services of utility companies. Efficient and economic operation of water supply and sewerage service provider and lower prices of water services and increased quality of water.
	5. Monitoring the amounts of state aid awarded in Croatia	Better efficiency of funds that are directed into economy through subsidies. Strengthening the competitiveness of Croatian economy.
	6. Railway infrastructure development	Improving the quality of railroad transport and services, with enhanced safety, functionality and protection of the environment. Better positioning and integrating, especially at international routes.
	7. Development of infrastructure in maritime and harbour transport	Development of maritime transport and increasing the competitiveness of economy. Increasing traffic and economic cooperation with inner parts of Croatia. Increased safety of Croatian ships and harbours. Built and modernized infrastructure in six Croatian harbours (Rijeka, Zadar, Šibenik, Split, Ploče and Dubrovnik).
	8. Infrastructure development of inland waterways	Better positioning of inland waterways and its integrating in intermodal transport network.
	9. Development of broadband access infrastructure	Increasing the number of broadband connections and density by counties. Increasing the level of knowledge of ICT technologies among citizens. Further development of the information society and knowledge society. Contribution to ensuring effective market competition.
	10. Sustainability of water management development	Increased ability to connect people and businesses on public water supply systems. Increased protection of water and sea from pollution and improving the living standards and conditions for economic development (tourism, sport, recreation). Increasing the protection of people and property from flooding and other adverse effects of water. More stable and safer agricultural production - increased competitiveness of the agricultural sector. Development costs of public sewerage and water protection and the sea amount to HRK 419,944,215. Costs of developing and managing water supply system amount to HRK 10,052,500. Cost of irrigation system and protection from the harmful effects of water amount to HRK 155,195,000. Said funds come from the state budget for 2013. With funds from the state budget projects in the water sector are also financed by the Croatian waters budget, CBRD, EU funds and loans from other international financial institutions.
	11. Improvement and development of the rural infrastructure	Increasing the quality of life and working conditions in rural areas. Contribution to economic growth and development in rural areas.
	12. Amalgamation of average agricultural property	Long-term development of competitive agricultural properties Increasing the use of cultivated land and putting into operation the unused agricultural land. The cost of the measure is estimated at HRK 18,841,821.
	13. Further development agricultural holdings	Increasing the competitiveness of the agricultural sector, reducing of production costs and opening new market opportunities for farmers. Increased quality and safety of food. Increased level of protection of public health and the environment.
	14. Organization of the market of agricultural products	Easier operation and use of trade mechanisms under the common organization of agricultural markets in the EU.

	15. Preparation and implementation of local rural development strategies	Better quality of life in rural areas on the local level. Contribution to an increase of employment.
	16. Integrated physical planning and reconstruction of space	Facilitated the realization of investment in the space for the purpose of utility, energy, transport and other infrastructure. Constructed physical plans of legalized areas. Rehabilitated area by adjusting the network of communal and traffic infrastructure.
	17. Sustainable urban development and urban reconstruction	Improved quality of life in urban areas. Cost of planned activities is estimated to be HRK 2,780,600,000.
	18. Achievement and maintenance of good condition of marine environment and the coastal area	Reducing pollution in the marine and coastal environment in order to safeguard human health, ecosystem and enabling the use of the sea and coastline.
	19. Setting up of areas important for the preservation of endangered and rare species and habitat types EU Natura 2000 and sustainable management mechanisms	Better management of nature protection. Contribution to protection and the survival of target species and habitats.