



REPUBLIC OF CROATIA

NATIONAL REFORM PROGRAMME

Zagreb, April 2014

Foreword

The National Reform Programme of the Republic of Croatia was adopted by the Government of the Republic of Croatia on 24 April 2014. This is the first national reform programme prepared by the Republic of Croatia as a member state of the European Union, as part of a yearly cycle of economic policy coordination on the European level called the European Semester. The document was prepared by the Working Group for the Coordination of Participation of the Republic of Croatia in the European Semester, chaired by the Deputy Prime Minister of the Republic of Croatia and the Minister of Regional Development and EU Funds, and its Operating Team. The Working Group has closely cooperated with the Working Group for the Coordination and Implementation of Monitoring of Reform and Other Fiscal Consolidation Measures for the Period from 2014 to 2016 and its working bodies. The establishment of the mentioned working groups ensured strong political support to the process of participation in the European Semester.

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Abbreviations

AEP	Active Employment Policy
ALMP	Active Labour Market Policy
ARZ	Autocesta Rijeka – Zagreb d.d.
BERD	Business Expenditure on Research and Development
CA	Croatia Airlines
CBS	Croatian Bureau of Statistics
CBRD	Croatian Bank for Reconstruction and Development
CERA	Croatian Energy Regulatory Agency
CES	Croatian Employment Service
CFSSA	Croatian Financial Services Supervisory Agency
CIHI	Croatian Institute for Health Insurance
CJIS	Cadastre Joint Information System
CNB	Croatian National Bank
COFUND	Co-funding of Regional, National, and International Programmes
CPI	Consumer Price Index
CPII	Croatian Pension Insurance Institute
CR	Clearance Rate
CRD	Capital Requirements Directive
CROQF	Croatian Qualifications Framework
CTS	Case Tracking System
DT	Disposition Time
ECFs	Economic Cooperation Funds
ELIXIR	The European Life-science Infrastructure for Biological Information
ERIC	European Research Infrastructure Consortium
ESIF	European Structural and Investment Funds
ESRB	European Systemic Risk Board
ESS	European Social Survey
EU	European Union
FP7	Seventh Framework Programme
GDP	Gross Domestic Product
GERD	Gross Expenditure on Research and Development
GMB	Guaranteed Minimum Benefit
GOVERD	Government Intramural Expenditure on Research and Development
HAC	Hrvatske autoceste d.o.o.
HAMAG INVEST	Croatian Agency for SMEs and Investment
HERD	Higher-Education Expenditure on Research and Development
ILO	International Labour Organization
KET	Key Enabling Technologies
LC(R)SGU	Local and county (regional) self-government units
LR	land-registry
MFIN	Ministry of Finance
NEET	Not in Education, Employment, or Training
NEWFELPRO	New International Fellowship Mobility Programme for Experienced Researchers in Croatia
OG	Official Gazette
PNUSKOK	Police National Office for the Suppression of Corruption and Organized Crime
R&D	Research and Development
RES	Renewable energy sources

RIA	Regulatory Impact Assessment
ROAA	Return On Average Assets
ROAE	Return On Average Equity
RSC	Restructuring and Sale Centre
SAORC	State Attorney's Office of the Republic of Croatia
SAOSPM	State Administrative Office for State Property Management
SFDRI	Single form for the collection of data on paid receipts from income
SHARE	Survey of Health, Ageing and Retirement in Europe
SME	Small and medium enterprises
SPC	Single Payment Centre
STPII	Science and Technology Project II
TA	Tax Administration
TOE	Tonne of Oil Equivalent
USKOK	Office for the Suppression of Corruption and Organized Crime
VAT	Value-added tax

1. INTRODUCTION

Croatia is officially participating in the European semester for the first time in 2014.. The experience acquired from the informal participation in the European semester 2013 was highly beneficial as regards the planning and organisation of this year's process at the national level, whereas the set of conclusions adopted by the Economic and Financial Affairs Council in June 2013, based on the 2013 Economic Programme of Croatia, served as the basis for the structure and the content of the first national reform programme. Important guidelines in the process of preparation of the document were undoubtedly the requirements of the Excessive Deficit Procedure opened for Croatia in January 2014, as well as the findings of the In-Depth Review, which indicate that the Croatian economy is facing a series of challenges which have brought it in a state of macroeconomic imbalance.

The National Reform Programme was prepared in accordance with the Guidance on the content and format of the National Reform Programmes. Thus, chapter 2 contains the main elements of the macroeconomic scenario described in the Convergence Programme, while Chapter 3 describes the reform measures already undertaken and whose implementation will be reinforced in the next period, in four key areas (public finances, financial sector, labour market and competitiveness) and 13 subcategories dealing in more detail with the envisaged reform measures. An overview of all measures is also given in Tables 1 and 4 annexed to the National Reform Programme. The described measures are directly motivated by the sustainability of public debt, the reduction of budget deficit in accordance with the defined procedure, along with the simultaneous creation of favourable conditions for economic recovery and growth, as well as by the reduction of unemployment and mitigation of the social consequences of a prolonged period of recession. Consequently, the following years will be extremely intensive in terms of improvement of the conditions of doing business and the investment climate, strengthening of competitiveness of national production and its export capacities, further rationalisation of expenditure through comprehensive reorganisation and modernisation of the public sector, as well as adaptation of the educational system to the needs of the labour market.

This year will also be intensive with in terms of the improvement of the entire strategic development framework for a series of sectors, as the precondition for a proper adoption of policies, primarily through the adoption of the Strategy of Education, Science and Technology, the Smart Specialisation Strategy of the Republic of Croatia, the National Innovation Strategy 2014-2020, the Strategy of Public Administration Modernisation and the Strategy for Combating Poverty and Social Exclusion. The Industrial Strategy, as a strategic document of great importance, is also in preparation, while its implementation in the period of up to 2020 is expected to lead to an increase of the industrial production volume and labour productivity, as well as an increase and change of the export structure in favour of the export of products of a high added value, while its effects will be measured with respect to the increase in the number of the newly employed (85,619 by 2020, of which at least 30% must be highly educated) and an increase from 16% to 20% of the share of industry in the gross value added of the economy.

Chapter 4 of the document and the accompanying Table 3 present a framework for the implementation of measures and policies oriented towards the fulfilment of the headline targets of the Europe 2020 strategy related to employment, research and development, climate changes/energy, education and the reduction of poverty and social exclusion.

The EU funds have a significant role in the existing macroeconomic circumstances, which are described in more detail in Chapter 5. With respect to the previous pre-accession period, as of 2014 Croatia will make use of several times larger annual allocations, which also represent a significant development potential that will need to be geared towards achieving growth and higher employment, and conformant to the on-going and planned reforms. The technical secretariat of the Working Group has been established within the Ministry of Regional Development and EU Funds, which is also in charge for the overall coordination of preparation and subsequent implementation of projects co-financed from the EU funds, due to the necessity of harmonising to the greatest possible extent the process of programming EU funds for the EU financial period from 2014 to 2020 with the reforms envisaged for the following period, so as to secure additional funds for the support of faster and more efficient implementation of necessary reforms in Croatia.

Chapter 6 presents in more detail the process of consultation on the reform measures with key stakeholders, primarily through their involvement in the preparation of specific legislative packages and the creation of sectoral development strategies.

Due to the complex and demanding process of participation in the European Semester and the resulting preparation of the Convergence Programme and the National Reform Programme, as well as the need for improvement of stakeholder dialogue and coordination regarding questions related to reform measures, not just on the national level, but with the European Commission as well, the work of the Operative Team is coordinated by the Ministry of Foreign and European Affairs, regarding communication with the EC, the Ministry of Regional Development and EU Funds, regarding the preparation of the National Reform Programme, and the Ministry of Finance, regarding the preparation of the Convergence Programme. Considering that this is the first official participation of Croatia in the European Semester, the processes and work methodologies will be systematically upgraded on the basis of the acquired experience and further supported by the development of skills, expertise and competences of the people who are systematically involved in the related tasks.

2. MACROECONOMIC CONTEXT AND SCENARIO

2.1. Macroeconomic outlook for the period covered by the programme

CURRENT MACROECONOMIC TRENDS

The negative economic developments in Croatia have continued in 2013. According to the first assessment of the gross domestic product (GDP), in 2013, economic activity decreased by 1.0% as compared to 2012, which represents a cumulative decrease of 11.9% as compared to 2008. The most significant contribution to the drop of real GDP has come from household consumption (-0.6%) and gross capital formation (-0.2%). In 2013, almost all GDP components have decreased. An increase of 0.5% was recorded only in government consumption, due to payment of debts in the health care system.

The decrease of household consumption by 1.0% is largely the result of the decrease of disposable income linked to the negative trends on the labour market, the discharge of household debts and the generally unfavourable economic situation which has negatively influenced consumer optimism and spending. Gross fixed-capital formations have been reduced by 1.0% as compared to 2012. The reason for this is the delay of investment projects of public companies and reduced investment of the over-indebted private sector, faced with the problem of low home demand and aggravated financing conditions.

Decrease was also recorded with regard to the import and export components. There has been a real year-on-year decrease of 1.7% of the import of goods and services, as well as a decrease of export by 1.8 %. Considering that the decrease of export was more prominent than that of import, the net exports component has negatively influenced GDP growth. Data on trade in goods reveal that, in 2013, export of goods expressed in HRK decreased by 4.1%, while import of goods decreased by 1.7%. The decrease of the export of goods under the conditions of the strengthening of foreign demand points to the continuation of the trend of reduction of the share of Croatian companies on foreign markets. In 2013, the current-account deficit increased by 1.9%.

Observed by production sectors, the real decrease of gross value added was mostly caused by the decrease in construction, the processing industry, as well as mining and extraction. High-frequency data indicate that, at the beginning of 2014, the negative trend has been stopped and a mild increase was recorded in certain sectors such as the industry.

The continued decline of economic activity in 2013 was also reflected on the labour market. The average number of the employed decreased by 2.7%, primarily because of the reduction of employment in the processing industry, construction, commerce, the trades and crafts business and freelance occupations. The average survey unemployment rate amounted to 17.2% in 2013, which is 1.4 percentage points more than in the previous year.

In 2013, the trend of the real decrease of salaries continued, despite their nominal increase. There was a real decrease of the average gross wage by 1.4%, as well as a real decrease of the average net wage by 1.5%.

According to preliminary data, in 2013, a positive balance of the balance-of-payments current account was achieved, amounting to EUR 0.6 billion or 1.3% of the GDP. This was preceded by four years of considerable contraction of the deficit, which amounted to a minor 0.1% of the GDP in 2012. The further increase of the balance of the current account in 2013 was primarily

influenced by the decrease of deficit on the factor income account, due to lower revenue from direct equity investments. The downturn of business results was particularly prominent in activities of financial intermediation, production of oil derivatives and telecommunications. The interest expenses for foreign liabilities were also reduced. Another positive influence on the current account was realised by the continuation of positive trends in the international exchange of services, which primarily refers to the increase of revenue from tourism (by 4.9% on an annual basis). As opposed to this, the deficit in the trade in goods with the abroad has increased due to the decrease of export, which was more prominent than that of import. This was predominantly influenced by unfavourable trends in the trade of other means of transport (mostly ships), whose net exports decreased almost by half as compared to the previous year. The positive balance on the account of current transfers was slightly decreased due to the prominent increase of expenditure (mostly due to payments made to the EU budget) over revenue, while the capital transfers were retained on the level of the previous year.

With respect to foreign markets, the capital flows in 2013 were marked by high indebtedness of the state, which has issued two bonds on the US market (in the value of USD 1.5 billion in April and in the value of USD 1.75 billion in November). At the same time, the credit institutions have continued with the process of debt discharge, reducing their long-term liabilities towards foreign creditors, although at a weaker intensity than in the previous years. Due to ongoing reticence of foreign investors, the inflow of foreign direct equity investments into Croatia was lower than in the previous years. The biggest inflow of foreign direct equity investments was realised through property investments, financial intermediation, retail trade and the production of metal. If transactions related to the conversion of debt into equity are eliminated, new equity investments amounted to only EUR 0.3 billion, compared to EUR 0.4 billion in 2012.

The international reserves of the Croatian National Bank (CNB) increased by 14.9% in 2013, amounting to EUR 12.9 billion at the end of December. The increase of reserves is a result of the inflow of foreign currency due to government indebtedness on the foreign and domestic market, net purchasing of foreign currency from the government and realised profit from investments. The opposite effect was realised by the sale of foreign currency to banks in Croatia and the European Commission (as payments made by Croatia to the EU budget). In the first two months of 2014, the gross international reserve was slightly reduced, amounting to EUR 12.6 billion at the end of February.

The movement of the price competitiveness indicator for Croatian exports in 2013 points to the deceleration or even halting of the trend of strengthening of competitiveness, which was present in the previous several years. Thus, the real effective exchange rate of the kuna with respect to producer prices has additionally depreciated, but at a much lower intensity than in the previous years. As opposed to that, the real effective exchange rate of the kuna with respect to consumer prices has slightly appreciated under the influence of the increase of administered prices, which do not directly influence the prices of exported products. Data on the trend of the real effective exchange rate of the kuna with respect to the unit costs of labour for the overall economy, available for the first three quarters of 2013, indicate that, despite its mild appreciation as compared to the end of 2012, on average, a mild depreciation is still recorded on an annual basis. The trend of export sector competitiveness, measured with respect to changes of this indicator in the industry, might be somewhat more favourable, considering that, in the observed period, the decrease of unit costs of labour in the overall economy on an annual basis was slower than that in the industry.

In 2013, the CNB has continued to support a high primary liquidity of the monetary system, maintaining at the same time a stable nominal kuna-to-euro exchange rate. The policy of high

kuna liquidity enabled the continuation of the expansive orientation of monetary policy, which, under the conditions of unfavourable economic developments, was aimed at influencing the improvement of domestic financing requirements, thereby supporting the recovery of domestic credit financing. The average excess liquidity of the monetary system increased in 2013, amounting to HRK 5.0 billion, while the average overnight rate on the interbank market dropped to the lowest level recorded to date, that of 0.37%. In accordance with the described conditions on the money-market, the CNB reduced the interest rate on overnight deposits of credit institutions with the CNB from 0.25% to 0.00% in April 2013, while in December, the lombard loan rate was also reduced from 6.25% to 5.0%.

The kuna-to-euro exchange rate was stable in 2013 and at the beginning of 2014. During 2013, the nominal daily kuna-to-euro exchange rate ranged between -1.6% to 1.0% with respect to the average annual exchange rate of 7.57 EUR/HRK, indicating a decrease of 0.7% as compared to 2012. In 2013, the basic instrument of monetary and foreign-exchange policy were the foreign-currency transactions of the central bank, which have enabled net purchasing of foreign currency in the amount of EUR 0.3 billion, which has created HRK 2.6 billion of primary money. In the structure of foreign-currency transactions in 2013, purchasing foreign currency was related to transactions with the central government (foreign currency received on the basis of foreign incurrence), while sales of foreign currency were almost exclusively related to the intervention on the foreign exchange market for the purpose of stopping the depreciation pressures in April 2013. Similar trends have continued at the beginning of 2014. At the end of January 2014, the CNB intervened on the foreign exchange market by selling foreign currency to commercial banks in the amount of EUR 0.2 billion, by which part of the foreign-exchange inflow from foreign incurrence of the government in 2013 was directed to the market in the period of seasonal increase of the demand for foreign currency.

The crediting model initiated in mid-2012 by the CNB in cooperation with the Croatian Bank for Reconstruction and Development - CBDR (Economic Development Programme), was completed at the end of 2013. At that time, the CNB initiated a new model focussed on supporting the crediting of companies. At the same time, the reserve requirement rate was reduced, which secured additional sources for commercial banks, for the purpose of crediting companies.

The trend of the monetary and credit aggregates in 2013 continued to reflect a lack of recovery in the real sector of economy, despite highly favourable liquidity. The net foreign assets of the monetary system have increased, due to the improvement of the CNB's foreign-market position, but also the improvement of the net foreign-market position of credit institutions, which were characterised by a less prominent discharge of foreign debt than in the previous years. The net domestic assets of the system recorded a moderate increase, while, with regard to their structure, the increase of loans to the central government recorded the biggest increase, while loans to other sectors (excluding the exchange rate changes and one-time effects) remained almost unchanged. A mild increase of the crediting of companies was recorded in 2013 (2.0%), while the sector of households continued the discharge of debt (-16%). The realised changes of net domestic and foreign assets resulted in the increase of total liquid assets (M4) by 2.9%. A similar trend of monetary and credit aggregates marked the beginning of 2014, therefore, credit activity in the private sector is still attenuated, while the trend of financing the central government through credit institutions has continued to increase.

The average annual rate of inflation of consumer prices decelerated from 3.4% in 2012 to 2.2% in 2013. Weak economic activity and the absence of domestic cost pressures are factors which have contributed to the realisation of a low inflation rate over the past several years. Thus, a negative gap of domestic products has been realised for the fifth consecutive year. Unfavourable conditions on the labour market resulted in a decrease of the nominal unit

labour costs by 0.3% in 2013, following the prominent decrease in 2010 and a very weak increase over the next three years. The decrease of the unit labour costs is primarily a result of a severe drop of employment. Short-term factors have also influenced the deceleration of the inflation rate in 2013, especially the positive impact of the base period (related to the increase of value-added tax (VAT) and certain administrative prices in the first half of 2012) and a positive shock on the supply side, i.e. a drop in the prices of food products on the world market, which was a result of good harvest and which spilled over to the decrease of prices of domestic food products. Moreover, favourable weather conditions in the country (a relatively warm winter) have influenced a year-on-year drop of the prices of fruit and vegetables. Intensified competition and lifted retaliatory duties remaining after the accession of Croatia to the EU have also stimulated the decrease of prices of food. In addition, the inflation pressures from the crude oil global market have decreased. The trend of import prices was also favourably influenced by the appreciation of the average nominal effective kuna exchange rate. The trend of the decrease of the inflation rate continued in the beginning of 2014, while the annual rate of change of consumer prices has dropped to -0.6% in February 2014, from 0.3% recorded at the end of 2013. At the same time, the contribution of all major components of the inflation rate was reduced, mainly that of the processed and unprocessed food products and energy (each by 0.2 percentage points). Considering that the share of the prices of food in the harmonised index of consumer prices was smaller, the annual drop in prices measured according to the trend of the mentioned indicator was less prominent in February, amounting to -0.2%.

MEDIUM-TERM MACROECONOMIC SCENARIO

The macroeconomic projections are based on available statistical indicators released by mid-April 2014 and also contain impact assessments for all economic policy measures. External conditions, such as the movements of relevant bilateral and effective exchange rates, the prices of primary commodities and world economic developments, were adopted from the European Economic Forecast – Winter 2014, published by the European Commission in February 2014. A comparison of the mentioned forecast with the previous forecasts of the European Commission indicates as prominent a minor positive correction of the growth of the GDP of the EU in all years of the forecast period, as well as a mild positive correction of the growth of Croatian export markets, where some of the most important Croatian export destinations (such as Slovenia and Italy) have recorded considerable positive corrections.

The real sector

It is expected that in 2014 the years-long negative trend in the Croatian economy and the stagnation of economic activities, i.e. the real growth of the GDP of 0.0% will be halted. Also expected is the most significant positive contribution to growth from exports of goods and services and the most significant negative contribution from imports of goods and services and consumption by households. Gross fixed-capital formations will also positively contribute to the GDP growth due to investments of the public sector, including public companies. In 2015, a GDP growth of 1.2% is expected, which will accelerate to 1.3 % and 1.5% in the following years. By analysing individual items of the GDP on the expenditure side, it becomes evident that the main driving force of economic growth in the 2015 – 2017 period will be the export of goods and services, accompanied by gross fixed-capital formations, whereas the main negative contributions will come from the import of goods and services and government spending.

In the entire projection period, GDP growth will be limited by a weak dynamics of household consumption. Primarily influenced by continuing unfavourable trends on the labour market and

low levels of borrowing by households, but also negative impacts of some measures of fiscal consolidation, household consumption will continue to record a negative trend in 2014, although its drop will be milder than in 2013. However, in 2015 the beginning of a gradual recovery of consumer trust is expected, prompted by accelerated investment activities and more positive general economic developments, particularly more favourable trends on the labour market. In the following years, a further mild acceleration of household consumption is expected, but its contribution to the economic growth will remain low until the end of the medium-term period. Measures of fiscal consolidation as part of the excessive deficit procedure will determine trends in government spending. However, the multiplier of government spending is lower in the short term than was originally expected due to the structure of the fiscal adjustment. On the other hand, such a consolidation structure could jeopardize the dynamics of potential growth in the long term. Through the entire observed period, the reduction of social transfers in kind, influenced by savings created by an increased efficiency of the health care system, as well as the reduction of benefits to employees due to a drop in employment and a minor increase of labour costs in conditions of a decrease of salaries and an increase of health insurance contributions, will impact a real drop in government spending.

A real drop of intermediate consumption of the general government sector will also contribute significantly to the decrease of government spending in 2016. In 2017, the recovery of economic activities and the end of the excessive deficit procedure could lead to a real drop in government spending.

The growth of gross fixed-capital formations in 2014 and 2015, and to a great extent in the last two years of the observed period, will be a result of new or previously initiated investment projects of the wider public sector (including consolidated investments of the general government sector and public companies). On the other hand, a reduction in private sector investments is expected in 2014, similar to the reduction of the previous year. Namely, private sector investment recovery will be restricted by considerable uncertainty concerning future trends in demand, continuing low levels of business trust indicators, as well as by specific fiscal policy measures adopted as part of the excessive deficit procedure. This is why in 2015 a mild real drop in private sector investment spending is expected, while its delayed recovery is expected in the last two years of the projection period. The predicted strengthening of investment activity in the private sector in the second half of 2015 and the rest of the medium-term period is based on the prominent recovery in domestic and foreign demand and the growth of business optimism, improvements in liquidity in the economy and efforts of the government aimed at creating preconditions for a positive investment climate, and primarily on acts aimed at the stimulation of investment projects and competitiveness. The intensification of the use of EU funds, particularly from 2015, will give a strong boost to investment activities.

Positive economic trends in the international environment, as well as in the economy of the EU, the most important trading partner of Croatia, will lead to the strengthening of foreign demand for domestic goods and services, which is why a proportionally favourable real growth in the export of goods and services is projected. This growth will, among individual items on the expenditure side of the GDP, provide the biggest positive contribution to the economic growth in the entire projection period. In addition to the expected acceleration of foreign demand toward the end of the projection period, such a projection of export presumes the continuation of the implementation of structural reforms, which should produce positive results as early as in the medium term in terms of slowing down the loss of the market share on Croatian export markets. Under the conditions of a mild recovery of final demand, an increase in the import of goods and services is expected in 2014, generated primarily by the

export of goods and services and increased investment activities of the public sector. The net exports will contribute positively to the economic growth in 2014, due to a stronger import of goods and services than export, whereas in the continuation of the observed period net exports will again have a negligible growth.

Despite the stagnation of economic activity, a continuation of negative trends is expected on the labour market. A belated mild recovery of labour market indicators cannot be expected until 2015. According to projections of indicators from the EU Labour Force Survey, the survey unemployment rate is expected to rise to the level of 17.9% in 2014, then drop to 17.7% in 2015 and to 17.3% and 16.5% in the last two years of the observed period. Considering the belated recovery of employment, average labour productivity will gradually drop from 2.4% in 2014 to 0.1% in 2017. In accordance with these trends, labour unit cost will drop mildly in 2014, and over the rest of the projection period it is expected to gradually increase to 2.4% 2017.¹

Monetary and foreign exchange policy and inflation

Risks for a more significant recovery of domestic credit activities are still prominent. The weak recovery of the real sector and the low credit demand, especially the unfavourable trends on the labour market, the unwillingness of banks to take over risks and the still present trend of the deterioration of the quality of bank assets are all factors limiting the growth of credit activities. In such conditions, the projection of trends of domestic credit and monetary generators for 2014 is slightly more favourable compared to the results of the previous year, and credit activity might be stronger in 2015.

A significant deceleration of inflation from 2.3% in 2013 to 0.6% in 2014 is expected. In accordance with the expected reduction of prices of raw materials on the global market², a drop in food prices is expected in 2014 and a slowdown in the rise of energy prices compared to the previous year. Domestic inflationary pressures might also weaken, due to low household consumption and a mild reduction of the labour unit cost. Aside from this, other factors affecting inflation trends in 2014 will be the increase of the VAT medium-rate from 10% to 13%, the increase in health insurance contributions, increase in fuel and tobacco product excises as well as the increase of administratively regulated water prices. Their joint contribution to the increase of the inflation rate in 2014 should amount to 1.1 percentage points. In the first quarter of 2014 the annual rate of consumer price index changes amounted to -0,3 %, and in the rest of 2014 inflation will rise under the influence of the above mentioned administrative changes, as well as due to the disappearance of the basic effect of raw material price cuts on the global market in 2013. In the remaining years of the projection period, an acceleration of inflation is expected, to the levels of 1.6% in 2015 and 1.9% in 2016 and 2017, impacted by the recovery of foreign and domestic demand and the weakening of imported inflationary pressures.

Table 1: Macroeconomic framework 2014 – 2017

¹ In the calculation of the average labour productivity and labour unit costs, the methodology of the European Commission was used, in accordance with Eurostat data.

² According to the latest projections of the European Commission, the prices of primary commodities on the global market will decrease by 3.7% in 2014.

	2013	Projection 2014	Projection 2015	Projection 2016	Projection 2017
GDP – current prices	328,252	331.413	341,063	351,791	363,988
GDP - real growth (%)	-1.0	0.0	1.2	1.3	1.5
Households consumption	-1.0	-0.8	0.4	0.8	1.3
Government consumption	0.5	-0.9	-0.9	-1.9	0.0
Gross Fixed Capital Formation	-1.0	1.9	5.7	5.7	4.3
Exports of goods and services	-1.8	2.0	2.7	2.9	3.0
Imports of goods and services	-1.7	1.3	2.9	3.2	3.4
Contributions to GDP growth	-1.0	0.0	1.2	1.3	1.5
Households consumption	-0.6	-0.5	0.3	0.5	0.8
Government consumption	0.1	-0.2	-0.2	-0.4	0.0
Gross Fixed Capital Formation	-0.2	0.3	1.1	1.1	0.9
Exports of goods and services	-0.8	0.9	1.2	1.3	1.4
Imports of goods and services	0.7	-0.5	-1.2	-1.4	-1.5
Growth of GDP deflator (%)	0.9	0.9	1.7	1.9	1.9
Growth of CPI (%)	2.2	0.6	1.7	1.9	1.9
Growth of employment (ILO)	-3.9	-2.3	-0.4	0.5	1.4
Unemployment rate (ILO)	17.1	17.9	17.7	17.3	16.5

Source: CBS, MFIN, Eurostat, CNB

3. IMPLEMENTATION OF THE COUNTRY-SPECIFIC RECOMMENDATIONS

The reform measures that Croatia is undertaking and plans to undertake in the future period are presented in four key areas – public finances, financial sector, labour market and competitiveness, and 13 subcategories. Such a structure is modelled to a great extent after the structure of the conclusions of the Economic and Financial Affairs Council of June 2013. The policies undertaken in response to the results of the in-depth analysis are presented in the same areas. The information presented below is dealt with in more detail in the annexes of the National Reform Programme, in Tables 1 and 4.

3.1. Public finances

3.1.1. Institutional framework for fiscal policy management

The Fiscal Responsibility Act³ introduced fiscal rules and rules for enhancing fiscal discipline and the obligation of issuing fiscal responsibility statements for heads of state budget users and local and regional government units. In the second semester of 2013 the preparation of further amendments of the Fiscal Responsibility Act began. In this context, the following activities are envisaged in 2014 for the purpose of further developing and advancing the institutional framework of public finances: harmonising the Regulation on the completion and submission of fiscal responsibility statements and of reports on the application of fiscal rules with the provisions of the Act on the Amendments to the Fiscal Responsibility Act⁴, reinforcing the independence of professional bodies responsible for the monitoring of the implementation of the Fiscal Responsibility Act, and the improvement of fiscal statistics.

ACT ON AMENDMENTS TO THE FISCAL RESPONSIBILITY ACT

The amendments of the Fiscal Responsibility Act changed the fiscal rule that envisaged decreasing expenditures of the general budget reported as a share in the GDP by at least one percentage point annually until the primary balance at the level of zero or in a positive amount (in nominal terms) is achieved. In the prevailing conditions of decreasing economic growth, such a rule, due to its procyclical nature, would only additionally jeopardise the chances of growth. Harmonisation with EU requirements regarding the new framework for economic policy management in the EU, aimed at reinforcing the implementation of the Stability and Growth Pact, was an additional reason for the changes of the rule.

The target value of the new fiscal rule is the medium-term budget goal that will be achieved according to the adjustment plan, at the recommendation of the EU Council, where the year-on-year decrease of the structural balance must amount to at least 0.5% of the GDP. The medium-term budget goal is determined as a value of the structural balance that ensures that the deficit of the general budget does not exceed 3% of the GDP, and the public debt does not exceed 60% of the GDP. As regards sustainable expenditures management, a provision was introduced that the annual increase of expenditures of the general budget may not exceed the reference potential growth rate of the GDP, determined by the EC, increased by the expected price growth, where exemptions are allowed for particular categories of expenditures. Also, the Act on Amendments to the Fiscal Responsibility Act defines circumstances in which the fiscal rule does not apply, provided that this does not jeopardize fiscal viability in the medium term.

³ OG 139/10

⁴ OG 19/14

These circumstances are limited to cases of disasters and greater economic disorders that have a significant financial impact on the state of the general budget, which is in accordance with the provisions of the Stability and Growth Pact. The occurrence of such circumstances is determined by the Fiscal Policy Committee. This fiscal rule will apply only after the government adopts the Adjustment Plan aimed at attaining the medium term budget goal, at the recommendation of the EU Council.

With regard to EU accession, Croatia was obliged to completely transpose the provisions of Council Directive 2011/85/EU as part of the "sixpack" into the national legislation by the end of 2013, thus achieving harmonisation with the budgetary discipline in accordance with the requirements of the Treaty on the Functioning of the EU. The provisions of the Directive have been partly transposed into the Act on Amendments to the Fiscal Responsibility Act, which defines standards of fiscal planning in documents that refer to the preparation of the state budget, as well as the budgetary projections adopted by the government or which the government proposes to the Croatian Parliament for adoption. Furthermore, these amendments also prescribe the obligation to publish information on the effect of tax expenditures on revenues, as well as information on contingent liabilities with a significant effect on the budget (e.g. state guarantees), which also follows from Council Directive 2011/85/EU.

The amendments to the Fiscal Responsibility Act also introduce the obligation of completing and submitting fiscal responsibility statements⁵ for trading companies and other legal persons owned by Croatia as well as for trading companies and other legal persons owned by one or more units of local and regional self-government, thus requiring and creating a transparent financial management and control system. In order to accentuate the reliability of these fiscal responsibility statements and to reinforce the system of responsibility, alongside political responsibility, misdemeanour responsibility was introduced for top officials at all levels.

The Act on Amendments to the Fiscal Responsibility Act prescribes a deadline of ninety days (end of April 2014) in which the government shall coordinate the Regulation on the completion and submission of fiscal responsibility statements and of reports on the application of the fiscal rule with the provisions of the Act. The regulation will prescribe the form and content of the report on the application of the fiscal rule and the documentation based on which the fiscal responsibility statement is to be given.

The Fiscal Policy Committee was established pursuant to the Decision of the Government of the Republic of Croatia on the establishment of the Fiscal Policy Committee in 2011. The Decision also appoints its members. Because of the need to reinforce the independence of the Committee, in accordance with the provisions of Council Directive 2011/85/EU, and the strengthening of the role of the Committee as a supervisor of the application of the Fiscal Responsibility Act, the Croatian Parliament adopted a Decision establishing the Fiscal Policy Board as a working body of the Croatian Parliament. The Board of the Croatian Parliament has replaced the previous Parliamentary Committee for Fiscal Policy as the independent body for the monitoring of the implementation of the Fiscal Responsibility Act. The primary task of the Board is to monitor the application of the fiscal rule and to examine and compare macroeconomic and budgetary projections of the government with the most recent projections of the EU.

⁵ The Fiscal Responsibility Act introduces the fiscal responsibility statement. Heads of state budget users and extrabudgetary users and heads of users of the budgets of units of local and regional self-government as well as heads of units of local and regional self-government must sign this statement once an year, confirming that in their work they ensured the legal, dedicated and purposeful use of funds as well as the efficient and effective functioning of the financial management and control systems within the framework of the funds determined in the budget or financial plan.

FISCAL STATISTICS

Regarding the measure of improving fiscal statistics, the main goal is the improvement of the quality of data in financial reports, which, among other things, are used as one of the key bases for the preparation of the fiscal report prescribed by the excessive deficit procedure. Recommendations in this sense were provided in the Conclusions and action points resulting from the pre-accession dialogue visit of Eurostat in June of 2013 (action point 5).

In the second semester of 2013 the strategy of the financial reporting system reform was prepared, determining the measures for the improvement of financial reporting on the budget and budgetary and extrabudgetary users with regards to the following:

- addressing the burden of reporting units, achievement of statistical and consolidation goals,
- adjustment of reporting deadlines with the requirements of the fiscal report,
- improvement of data quality in financial reports.

The reforms primarily concern supplementing the content of the account plan, revising the content and deadlines for the submission of financial reports, simplifying the consolidation via a better distinguishability of data of the budgets of units of local and regional self-government in financial reports from the data of the users of their budgets. All preparations, including the adoption of regulations, must be carried out in 2014 because of the implementation of the new solutions from the beginning of 2015, that is in 2014 as far as the account plan is concerned. This is why initial activities have already been undertaken on the action plan (the Ministry of Finance in cooperation with the Croatian Bureau of Statistics and the CNB for the optimisation and for statistical needs). The other segments of the reforms will also be tackled in cooperation.

The reforms include a continuous improvement of the new logic controls in forms of financial reports in order to ensure a high quality level (already carried out on two occasions in 2013). The possibility of improving the methods of collecting and storing the financial reports, for example via an Internet-based application, will also be considered.

3.1.2. Tax system

Activities of taxation policy are undertaken in order to reduce the budget deficit and to reduce grey economy via changes in tax regulations and procedures in the work of tax authorities and the reorganization of the Customs Administration and the Tax Administration.

REDUCTION OF BUDGET DEFICIT

From January 2014, the reduced VAT rate was increased from 10% to 13% for specific goods and services. With this measure, an increase of budget revenues on the basis of VAT is planned in the amount of HRK 600 million annually. Namely, the range between the highest tax rate of 25% and the reduced rate of 10% was greater than such ranges in other EU member states, which is why this measure brings Croatia closer to the practice of other EU member states.

The amendments to the Act on Games of Chance ⁶ passed on 01 April 2014 introduced the taxation of gains from games of chance exceeding HRK 750 (until now only gains exceeding

⁶ OG 41/14

HRK 30,000 were taxed). Annual revenues in the amount of HRK 500 million are expected (for 2014, the expected effect amounts to HRK 300 million since the measure is applied from the second quarter).

On 01 April 2014 the health insurance contribution was increased from 13% to 15%. An increase of revenues in the amount of HRK 1.6 billion for 2014 and HRK 2.4 billion for 2015 is expected. The increase of the contribution follows efforts to restructure the health care system. The paying of contributions directly to the Croatian Institute for Health Insurance (CIHI) is planned, which would lead to a higher quality level of the management of revenues and expenditures in the health sector.

The introduction of an ad valorem property tax from 01 January 2016 would annually add about HRK 1.5 billion to the budget. With the introduction of an ad valorem property tax, the following two existing levies would be abolished: utility-service fee and property tax on vacation homes (revenues of local self-government units).

Through the amendments of the Income Tax Act, the introduction of the taxation of interests on savings is planned from 01 January 2015. According to an estimate based on available data, revenues of about HRK 300 million are planned. In the analysis of the introduced taxation, special attention will be given to monitoring the nonfinancial impact of the introduction of the savings interest tax with respect to the conduct of the holders of the savings accounts towards financial institutions.

The adoption of an Ordinance that would enter into force on 01 May 2014 is considered, which would increase the licensing fee for the right to the economic use of spectrum frequency bands for public mobile networks. According to estimates based on available information, revenues of about HRK 350 million are expected annually.

In 2014, amendments to the article of the Corporate Income Tax Act that defines the use of profit tax reliefs will be considered, which would prescribe that reliefs can only be used for the part of the profit registered as capital stock or invested in the fixed assets. Should the amendments be introduced in 2014, the effects of the reduction of the use of such tax reliefs would be reflected in 2015 with an increase of tax revenues in the amount of about HRK 500 million.

With the amendments of the income and profit taxation, reliefs for areas of special state concern and hilly areas no longer apply since 01 January 2014. Tax reliefs for assisted areas started to apply, but in a reduced amount. The full effect of these amendments will be evident in 2015 through a reduction in expenditures in the amount of HRK 490 million.

REDUCING THE GREY ECONOMY VIA AMENDMENTS OF TAX REGULATIONS AND CHANGES IN THE PROCEDURES OF TAX AUTHORITIES AND THE REORGANISATION OF THE CUSTOMS AND TAX ADMINISTRATIONS

With the goal of suppressing the grey economy and tax evasion, and strengthening fiscal discipline, in December of 2012 the Act on the Fiscalisation of Cash Transactions ⁷ was passed. The fiscalisation refers to a group of measures applied in order to secure an efficient monitoring of cash transactions. During 2013, fiscalisation was implemented in three stages. After the first year of application, the true results of the fiscalisation will become evident through the submission of annual tax returns (income tax returns and profit tax returns) for

⁷ OG 133/12

2013. A better collection of VAT, profit tax and income tax is expected. Collected data pointed to patterns of illegal conduct, and addressing this pattern through fiscalisation will allow better planning and the focusing of tax inspections, which will enable other public bodies to determine potential irregularities. It is expected that the measure will bring about an annual increase of collected tax revenues of about HRK 1 billion.

In addition to the primary objective of reducing the grey economy, in January of 2014 a legal framework for the introduction of a new uniform form for the collection of data on paid receipts from income was introduced with a view to reduce administrative costs and simplify the procedure of submitting tax returns (the JOPPD form). This form replaces five existing forms. It allows for real-time information on the payment of taxable and non-taxable receipts, which allows for swift reactions of the Tax Administration (TA) in case of the non-payment of wages or non-payment of contributions. The data from the form allows a comprehensive review of the income and receipts of individuals, which enables a better implementation of the other tasks of the TA: control of the origin of assets, the right to tax exemptions and reliefs in the tax system, as well as social benefit rights.

The new Tax Administration Act⁸ introduces changes in the organisation and powers of the TA with the aim of increasing the efficiency of this institution, which contributes to a better establishment and collection of tax revenues, the reduction of the grey economy, the reduction of the operating costs of the state administration and businesses, as well as to a level of certainty in the collection of planned budget revenues. In 2014, activities in the TA will be organised according to the principle of functionality, that is to say activities of national significance will be carried out at the central level, activities of regional significance at the level of regional offices, and activities of local significance at the level of local offices. The new organisational model of the TA comprises a rationalisation of the network of offices - the reduction of the number of regional and local offices. Instead of the previous 20, five regional offices were established (Centre, North, East, West and South) with headquarters in Zagreb, Varaždin, Rijeka, Split and Osijek. In addition to this, local offices were harmonised with regard to their size and the workload of officers, and were also organised in accordance with the principle of functionality. The number of local offices was also reduced from 124 to 55. Future activities of the TA in the field of administrative cooperation and exchange of information are aimed at the development of administrative capacities and further international cooperation as an important instrument in the prevention of international tax fraud. The new organisation will be accompanied with IT support in terms of risk analysis, which will be realised through a project with the World Bank during the 2014-2016 period.

The reorganization and restructuring of the Customs Administration will ensure an efficient implementation of the collection of revenues and customs control at the external borders of the EU and on the territory of the Customs Union, strengthen the functioning of the Customs Administration as a tax authority for an efficient and comprehensive control of the circulation of goods, transactions in the circulation of goods and provision of services, secure a better collection of budgetary and other revenues as well as improve the excise control system and controls carried out in accordance with special regulations. At the same time, over the long term, better control of the implementation of regulations on the prohibition and prevention of unregistered business activities will be ensured as well as better control in the detection and prevention of all forms of prohibited and illicit trade, which, in turn, will ensure a reduction in occurrences of tax evasion and suppression of the grey economy. The reorganisation of the Customs Administration has led to the consolidation of organisational units according to the principle of rationality and flexibility - 176 organisational units ceased to operate (services,

⁸ OG 148/13

departments, customs houses, customs offices, customs units). The activities of the units were completely reorganized in that they were structured according to levels of complexity. Due to this, instead of the previous 7 customs houses, 4 regional customs offices were established, which perform activities at the regional level; instead of the previous 203 customs offices and customs units, 18 customs offices and 10 border customs offices were established, which perform activities at the operational and local level, whereas the Central Office of the Customs Administration performs activities at the national and international level. The reduction of material costs and employee expenditures for the period from July 2012 to 01 January 2014 amounts to HRK 10 million. The redefinition and extension of the activities of the Customs Administration is a result of the new Customs Service Act⁹ which also defines the application of all e-customs systems.

3.1.3. Public companies

RESTRUCTURING OF PUBLIC COMPANIES

Activities concerning the restructuring of public companies primarily concern the process of restructuring the companies Hrvatske autoceste d.o.o. (HAC), Autocesta Rijeka-Zagreb d.d. (ARZ), HŽ Cargo d.o.o., HŽ Putnički prijevoz d.o.o. and Croatia Airlines d.d. (CA). The restructuring process of these companies includes the rationalisation, reorganization, modernisation and improvement of all business processes as well as the outsourcing of non-core business activities into separate trading companies in order to privatise them.

These changes are essential in order:

- For the public companies to adjust to their business environment,
- To increase the competitiveness of public companies,
- To ensure the survival of public companies on the open market, and
- To reduce the need of public companies to borrow in the financial sector.

In the field of road transport, in the companies HAC and ARZ, through an operational restructuring, the activities of the toll collection and routine maintenance were outsourced into a joint specialised company, whereas the parent companies retained the core business activity - control of management, design and construction of motorways. The monetization process is under way, which will be implemented through the granting of a concession, and the concession holder will become the designated competent authority for the activities of toll collection and maintenance. With the completion of this process by the end of 2014, the payment of the concession fee into the state budget in the amount of approx. HRK 22.5 billion (EUR 3 billion) is expected. After the collection of this revenue, at the beginning of 2015, these funds will be used for the early loan repayment of unfavourable loans guaranteed by state guarantees, which will reduce liabilities based on state guarantees in the same amount. Furthermore, with the implementation of the monetization process, HRK 900 million (EUR 120 million) of the annual revenues of HAC from excise duties and fuel fees will be redirected into other transport infrastructure projects concerning state roads and railway infrastructure.

The companies HŽ Cargo and HŽ Putnički prijevoz are undergoing a restructuring and privatisation process, with emphasis on retaining the core business activity. The goal of the restructuring is to prepare the companies for market liberalisation of rail services and raise

⁹ OG 68/13, 30/14

the efficiency of their business operations, given that they, when compared to companies operating in the EU, show much weaker results.

In HŽ Cargo, the restructuring will be implemented through recapitalisation, a redundancy programme and the incorporation and/or sale of subsidiary companies. In the first stage of restructuring, the company will be additionally capitalised with the amount of HRK 800 million, 800 excess employees will be made redundant, which will reduce labour costs. For the financing of the restructuring programme, a new state guarantee loan in the amount of HRK 250 million will be approved. During 2014, the privatisation of the company RŽV d.o.o. Čakovec and the incorporation of the companies AGIT d.o.o. and OV d.o.o. into HŽ Cargo are planned. Also planned is the sale of assets of subsidiary companies that are not used for performing of core business activities. After the completion of the restructuring process, there is a possibility of privatising HŽ Cargo.

The restructuring programme of HŽ Putnički prijevoz comprises a reduction of operating costs through the procurement of new trains, which will ensure a better-quality transport service along with reduced environmental pollution due to the new eco-technology of traction generating units and the use of electric motor drives. Integrated transport with other transport modes will reduce total transport costs at the company level. The provision of transport services that are of a general economic interest for Croatia (so-called public service obligation contracts - PSO) is an integral part of the restructuring programme and the signing of a ten-year contract is expected, after obtaining EC approval.

The restructuring programme of CA of 27 June 2013 was approved by the Agency for the Protection of Market Competition. The programme is carried out in accordance with special EU regulations for the sector of air transport, which refer to capital investments, guarantees and loans in air transport. The envisaged duration of the restructuring programme is five years, from 2011 to 2015, and the total costs of the restructuring programme are estimated at HRK 1.6 billion. Thanks to the recapitalisation by the government and the Zagreb Airport, the implementation of the revenue management system and the reduction of the aircraft and equipment groundhandling costs, the conclusion of a new collective agreement, the closing of two representative offices abroad, and the revision of a procurement contract for four A319 aircraft, the expected goals will be met. Other expected effects of the implementation of the restructuring programme are financial stabilisation and consolidation and the complete takeover of the existing financial obligations, for which, so far, state guarantees have been invoked. In 2014, the CA will independently finance existing liabilities for loans, which will positively impact the public debt, and for 2013, a profit of about HRK 0.6 million is expected. The financial stabilisation and consolidation of CA should significantly facilitate the privatisation process and make CA more attractive on the market.

MANAGING THE DEBT OF PUBLIC COMPANIES

The total debt of public companies¹⁰ of HRK 81.9 billion represents a burden in the further implementation of active business policies, which manifests itself in the price of new loans, as well as a burden in the provision of public services. This particularly concerns public companies that manage and build infrastructure and transport operators in air and railway transport. This is the result of the failure to carry out indispensable restructuring processes, the postponement of which negatively affected the investment potential of public companies through necessity of new loans. The government, as the majority owner, undertook a series of measures during 2012 and 2013, aimed at restructuring of these companies in order to create

¹⁰ The analysis includes 59 trading companies and other legal persons of strategic and special interest for the Republic of Croatia, and the data used for the analysis are preliminary data on the business operation of these trading companies.

conditions for the implementation of efficient business policies with the aim of stabilising their business operations and strengthening investment capacities.

The total planned loan repayments in 2014 amount to HRK 14.4 billion, exceeding last year's repayments by approximately HRK 2.4 billion. HAC and ARZ have contributed to this significantly since their annual repayment amounts have increased by HRK 3.8 billion, amounting to almost HRK 7 billion in 2014, which comprises almost 50% of the total repayments planned for 2014. The monetization process will have a positive impact on the total amount and structure of the debt with expected revenues of about HRK 22.5 billion (EUR 3 billion), which would reduce the total debt of public companies by 27.4% by the end of 2014, when the debt would then amount to HRK 59.5 billion. Total new debts, excluding the debt of HAC and ARZ, amount to HRK 12.3 billion in 2014. This represents an increase of about HRK 2 billion compared to 2013. The total new debts, excluding HAC and ARZ, exceed the envisaged repayment of debts maturing in 2014 by HRK 4.8 billion.

While analysing the public company debt management policy, it is important to take into consideration the allocation of new debts with respect to the planned investments. Total investments for 2014 are planned in the amount of HRK 12.9 billion, which represents an increase of HRK 3.3 billion or 34.2% compared to the investments in 2013. Funds for these investments are partly from internal resources, and partly from EU funding, which will favourably impact the structure of total debts of public companies in the future periods.

Along with the expected favourable structure of the debt of public companies, during 2014 some costs will increase in specific areas because of the implementation of restructuring measures and related financial activities, which will ultimately have a positive effect on revenues and on the level of state subsidies. It is estimated that in 2014 subsidies will be reduced by 7% compared to the previous year, with a simultaneous increase of profits of 15.3%, and a reduction of losses of 82.6% on an annual basis, as well as an increase in the share of investments in total revenues from 18% in 2013 to 30.3%.

CONTROL OF BUSINESS OPERATIONS OF PUBLIC COMPANIES

Pursuant to the provisions of the Companies Act¹¹, the management board of a company is responsible for the business operations of a company, and the management board members are obliged to manage the business activities with the diligence of a conscientious business operator in good standing. The supervisory board of a company supervises the management of the company and gives its approval of the decisions of the management board. The state as the owner appoints its representatives to the supervisory board of trading companies and other legal persons of strategic and special national interest for Croatia¹² and in this way participates in the decision making and the management. Consequently, the management and supervisory board are responsible for the business operations of a company and the taking of appropriate measures and activities, for which they answer to the owner. The representatives of the state in supervisory boards have the responsibility for implementing the decisions and requirements of the state as the owner.

In order to establish an efficient management of public companies, a comprehensive monitoring, analysis and reporting system concerning their business operations will be

¹¹ OG 152/11

¹² OG 120/13

established, aimed primarily at liquidity, financial stability (optimal financing structure and regularity in the servicing of existing debts), investments and the monitoring of the implementation of the restructuring process, which will allow for a sound basis for decision-making aimed at an efficient management, the reduction of losses and the creation of a sustainable framework of business operations and the definition of business policies.

The Act on the Execution of the State Budget introduced the obligation of trading companies and other legal persons of strategic and special national interest for Croatia to pay a part of their profit into the state budget, as well as the obligation of agencies, institutes and other legal entities with public authority established by Croatia that do not have the status of budget user, to pay part of their surplus revenues into the state budget.

The decision on the payment of the funds is passed by the government as a measure for the reduction of the excessive deficit. The fiscal impact of this measure is estimated at HRK 500 million in 2014.

The management of public companies is part of a wider framework established with the aim of rationalising state-owned property management, presented in Box 3.1. State Property Management.

Box 3.1. State Property Management

In June 2013, the Strategy for Management and Disposal of Property owned by the Republic of Croatia was introduced for the period from 2013 to 2017, where a significant step was made in the direction of establishing a comprehensive property management system to be used in the interest of economic development. In 2013, data on the property owned by the Republic of Croatia were first made publicly available through the State-Owned Property Register (<http://podaci.duudi.hr/>). Also, a detailed property management plan for the property will be introduced by the end of April 2014.

The State Administrative Office for State Property Management (SAOSPM), within the owner's management activities concerning property in the form of stocks and equity shares of trading companies and other legal entities of strategic and special interest for Croatia, performs the assessment of efficiency of the above companies in the context of rationalisation of their business activities. This includes the reduction of the surplus of employees, rationalisation of all operating costs, reduction of overtime work and costs, cancellation of fringe benefits, reduction of salaries based on managerial contracts, bans on employment above the certain number of workers. For that purpose it prepares documentation for the Commission of the Government of the Republic of Croatia for the management of strategic trading companies and real estate which bring the conclusions and propose them to the government for final adoption. As a part of business operations regarding management and disposal of real estates, the SAOSPM will try to implement the replacement of joint ownership shares, revoke co-ownerships, rationalise the use of apartments for government officials' purposes, rationalise the use of commercial properties in such a way that residential issues of state administration bodies are dealt with by taking the commercial properties on lease only if the SAOSPM does not have the adequate premises which are owned by Croatia, try to avoid transfer of real estate from the ownership of Croatia as much as possible, reduce the number of donation decisions, use the institute of usage, rent, building permissions, easement rights and similar as much as possible, as well as reduce the number of residential facilities which are being used by the State Administration Bodies, officials and guests, according to the defined criteria.

In 2013, the SAOSPM has issued a public tender for the sale of ownership shares/stocks for 4 trading companies, of which one - Croatia osiguranje d.o.o. - was realised.

The Restructuring and Sale Centre (RSC) manages the stocks and equity shares in trading companies owned by the Republic of Croatia which are not established as companies of strategic and special interest for Croatia, as well as the stocks and equity shares in trading companies owned by the Croatian Pension Insurance Institute (CPII) and the State Agency For Deposit Insurance and Bank Rehabilitation for stocks and equity shares in trading companies which it acquired during the rehabilitation and privatisation of banks, except the trading companies whose management and use are regulated by a special law. As of 31 December 2013, a total of 561 trading companies were under the jurisdiction of RSC, performing business activities in Croatia's total nominal portfolio value of HRK 6,306,483,035. The sale of stocks and equity shares is possible by means of a public tender procedure, public call for proposals, collection of public tender offers, offering the stocks on the organised capital market, accepting the offer during the takeover of joint stock companies, direct sale and pushing out the minority shareholders.

In 2013, the RSC has announced the sale of stocks/equity shares of 101 trading companies in total, of which the stocks/equity shares of 66 trading companies in total were sold. Also, the bankruptcy or liquidation procedures were started for 22 trading companies. The realised sales revenue in 2013 amounted to

3.1.4. Pension system

The goal of the reform measures within the pension system is achieving long-term sustainability of the system and harmonising it with the economic capacities of the state, while at the same time maintaining a minimum level of adequacy of the pensions.

Order is introduced to the pension insurance system, currently regulated by 16 different regulations. In January of 2012, one of these regulations was abolished – the privileged pensions of representatives in the Croatian Parliament. Amendments of the legal framework (the new Pension Insurance Act¹³, the Obligatory Pension Funds Act¹⁴, the Voluntary Pension Funds Act¹⁵ and the Pension Insurance Companies Act¹⁶), which entered into force on 1 January 2014, improved the system of penalizing early retirement and rewarding late retirement. The maximum reduction of early retirement pensions amounts to 20.4%, and the maximum increase of pensions to 9%. A higher level of penalization would be counter-productive since the achieved savings would only manifest themselves later as costs of the social welfare system. Only 12.8% of pensioners go into retirement with a full working record of 40 years, and the already unfavourable ratio of the number of insured persons and pensioners worsened even more in 2014, due to years of economic crisis and the loss of workplaces, decreasing to 1.15:1. The harmonisation of the retirement age for men and women is under way (the retirement age of women is to gradually increase to 65 until 2030). The retirement age for both men and women will be gradually raised to 67 until 2038. All of these measures stimulate staying in the labour market longer and going into retirement later.

By the end of the year, the separation of pensions acquired on the basis of general regulations from those based on special regulations will be complete. This way, the sources of financing for these pensions (contributions or state budget) will be known. A 10% reduction of privileged pensions exceeding HRK 5,000 (war veterans' pensions and other pensions acquired on the basis of special regulations) in January of 2014 created direct savings for the budget in the amount of HRK 300 million, and changes in the method of pensions adjustment will bring about considerable savings for privileged pensions in the following years, whereas the pension adjustment of general pensions will ensure their adequacy.

A new system for controlling the procedures of acquiring disability pensions has been established as well as reviewing those already acquired, while the occupational rehabilitation system is being improved. Obligatory medical assessment every 3 years has been introduced for beneficiaries of disability pensions as well as the possibility of *ad hoc* control assessments. Croatia has the largest share of disability pensions in the EU (in 2010, the expenditures for disability pensions in Croatia amounted to 3.24% of the GDP or 29.6% of the total pension expenditures¹⁷, while in the same year in the EU-27, the expenditures for disability pensions amounted to 1.1% of the GDP or 9.73% of the total pension expenditures¹⁸). These measures will reduce the share of disability pensions, and part of the beneficiaries of disability pensions will return to the labour market. The content of decisions for acquiring disability pension entitlements have been changed. Now, such decisions indicate which types of activities the worker can still perform, allowing employers to reassign employees to another more suitable position. Stricter controls of the conditions for acquiring disability pension entitlements halved

¹³ OG 157/13

¹⁴ OG 19/14

¹⁵ OG 19/14

¹⁶ OG 22/14

¹⁷ Source: Croatian Pension Insurance Institute

¹⁸ Source: The 2012 Ageing report

the number of persons acquiring such pensions in 2013 compared to the year before, and the total number of disability pensions was reduced by 13,000 or 4.6%.

The reform is also aimed at returning a part of the pensioners who acquired their age pension to the labour market by allowing them to work part-time while retaining their pension. Plans to extend this right to other categories of pensioners are under way.

The separation of the voluntary from the obligatory capitalised system allows members of the obligatory pension funds, who obtain their pension based on special regulations, to leave such funds and transfer their assets to the state budget, which will create revenues of HRK 2.8 billion in 2014 and HRK 2.2 billion in 2015. As a result of this measure, additional revenues of about HRK 400 million are expected from such contributions annually, starting this year. The establishment of special portfolios in the obligatory pension funds will create greater revenues from younger members of the fund, whereas for older members a more conservative approach is planned, increasing their social security.

Changes of the obsolete system of early retirement are under way, and they will include a review of the working conditions of professions currently enjoying early retirement benefits on the basis of extended duration of insurance periods and changes of the existing obligatory capitalised system.

The introduction of benefits for beneficiaries, who acquire their pensions from both obligatory pension insurance pillars, is being considered in order to ensure the adequacy of pensions for future pensioners.

The computerisation of the generation solidarity system is under way, aimed at the modernisation of the existing business processes and the improvement of the satisfaction of the beneficiaries of the system (on-line registration of insured persons etc.).

3.1.5. Healthcare system

The key goals of the healthcare system reform, defined in the 2012-2020 National Healthcare system Development Strategy, are the following:

- Improvement of coherence and continuity in the healthcare system,
- Harmonisation and quality improvement of healthcare,
- Increase of the efficiency and efficacy of the healthcare system,
- Improvement of availability of health care, and
- Improvement of health indicators of the population.

Measures comprised in the National Reform Programme contribute differently to the achievement of these goals and will have a positive impact on the reduction of total expenditures and the expenditures for the healthcare system.

The 2014-2016 National Development Plan for clinical hospital centres, clinical hospitals, clinics and general hospitals in the Republic of Croatia (National Plan) represents the basis for the reorganization and restructuring of the hospital system, which is one of the priority measures in the healthcare system (Box 3.2. 2014-2016 National Development Plan for clinical hospital centres, clinical hospitals, clinics and general hospitals in the Republic of Croatia). The implementation of the National Plan will increase the availability of hospital healthcare and the efficiency of the operation of hospitals. An integral part of the

development of hospitals, as well as the entire healthcare system, is also the further development of the information-communication systems and applications for the support of processes and procedures in the healthcare system. In Croatia, advanced information systems like the "e-prescription" and the "e-referral" already exist in biochemical laboratories, and in the last year new systems like the "e-waiting list", "e-appointments", "e-hospital referral" and business intelligence systems have been introduced as pilot programmes.

Alongside the development of new information-communication systems in the healthcare system, the already existing systems are continually being developed and improved in order to improve their functionality, safety and interoperability. Ultimately, all new or improved information-communication systems are aimed at improving and harmonising the quality and availability of healthcare. The computerisation of the healthcare system will create tools for more successful implementation of other measures envisaged by the National Reform Programme. Contracting primary healthcare based on measurable efficiency and quality indicators, already introduced last year, will be supported by the new information systems for monitoring chronic noncommunicable diseases, which represent the greatest disease burden in the population of Croatia. In addition to this, additional incentives for the development of collective practices will be established as they are an important and purposeful form of integration in primary healthcare.

Controls of the expenditures for sick leave will also be continued. Intensified controls have already reduced expenditures for sick leave in 2013 by HRK 106 million, which represents a decrease of 0.24%, and the efficiency of these controls will be additionally increased through the creation of IT solutions for the monitoring of forms approving temporary work incapacity, aimed at early detection of deviations from usual forms and early controls.

Furthermore, the formation of medication prices on the medication list of the CIHI will reduce the amount of expenditures for prescription medication, primary healthcare and hospital healthcare.

A significant portion of the measures envisaged by the National Reform Programme in the field of the healthcare system is partially or completely within the scope of competence of the CIHI. Separating CIHI from the state treasury system, which is one of the reform measures, will allow for greater freedom and flexibility in the operation of CIHI, and a more complete utilisation level of the resources planned for the healthcare of insured persons.

The restructuring of the healthcare system is accompanied by an increase in health insurance contributions from 13% to 15%, increasing state budget revenues, which will be used to finance the implementation of measures within the reform of the healthcare system.

Box 3.2. 2014-2016 National Plan for the development of clinical hospital centres, clinical hospitals, clinics and general hospitals in the Republic of Croatia

Hospitals are the largest part of the Croatian health system, not only with respect to the number of health and non-health workers employed in them, but also with respect to their share in total healthcare expenditures. The existing hospital system in Croatia, designed and established more than 50 years ago, and based on large and acute stationary capacities, does not manage to effectively and efficiently satisfy the hospital healthcare needs of the population, since development of the hospitals during the recent decades failed to follow significant changes in demographic and epidemiological properties of the population, as well as in medical technologies. The growing share of older population and persons infected by chronic non-communicable diseases demands longer care of lower intensity, which is thereby also cheaper than the one provided in existing acute stationary hospital departments. On the other hand, development of medical technologies enables a large number of therapy practices to be performed within the modality of a daily hospital or daily surgery, without admitting the patients to the stationary department, which also results in savings. In general, the costs of the intervention/surgery per day make 40-60% of the total stationary treatment costs. The increase of daily procedures by 15-20% within the period of three years can generate the savings of 50% in such cases, and consequently the savings of 5-7% in total healthcare system budget.

Increase in the number of patients processed in daily hospitals and daily surgeries, together with the increase of average occupancy rate of hospital beds to the optimum 85 % and decrease of average duration of stay in hospitals by 10-30% will increase the flow of patients and enable significant reduction of acute stationary capacities in hospitals, without endangering the availability of hospital healthcare. The change of modality of hospital treatment also positively affects the quality of healthcare, because the risk of hospital infections is lowered by avoiding the unnecessary hospitalisations. Therefore, the capacity expansion of daily hospitals and daily surgeries is planned in all hospitals which provide acute medical treatment, and the emphasis will be on disciplines and procedures having the largest potential for transition from acute stationary to daily forms of treatment. Implementation of the National Plan until 2016 will reduce the number of acute stationary beds by 32% on average, while the number of beds in daily hospitals for the same period will increase by 44%, and the number of beds for extended, long-term and chronic treatment by 186%. During the next three years, harmonisation of the average rate of acute stationary beds occupancy towards the optimum 85 % is expected, as well as the reduction of the average stay in hospitals by 10-30%, for all hospitals. The National Plan also defines the reduction of these categories at the level of hospitals themselves, as well as the particular activities in them.

Besides the changes in modality of hospital treatment, functional hospital integrations are also planned, which would rationalise hospital operation by means of redistribution and concentration of hospital services, better use of all contracted capacities, increased mobility of health and non-health workers within the functionally integrated hospitals, as well as the avoidance of unnecessary duplication of expensive and sophisticated diagnostic and therapeutic procedures within short geographical distances.

The 2014-2016 National Plan for the development of clinical hospital centres, clinical hospitals, clinics and general hospitals in the Republic of Croatia is one of nine long-term reform fiscal consolidation measures for the 2014-2016 period. In order to ensure successful implementation of these measures, the government decided to establish a Working group to coordinate and implement the monitoring of reform and other fiscal consolidation measures for the 2014-2020 period, thereby providing a strong political support to the implementation of these measures. At the operational level, hospital managements encompassed by the National Plan will prepare their implementation projects, which will be reviewed and adopted by the Ministry of

3.1.6. Social welfare system

In addition to essential strategic changes established by the new Social Welfare Act¹⁹, which entered into force on 1 January 2014, such as the assurance of a minimum living standard of the most endangered part of the population, facilitating access to social welfare rights and improving the system of awarding social benefits, the social welfare system is also going through structural administrative operation reforms. These structural changes will be achieved

¹⁹ OG 157/13

through a series of mutually connected reform measures included in the National Reform Programme.

The Social Welfare Act introduces a guaranteed minimum benefit (GMB), which unifies four social welfare benefits (social assistance benefits, two war veterans' benefits and the extended unemployment benefit). This unification has opened the possibility of simplifying the procedure of administrating, directing and controlling benefits and serves as a basis for the implementation of the Single Payment Centre (SPC) - a one-stop-shop that serves as the single administrative point in the relation between citizens and the state in the field of the realization of rights to benefits (Box 3.3. Single Payment Centre). The project will contribute to the reform by determining permitted limits of social benefits and/or other groups of benefits on other bases for the purpose of a better financial control and fiscal viability. The SPC is an integral part of the project of the modernisation of the social welfare system, which will be carried out with support from The World Bank loan via technical assistance and consultancy services, as well as infrastructure investments in the amount of EUR 70 million for the modernisation of the social welfare system.

Another part of the project is coordinating different benefits so as to avoid overlaps, and connecting information systems on the basis of further upgrades of the SocSkrb system. The SocSkrb electronic system keeps records of all beneficiaries and enables, via the personal identification number, the search of all data from the database of Ministry of Internal Affairs, the Tax Administration and the Financial Agency in order to accelerate administrating benefits and preventing irregularities.

With respect to the care for the elderly and disabled, the reform is aimed at changing the model of financing social services so as to allow equal access to the network of social services to all service providers under same financing conditions. Services will be financed in accordance with a determined methodology for the calculation of service prices, and the previous (generalised) financing model according to expenditures will be abolished.

These measures, together with the 2014-2020 Strategy for Combating Poverty and Social Exclusion in the Republic of Croatia as the basic document, serve as a basis of a systematic approach of all relevant stakeholder to dealing with issues of poverty and social exclusion and the modernisation and increase of the efficiency of the social welfare system.

Box 3.3. Single Payment Centre

The primary objective of the Single Payment Centre (SPC) concept is to create a single administrative point for citizen-state relations in the area of realisation of the rights to various benefits with a social component or of social character. More than 400 different regional offices of the Croatian Institute for Health Insurance, Croatian Pension Insurance Institute, Croatian Employment Service and Social Welfare Centre are currently used for the administration of only four benefits (social assistance benefits, unemployment benefits, maternity benefits and child support benefits). Standardising, unifying and merging the processes will simplify and accelerate the administrative procedures, providing the beneficiaries all the required services at one single location, which would also improve the effectiveness of control and monitoring of those funds.

The project is divided in three phases. Phase 1 represents the administration of GMA (N1), which integrates earlier social assistance benefits, prolonged unemployment benefits and two war veterans' benefits. In Phase 2, additional 3 allowances will be included into the GMA through the SPC (N4), followed by the inclusion of surcharges (N+) from the portfolio of 65 remaining benefits for the citizens which are subject to merging. The significant reduction of administrating costs and increase of control and monitoring functions will result in overall rationalisation of the system, and its monetary effect on the rationalisation, i.e., the reduction of total expenses for social benefits, ranges between 10-15%. Pre-financing in the amount of EUR 890,000 will be used to equip the SPC and prepare the action plan.

The SPC network has been defined; it consists of 126 centres (state administration offices) across Croatia and one in the City of Zagreb, which will start their payment of social benefits from October 2014. Until then, administration and payment of the GMA are still within the competence of the Social Welfare Centres. Defining the legal grounds and conditions for merging the benefits is ongoing, and several regulations were amended for that purpose (the Child Support Act, the Maternity and Parental Benefits Act, the Act on Employment Mediation and Unemployment Rights). Also, the interdepartmental team for administration of unemployment benefits was established, which will join the SPC during 2015 and 2016 as a part of the N4 phase. By the end of 2016, new benefits to be placed under the competence of the SPC will be determined.

In order to ease the exchange and flow of data and to ensure the operability of the system, it is necessary to implement the technical prerequisites for the administration of the benefits. The existing application of the system, SocSkrb, will be extended in order to unify the electronic application for the administration of benefits within the SPC. The new applications of the Management Information System One-stop-shop will integrate the SocSkrb system in such a way as to include all data regarding the existing benefits and then also all the other benefits to be placed under the competence of the state administration offices such as the SPC. This will be realised by the end of 2015.

The final goal of this measure is to unify a single procedure for the realisation of different types of benefits, system modernisation, cost reduction, efficiency increase and reduction of system misuse as a result of its fragmentedness. Completion of measure implementation is expected during 2016.

The SPC is one of nine long-term reform fiscal consolidation measures for the 2014-2016 period. In order to ensure successful implementation of these measures, the government decided to establish a Working group to

3.2. Financial sector

The reduction of the share of credit institutions in the total assets of financial intermediaries continued in 2013, with the share of all intermediaries - banks, savings banks and housing savings banks decreasing. Nevertheless, with a share of 72.8% of financial assets at the end of December of 2013, banks still dominate the financial sector of Croatia. Contrary to this, the share of obligatory and voluntary pension funds is on the rise ever since 2007, whereas insurance and re-insurance companies as well as factoring companies record a somewhat slower growth, reaching the highest share in the last five years.

Table 2: Structure of the financial sector (in HRK million, % and number of total assets, at the end of the period)

	2008			2009			2010			2011			2012			2013		
	XII			XII			XII			XII			XII			XII		
	amount	%	num	amount	%	num	amount	%	num	amount	%	num	amount	%	num	amount	%	num
Credit institutions																		
1. Banks*	369,955.05	76.8	33	378,726	75.3	32	391,060	75.3	32	406,903	75.7	31	399,888	73.9	30	398,118	72.8	29
2. Savings banks	137.95	0.0	1	155	0.0	2	11	0.0	1	35	0.0	1	27	0	1	16	0.0	1
3. Housing savings banks*	6,965.46	1.4	5	6,738	1.3	5	6,881	1.3	5	7,847	1.5	5	7,456	1.4	5	7,561	1.4	5
Insurance corporations and pension funds																		
4. Insurance and re-insurance corporations	25,690.09	5.3	29	28,806	5.7	30	30,115	5.8	27	31,923	5.9	28	34,050	6.3	28	35,799	6.5	28
5. Mandatory pension funds	22,590.93	4.7	4	29,265	5.8	4	36,328	7.0	4	41,067	7.6	4	51,134	9.4	4	58,238	10.6	4
6. Voluntary pension funds	948.04	0.2	21	1,363	0.3	21	1,760	0.3	21	1,969	0.4	21	2,429	0.4	23	2,703	0.5	22
Other financial intermediaries																		
7. Open-ended investment funds	9,890.23	2.1	126	12,042	2.4	128	13,674	2.6	124	11,929	2.2	121	12,962	2.4	114	13,257	2.4	89
8. The Fund for Croatian Homeland War veterans and Members of their families**	2,400.42	0.5	1	2,223	0.4	1	2,005	0.4	1	1,446	0.3	1	1,134	0.2	1	972	0.2	1
9. Closed-ended inv. f. and venture capital funds	1,895.58	0.4	11	2,138	0.4	12	2,233	0.4	15	1,985	0.4	14	2,140	0.4	14	1,869	0.3	11
10. Leasing companies	35,067.93	7.3	26	33,666	6.7	26	28,988	5.6	26	25,886	4.8	25	22,237	4.1	25	19,732	3.6	23
11. Factoring companies	6,342.89	1.3	13	7,007	1.4	15	5,748	1.1	19	5,801	1.1	17	7,212	1.3	16	7,987	1.5	14
12. Credit unions	n.a	n.a	n.a	515	0.1	33	530	0.1	23	569	0.1	22	602	0.1	26	660	0.1	26
Total (1+2+3+4+5+6+7+8+9+10+11+12)	481,885	100.0		502,643	100.0		519,333	100.0		537,359	100.0		541,272	100.0		546,911	100.0	

* = supervisory data (figure may differ from monetary statistics due to consolidation)

** = Since 14 April 2008 the members of fund are permitted to sell shares. Prior to this date, the fund was closed for payments.

Source: CNB

BANKING SECTOR

At the end of 2013, 35 credit institutions operated in Croatia: 30 banks (including one savings bank) and five housing savings banks. Compared to the end of 2012, the number of banks decreased by one because of the opening of bankruptcy proceedings in one bank at the end of September of 2013, while the number of housing savings banks remained unchanged.

At the end of 2013, the share of the two biggest banks in the financial assets amounted to 43.4%, and of the five biggest to 74.4%. Foreign-owned banks had a share of 89.8% in the total financial assets of banks. The share of domestic state-owned banks amounted to 5.2%, and of domestic privately owned banks to 5.0%. The total assets of banks at the end of 2013 amounted to HRK 398.1 billion which was 0.4% less than at the end of 2012. This decline is the result of several factors and changes in the methodology, i.e. regulations. The greatest single factor was the above mentioned bankruptcy of one bank. The increase in corrections of the asset value due to a more active evaluation of collateral, which stimulated more strict regulations on the classification of risk groups in October of 2013, had only a somewhat lesser impact. Primarily influenced by the revised regulations on classification, but also due to a more active role of the owner in the portfolio review, the coverage of off-balance liabilities with corrections in value and reserves increased. This increase led to considerably higher costs of reserves, which strongly burdened the profit of banks. In addition to this, interest revenues of

banks continued to decrease, which means that the profit of banks took a sharp decline, and the profitability indicators, ROAA and ROAE, decreased to 0.3% and 1.3%. 15 banks reported losses before tax, one more than in 2012. However, the capacity of capital to absorb the unfavourable profit trend is still adequate. The capital adequacy ratio remained at the level from the end of 2012 (20.9%), and due to the high share of first-class capital, the core capital ratio was at the level of 19.7%. The banks managed to alleviate the effects of the decline of interest revenues with savings on common overhead costs and by paying out loans on the domestic and foreign financial market, especially towards majority foreign owners, whose sources were reduced by 7.6%.

The majority of prudential requirements that credit institutions are obliged to meet are prescribed by the new Capital Requirements Regulation (CRR)²⁰ and the most recent (fourth) version of the Capital Requirements Directive (CRD IV)²¹. Both regulations started to apply on 1 January 2014. Croatia harmonised its legal framework with the new CRD IV by adopting the Credit Institutions Act²² at the end of 2013 and by amending the existing or adopting new bylaws. Furthermore, the political agreement between the EU Council and the European Parliament on the Bank Recovery and Resolution Directive and the Regulation on the Single Resolution Mechanism represents the main guideline for the further adaptation of the existing legal framework of Croatia. Also, preparations for the start of the Single Supervisory Mechanism (SSM) are under way. For now, Croatia will not participate in the operation of the SSM, in other words, the CNB will remain the supervisor of credit institutions in Croatia. However, it expressed its support to this mechanism and intends to join it in the future. At the beginning of 2014, the EU activated the final reform package focusing on the resolution of the issue of banks that are “too big to fail, too big to save”. The proposal is only at the initial stages of development, so the government and the CNB are preparing to join this issue.

Besides the above indicated changes in the regulation of the bank system, the legal framework was also changed with the adoption of the Financial Stability Council Act in accordance with the recommendations of the European System Risk Board (ESRB 2011/3), and the role of the Council is primarily forming macroprudential policy. An additional step in the improvement of the conditions of doing business is the planned adoption of the new Interest Rates Act during 2014, which would simplify the legal processing of this issue, and partially reduce borrowers' costs in case of overdue payments.

In order to preserve the financial stability and an efficient supervision of entities within their scope of competence, the CNB and the Croatian Financial Services Supervisory Agency (HANFA) signed a Memorandum of Understanding for financial crisis management (CNB, HANFA, Ministry of Finance). Also, CNB concluded a series of bilateral agreements with competent supervisory bodies from other states.

NON-BANKING SECTOR

Regarding the non-banking sector, dynamic business activities are expected in the pension funds considering the possibilities of the more open and liberal investments and establishing sub-portfolios. Also, the adoption of the Factoring Act will establish a framework for the business operations of factoring companies and allow an appropriate and efficient monitoring

²⁰ Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

²¹ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (1)

²² OG 159/13

of their operations. In addition to this, the new Leasing Act²³ facilitates the business activities of leasing companies and improves existing legal solutions concerning monitoring and risks. The insurance sector is stable, but there is significant room for growth in the field of life insurance. Finally, the results of activities of investment funds fluctuate, but there are no systematic problems in their business operations. The adoption of the new Alternative Investment Fund Act²⁴, which entered into force on 1 July 2013, simplified the possibility of investing into venture capital projects for entrepreneurs at the initial stage.

3.3. Labour market

3.3.1. Labour market flexibility and mobility

The primary objectives of the labour market reform include mitigating the impacts the economic crisis has had on the labour market, preserving jobs, increasing labour market flexibility, enabling atypical forms of employment as well as reducing and simplifying administrative procedures, while promoting social dialogue on the branch level, improving communication with representative unions and the process of collective bargaining and concluding collective agreements, as well as contributing to a stable environment for employers while preserving social peace.

In order to achieve the specified objectives, the amendments to the Labour Act²⁵ in June 2013 made the requirements and limitations concerning the duration of a fixed-term employment contract more liberal, a monthly limit in regard to overtime work was abolished, while the procedure of collective dismissal was shortened and simplified. The new Labour Act, currently being passed, includes a change in the institution of employment contract termination, regulations concerning working hours, the institution of performing work outside one's workplace, working through agencies for temporary employment, and working part-time.

The Act on Criteria for the Participation in Tripartite Bodies and the Representativeness for Collective Bargaining has abolished the unlimited validity of expired collective agreements, while enabling re-contracting, i.e. terminating public service collective agreements. The new legal framework will further improve representativeness, collective bargaining, as well as conclusion of collective agreements.

As of 31 December 2013, the public was consulted and a public discussion was held in regard to the Draft Proposal of the Act on Job Retention Aid, where the Draft Proposal was evaluated as ready for being passed into the government and the legislative processes. Unlike prior measures, the legal arrangement for the allocation of aid aimed at job retention will provide employers with more flexibility in using aid both during and after the process of restructuring, while the workers will have their employability and position on the labour market improved. Furthermore, it will effectively retain jobs and prevent entry into unemployment, and sustain the existing level of employment while maintaining income security for workers and their families. The Act is also designed to encourage cooperation between employers and worker representatives in reaching agreement concerning job retention aid, ensuring social peace and a stronger social partnership at employer level.

In order to ensure quality in vocational rehabilitation services and encourage employment of persons with disabilities, the Act on Vocational Rehabilitation and Employment of Persons with

²³ OG 141/13

²⁴ OG 16/13

²⁵ OG 73/13

Disabilities²⁶ was put into effect on 1st January 2014, while an Institute for Expert Evaluation, Vocational Rehabilitation and Employment of Persons with Disabilities has been established. Taking into consideration the innovation in the system, it is expected that the employability of persons with disabilities will improve. The conditions for their equal participation on the labour market will be secured as the impediments are removed, equal opportunities for work and employment secured, and the right to vocational rehabilitation ensured, all the while determining the measures and incentives for their employment.

As of 1 April 2014, the basic rate for calculation of government official salaries was reduced by 6%, as per the Decision on reduction of the basic rate for calculation of salaries of government officials²⁷. Moreover, the right to a salary raise based on years of service has been abolished, pursuant to the Act on Reduction of Rights to Salary Increase Based on Years of Service²⁸, otherwise determined by means of collective agreements to amount to 4, 8 and 10% for the employed in state and public services.

3.3.2. Ensuring relevance of education for labour market needs

In order to align education with labour market needs, new analytical, process and other capacities will be created for preparation of occupational and qualification standards within the framework of the Croatian Qualification Framework (CROQF) contributing to the competitiveness of Croatia. While the Act on the CROQF was passed in 2013, the Ordinance on the CROQF Register is planned for the second quarter of 2014. In 2014, all information about competences required for performing work on specific jobs will be collected by surveying employers, which will, then, be used to develop specific occupational standards. Sector profiles will also be developed to help determine the demand for occupations in the economy, based on historical data and future needs and demands of the labour market. In addition, an IT support system will be set up for supporting applications for occupational as well as qualification standards as well as the establishment of the CROQF Register with 3 sub-registers. The register will be public, freely used to provide information about existing standards. A new set of occupational standards, qualification standards and education programmes will also be developed aimed at reducing the skill gaps on the labour market thereby improving employability and mobility of the working population. Furthermore, in the second quarter of 2014, the National Human Resources Development Council, will be appointed by the Croatian Parliament with the function of monitoring the impact of policies of relevant ministries on human resource development in view of national priorities. Moreover, five sectoral councils are planned, which will provide expert assistance in evaluating proposed occupational and qualification standards and initiate their entry into the CROQF Register.

Considering the importance of preparing occupational standards for future skills needs, due emphasis is given to the sectoral, analytical and strategic foundation, and in order to justify the preparation of the document and entry of the occupational standard into the CROQF Register, priority will be given to occupations which are relevant in the context of the Smart specialisation strategy of Croatia.

3.3.3. Efficiency of labour market institutions

²⁶ OG 157/13

²⁷ OG 31/14

²⁸ OG 41/14

Within the overall aim of improving efficiency of labour market institutions, providing quality individual services to employers and unemployed persons via the Croatian Employment Service (CES) will lead to reduction in frictional unemployment through better coordination of the supply and demand of labour through improving implementation and monitoring of business processes in the CES and via developing e-services for users on national and local levels. In order to strengthen the capacities and ensure more professional service, the CES is currently in the process of reorganization which includes expanding its organisation form to include youth centres and career counselling and guidance centres. Furthermore, training programmes for specialised counsellors have been developed and will be implemented for work with groups with special needs on the labour market. The CES portal for career development will be put into experimental use by the end of 2014 showing employability indicators, duration of unemployment, total employment and unemployment rates, by occupation, county, provide data on salaries, educational institutions and training programmes. In 2013, there were 34 contracts signed within the Local Employment Development programme (Phase I) for grant support, while 2015 will see securing further financing for projects in accordance with the priorities as set in the county's HRD strategy, and there will be projects of capacity building of local employment partnerships.

3.4. Competitiveness

In the context of strengthening competitiveness, Croatian authorities are securing conditions for further reduction of the indebtedness level for the corporate sector, further market liberalisation (Box 3.4. Market Liberalisation), enhancement of business environment, and the modernisation of mechanisms of public administration operation towards the business sector, whereby the reform measures in this field are complimentary to labour market reforms and improvement of efficiency and scope of Active Labour Market Policy (ALMP) measures.

INDEBTEDNESS OF THE CORPORATE SECTOR

The 2008 economic crisis brought about a decrease in the competitiveness of business entities in Croatia, thus causing an increase in their total indebtedness. The insolvency and long-term account blocking of business entities, which generate internal irrecoverable debt, have very negative consequences on the optimal functioning of the entire economy. At the end of 2011, there were a total of 72,654 accounts blocked, belonging to business entities employing 61,066 workers, with the liabilities amounting to HRK 44.5 billion. The negative situation required establishing an effective and efficient legal framework with respect to the limited statutory implementation time frame for resolving financial burdens of the debtor, for the purpose of their renewed participation in economic activities.

The implementation of the insolvency procedure reform as an important tool in stimulating economic recovery will enable entrepreneurs to continue operation through debt restructuring and business plan redefinition. An effective application of the law regulating the procedure of tackling insolvency will provide the opportunity to retain the position on the market only to those entrepreneurs who have a sustainable plan regarding business activities and employment preservation.

The Act on Financial Operations and Pre-Bankruptcy Settlements²⁹, which was put into effect in October 2012, is designed to restructure companies with economic potential, preserve jobs and exclude from the market those entrepreneurs who cause a great damage to the market by performing various economic and legal works, while incapable of meeting their own obligation. Measures related to financial restructuring have been specified based on the established time frames and consequences of non-fulfilment of capital commitments, with the aim of establishing the renewed liquidity and further business operations. The Act considerably cut down the time for dealing with the issue of company insolvency, but introduced the possibility of financial restructuring for insolvent enterprises through agreements with creditors, within a 135-day period as determined by the Act.

Furthermore, the Act now stipulates the obligation of initiating a pre-bankruptcy settlement within 60 days after the business entity is evaluated as insolvent, whereas a 120-day time frame is prescribed for the procedure completion. Alternatively, insolvency proceedings with characteristics of a liquidation procedure are set for implementation, with respect to much shorter time frames following the predetermined receivables and other relevant facts. For liabilities less than HRK 2,000,000 in worth and subjects with fewer than 30 employed, a shortened pre-bankruptcy settlement procedure has been designed, with a prescribed time frame for finalisation set to a 100-day period. The settlement is concluded before a court of law within 15 days following the submission of a proposal and the restructured subject can resume operation. In case of discontinuance of the pre-bankruptcy settlement proceedings, the

²⁹ OG 108/12, 144/13, 112/13

bankruptcy proceedings are initiated with respect to the time frames already defined. If a settlement is not reached, the pre-bankruptcy settlement is consequently initiated, with respect to the acceleration of the bankruptcy procedure.

Since the Act on Financial Operations and Pre-Bankruptcy Settlements was put into effect, pre-bankruptcy settlements have ostensibly impacted a total reduction of insolvency in Croatia, starting from 1 October 2012 up to today, in the amount of HRK 9.8 billion. According to the data provided by the Financial Agency, as of 14 March 2014, there were 6,323 requests for a pre-bankruptcy settlement submitted, with a total liability of HRK 56,201,450,895.21 and a total employee number of 48,084. Out of the specified number of submitted proposals, as of 14 March 2014, a total of 918 pre-bankruptcy settlements have been formed, for the total amount of liability of HRK 16,535,064,278.32. The debtors to have concluded pre-bankruptcy settlements employ a total of 17,595 workers. On the other hand, in 3,698 cases, the plan proposed was not accepted, the request for settlement was denied, or the procedure was brought to a stop, for these cases further bankruptcy proceedings are imminent. These cases involve a total of HRK 13.2 billion and around 10 thousands employees. The remaining 1,707 cases include cases currently in initiation procedure or cases already initiated but waiting a vote regarding the plan. The caseload in question involves 20 thousands employees and HRK 26.4 billion in liability.

The resolution of insolvency in companies takes place on two levels – enabling financial restructuring for entrepreneurs for the purpose of reinstating their liquidity and solvency, with the resulting increase in on the revenue side of the state budget and, secondly, executing bankruptcy proceedings with liquidation characteristics with the purpose of establishing a better economic environment enabling continuous operation of the entrepreneurs.

Box 3.4. Market liberalisation

For the purpose of creating the preconditions for liberalised railway services market, the new Railway Act (OG 94/13, 148/13) was adopted in July 2013, by which the EU *acquis* in the field of railway transport was adopted in entirety. It also provides for railway transport operation licensing for all existing transport operators on the market and recognition of existing licenses issued in other EU member states. The Rail Market Regulation Act, which will be adopted by mid 2014, will completely organise the liberalised market. This Act will harmonise the rail market regulations with European regulations regarding the area of activity and procedures before the regulatory authority, the protection of passenger rights, and cooperation in market regulation area, non-discriminatory and equal access to the railway services market for all participants. It will also strengthen the competition, achieve higher quality of provided services and ensure conditions for the increase in the number of operators on the market.

By adopting the new Postal Services Act (OG 144/12, 153/13), which entered into force on 1 January 2013, Croatia has also been completely harmonised with the Third Postal Directive, aimed at creation of a single market for postal services in the EU by cancelling the so far guaranteed proprietary rights (monopoly) of national postal operators, ensuring the acceptable level of universal postal services for all users and the establishment of coordinated regulation principles under the conditions of a liberalised market, for the purpose of removing the obstacles to the functioning of the integral market.

Changes brought into the energy market in Croatia are based on the implementation of the third energy package of the EU legislation. Act on Regulation of Energy-Related Activities (OG 120/12) provides for the existence of markets in all aspects of energy, since the Croatian Energy Regulatory Agency (HERA) is competent for prices. Furthermore, all the relations between buyers and enterprises, between the providers of energy services and their users or their correlation, are monitored by HERA. The Act provides increased safety to the users, whose rights are ensured by the regulator, and also achieves business transparency in the energy sector.

By adopting the Electricity Power Market Act (OG 22/13), Croatia has significantly liberalised the electric energy market, where as much as 16 distributors are currently active. As for the electricity costs themselves, Croatia has one of the lowest electricity prices when compared to the neighbouring countries. The Gas Market Act (OG 28/13) provides the safety of investment to both domestic and foreign investors, and also opens the possibility for the price of gas to be regulated according to market principles. Supply as a public service

3.4.1. Business environment

In the Decision of 3 January 2013, the government established a Working Group for Business Climate and Private Investment with the aim of preparing a proposal of activities related to improving the business climate and monitoring as well as stimulating private investments, but also encouraging a total sustainable and competitive development of Croatia. The Working Group is charged with the following tasks: analysing and establishing key guidelines and priorities of enhancing the business and investment climate in Croatia, proposing legal and other solutions to enable an improved business and investment climate in Croatia, particularly in the sense of removing administrative and regulatory obstacles, continuous monitoring of work of public bodies taking part in the process of attracting and utilising investments and providing support to exports and systematic monitoring and implementation of investment projects. Since the foundation of the Working Group, numerous activities have been accepted and executed, aimed at improving the business and investment climate in Croatia, including specific changes of the legal and legislative framework concerning stimulation of investments and business environment (Frame 3.5 Doing Business), while many planned activities are to be realised in the following period.

Box 3.5. Doing business

Croatia has achieved positive progress in 2013, as compared to the previous year, in the area of dealing with construction permits (move from 155th to 152nd place), trading across borders trade (move from 104th to 99th place) and paying taxes (move from 43rd to 34th place). Croatia has also successfully performed reforms in the area of starting a business, solving trade disputes and resolving insolvency.

1. By introducing the electronic contribution payment system and reducing the fees paid for the forests and the Croatian Chamber of Economy, positive progress has been achieved towards easier business operations with respect to tax payment.
2. By introducing the electronic cargo tracking system at the Rijeka port and simplifying export customs procedures, easier trade across borders was made possible. Customs administration has systematically organised their work by using an advanced technology solution in order to establish complete functionality of the e-Customs system. E-Customs is a pure electronic solution, supporting import/export activities without paper documentation, and this significantly decreases the number of procedures, their duration and costs.
3. The changes in the Companies Act (OG 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 152/11, 111/12, 144/12, 68/13), enabled the establishment of a simple limited liability company (JDOO) with much lower cost (the amount of minimum initial capital has been reduced from HRK 20,000 to HRK 10). Regulations on the court register have also been changed, which made the foundation of trading companies much easier for the citizens. The limitation on company language has also been abandoned. Until 31 December 2013, 10,373 simple limited liability companies have been established.
4. Enforcing contracts has also been made easier by simplifying court proceedings and transferring certain enforcement procedures from courts to state agencies.
5. Faster resolving of insolvency has been made possible by the introduction of extra-judiciary procedures with specified time limits.

In the Doing Business 2015 report, Croatia has announced the following reforms:

1. By making new legislative changes in the area of dealing with construction permits, valid from 1 January 2014, a brand-new concept has been adopted for the future procedures: the location permit has been abolished (except in special cases), the proof of legal interest liberalised (which means simpler procedure for the investors), there are plans to introduce the Information System of Physical Planning and new generation of the GIS, and e-Permits electronic system has been implemented.
2. As for the electricity supply network, further liberalisation of electric energy distribution is planned, according to the new provisions of the Electric Energy Market Act.
3. In the area of registering property, further implementation of the Cadastre Joint Information System (CJIS) will make it possible for records from the land register to be issued regardless of territorial jurisdiction, electronic registration applications to be received from public notaries and attorneys, records from the land registry to be electronically delivered through the e-Citizens system, the CJIS to be examined and searched based on the OIB number, as well as the land register and the cadastre data to be harmonised.
4. Within the scope of resolving insolvency, the new Bankruptcy Act should additionally integrate the pre-

In general, there is a need for significant modifications for the improvement of the investment climate and simplification of business conditions, primarily by lowering operating costs and simplifying administrative procedures, as well as removing administrative barriers, in order to increase the profitability of entrepreneurs' business, increase competitiveness, encourage investments, innovation and technological level of the business sector. In the end, this would have positive effects on economic growth and employment rates. In addition, based on the results of regulatory screenings and notifications of the regulations governing the service market (more than 100 regulations in the service market and over 1200 regulatory notifications), there will be continuous support in view of simplifying specific legal conditions and removing obstacles to service market liberalisation. There will be further simplification of the procedures of starting and doing business in the service industry by stimulating e-business, electronic invoicing in communication with state administration, ensuring availability of all relevant information via a Point of Single Contact, as well as improving the options offered in the context of electronic registration.

In order to reduce the non-tax burden resulting from a great number of para-fiscal levies and place a greater emphasis on investment stimulation, as of the end of 2013, a total of 41

levies had been reduced or abolished, amounting to HRK 318.7 million. In 2014 and 2015, further efforts are planned as regards the reduction of the levies and changing a number of related laws and bylaws.

By placing heavier emphasis on the use of standards and timely adaptation to the technical EU legislation, a large contribution will be made to the development of entrepreneurial activities and competitiveness of production.

In the previous year, a legal framework was defined for encouraging a sustainable investment cycle, by means of the Act on Investment Promotion and Development of Investment Climate³⁰, Act on Strategic Investment Projects of Croatia³¹, while the Strategy on Stimulating Investments in Croatia 2014-2020 (Box 3.6. Stimulation of investments) is currently being developed.

A well-organised land registry system, which represents another prerequisite in view of stimulating free entrepreneurship and investments, will also be upgraded by many activities which lead to a swifter resolving of land-registry (LR) cases and a more proper and prompter LR and cadastral data, including the implementation of the CJIS in all LR and cadastral offices, the interlinking of key registers with the LR system, the introduction of the option of the electronic submitting of the request for the land registry registration, or the organisation of a LR digital archive. Significant modifications will be undertaken in the physical planning through the development of the Strategy of Spatial Development of the Republic of Croatia by the end of 2014, the preparation of the National Plan of Spatial Development, as well as the coordination of physical plans of the lower level with the plans of the higher level, which will, in the long term, help to facilitate investing into the area, as well as the construction of municipal, energy, transport and other infrastructures.

The Plan also includes improving the electronic method of document processing in construction and physical planning by developing the Information System of Physical Planning and its modules (e-permit, e-plans, e-catalogue, e-archive, and e-inspection), in order to strengthen the transparency and efficiency of the administrative procedures related to construction and physical planning and make a considerable cut in the number of days required for obtaining a construction permit, going down from the current 317 to 74 in 2014.

Developing broadband access, which is to be based on the Strategy of Broadband Access Development in Croatia in the 2012-2015 period and the corresponding Implementation Programme, represents a priority in further development of the IT society and society of knowledge. The primary objective related thereto is to ensure the availability of broadband access under equal conditions throughout the whole Croatian territory, thus contributing also to a more favourable business environment. The preparations for the development of a new Strategy of Broadband Access Development in Croatia for 2016-2020 are to start in 2014.

³⁰ OG 111/12, 28/13

³¹ OG 133/13

Box 3.6. Investment stimulation

The Act on Investment Promotion and on Improving the Investment Climate stimulates investment projects and strengthens competitive abilities in production and manufacturing activities, research and development activities, business support activities, high added value services, especially in increased added value activities, incentive measures for capital costs of investment projects and incentive measures for labour-intensive investment projects. The Ministry of Economy implements the Act in case of large businesses, and the Ministry of Entrepreneurship and Crafts in case of small and medium businesses (SMEs).

Based on 52 applications with the total estimated value of investment of HRK 4.5 billion and the estimation of 3,471 newly created jobs, the Ministry of Economy issued 13 approvals of the status of incentive measure, beneficiary for which HRK 20 million were paid in 2013. Based on the issued approvals, the realisation of the investments in the total amount of HRK 2.3 billion and the opening of 1,954 new workplaces is expected. In the first quarter of 2014, based on 11 applications with the total investment value amounting to HRK 900 million and the estimation of 581 newly created jobs, the Ministry of Economy issued 4 approvals of the status of incentive measure beneficiary for which HRK 4 million were paid. Based on the issued approvals, the realisation of the investments in the total amount of HRK 739 million and the opening of 141 new workplaces are expected.

In the period from the Act's entry into force to the end of 2013, based on 184 applications with the estimated total investment value of HRK 7.26 billion, and the estimation of 3,559 newly created jobs, the Ministry of Entrepreneurship and Crafts issued 15 approvals on the status of incentive measure beneficiary for which HRK 9 million were paid in 2013. Based on the issued approvals, the realisation of investments in total amount of HRK 240 million and the opening of 285 new workplaces is expected. In the first quarter of 2014, 38 applications were received, with total investment value amounting to HRK 1.24 billion, and the estimation of 625 newly created jobs. In the same period, 20 approvals on the status of incentive measure beneficiary were issued, for which HRK 92,060 were paid. Based on the issued approvals, the realisation of investments in total amount of HRK 457 million and the opening of 326 new workplaces are expected.

An amendment to the Act is in process in order to harmonise it with the Guidelines on regional State aid for 2014-2020.

The Act on Strategic Investment Projects of Croatia additionally improves the investment climate and significantly shortens and accelerates the processes of procuring the entire documentation necessary for the realisation of investment projects which are of strategic interest for Croatia. Based on this Act, the Government of Croatia can send a public invitation to the potential investors for the particular strategic projects.

By mid-2014, the Investment Stimulation Strategy in Croatia for the 2014-2020 period will be adopted with the following strategic goals: 1. Improving the investment environment through the improvement of legislative and institutional framework, i.e., the removal of administrative obstacles to investments; 2. Promotion of Croatia as a desirable investment destination, by preparing the Communication Strategy for the stimulation of investments and the corresponding Action Plan, by creating the Croatian "advantage package", by preparing the sectoral investment profiles of the country and branding particular sectors and regions; 3. Targeted attraction of investments, with the preparation and implementation of the Plan on Attracting *Greenfield* Investments in export oriented sectors, high technologies and KET, and in assisted areas of Croatia, by strengthening the role of economic diplomacy in the attraction of foreign direct investments and by increasing of *Brownfield* investments, by placing state property into function; 4. Delivering specialised support to the

EASIER ACCESS TO FINANCE

The process of crediting and supporting SMEs by means of favourable credit lines and guarantees provided by the CBRD and the Croatian Agency for SMEs and Investments (HAMAG INVEST) saw considerable improvements in 2013. The CBRD managed to secure (via several programmes) a total of EUR 460 million to SMEs, planning to maintain this amount in 2014 as well.

In 2013, HAMAG INVEST issued a total of 384 guarantees, in the total amount of EUR 56 million, which represents a 34% increase with respect to 2012. Those guarantees enabled EUR 171 million worth of new investments in the SMEs, which helped to partially compensate for lower credit activity of commercial banks. In 2014, HAMAG INVEST expects over 400 issued guarantees, thus continuing to provide support to SMEs by means of credit guarantees. Thereby, it will be possible to make new investments into SMEs by means of loans, which would otherwise not be approved without the HAMAG INVEST guarantees. The guarantees intended for entrepreneurs beginners will be issued together with a counter guarantee of the European Investment Fund (EIF).

In 2013, there was further crediting of microenterprises by means of 32 loans approved for entrepreneurs' beginners, amounting to a total of HRK 2.1 million, where the maximum individual loan value was set to HRK 70,000. By approving these micro-credits, 80 new jobs are expected to be created. In 2014, it is expected that HRK 5 million is to be granted via a micro-crediting programme, where the maximum microcredit limit has been raised from HRK 70 to 120 thousand. Micro-credits continue to be approved at the 1% interest rate, which enables microenterprises to initiate their business activity with success. In 2014, HAMAG INVEST plans on introducing equity guarantee instruments, thereby providing support to institutional investors engaged in innovative projects of Croatian enterprises and overcoming the availability period of venture capital funds from the EU Structural Funds. By merging with the Business Innovation Agency of Croatia (BICRO), it will become easier to develop new instruments of support to enterprises investing in innovative projects and strengthen the existing BICRO programmes. For the 2015-2020 period HAMAG INVEST plans to make use of the EU Structural Funds for finance instruments and in the process make a significant contribution to a stronger guarantee scheme, to declare growth in financing which is available for micro-credits, as well as to initiate use of venture capital funds. Economic Cooperation Funds (ECFs) represent a major source of alternative financing in Croatia, helping entrepreneurs by being incorporated into the owner's equity of company. In Croatia, there are five active ECFs, with a total investment amount of HRK 704 million (as of 31 March 2014), out of which 50 % involves investments to approved projects financed from the state budget.

In 2013, the development of entrepreneurship was mostly financed via the Entrepreneurial Impulse programme. Within its framework, a total of 1,815 entrepreneurial projects were co-financed with HRK 215 million, using an average aid intensity of 64%. HAMAG INVEST continues implementing the measures under the Entrepreneurial Impulse, providing entrepreneurs with an access to grants for business development. A total amount of funds intended for the Entrepreneurial Impulse programme in 2014 is over HRK 350 million. An additional grant of EUR 8.5 million was secured for entrepreneurial projects in 2013 within the OP Regional Competitiveness, which foresees EUR 37.5 million in 2014.

3.4.2. Public administration

The structure of a new public administration rests upon its basic operating principles – services oriented to the user (for citizens and entrepreneurs alike) and a strong sense of ethics. The public administration reform aims to establish a new public administration to truly be at service to all citizens, ensure efficiency in performing social activities, securing public resources, and satisfying everyday needs of the citizens, with respect to public interest and general welfare.

In developing a new public administration, there is a great need for a change in the way roles and tasks of civil and local servants are seen and understood. Such a need includes developing a system of continuous education for the servants which will not only secure a required level of expertise of the employees in the public administration, but also encourage modifications in the methods of behaviour and business performance, all aimed at providing quick and high-quality services to the user, that is, improving the general confidence in the public administration. In this respect, the existing information system for the central calculation of salaries (CCS) is to be upgraded by developing additional functional services intended for human resource management.

In the 2012-2014 period, a series of activities were and still are being implemented with that goal in mind. In particular, there is the e-Citizens project³², designed to centralize communication between the citizens and the public sector, and bring to a single place on the Internet (in form of a portal) all the information concerning the activities of the government and ministries as well as the information about public services and provide a secure access to electronic services by means of electronic identity.

The Act on the State Information Infrastructure is currently being prepared to define a unique method of establishing and managing a public register system, including the conditions that a state information infrastructure must secure with respect to public registers, and to determine a common base for secure data exchange within the state information infrastructure, a common identification and authentication system, a single interaction point for communication with citizens and other users and, lastly, to secure an information society in Croatia and include Croatia in the development of a European as well as global information society.

The Strategy of Modernisation of Public Administration of Croatia for the 2014 –2020 period, to be developed by the end of third quarter of 2014, is aimed at enhancing administrative capacities and improving the organisation of public administration. The public administration in the context of this Strategy includes state authorities and LC(R)SGU bodies performing administrative activities. The Strategy will establish a quality system for public services and human resource management, as an integral part of a quality management system. Such public administration represents an integral part of an efficient business environment. The public administration reform in Croatia has the following primary goals: to secure an efficient implementation of the Act and to create a high-quality, transparent, citizen-oriented, rational, professional, economical and efficient public administration.

With the new Act on the Right of Access to Information³³, the legal framework for the realisation of rights to access information has been improved. Furthermore, there have been improvements regarding the availability of data regarding the spending of public resources and the content of public registers, as well as the availability of data on donors to election campaigns and regular political action. LC(R)SGU have been delivered a recommendation to make public their decisions and other relevant information about the sessions of representative bodies.

Civil registrars are being integrated with the aim of developing a single register and connecting it to other registers. It is now possible to request documents be issued from the registrar regardless of the place of registration, which enables citizens to obtain their documents faster and easier. In addition, the central state portal is currently being improved in regard to contents as well as technical side, to provide a functional service including all the

³² OG 52/13

³³ OG 25/13

information about the way citizens may exercise their rights with the state administration bodies. A Register of Voters is accessible by the public.

By reorganizing state administration offices until the end of 2014, there will be 5 state administration offices, instead of the past 20 state administration offices in counties, as first-instance state administration bodies, where specific offices will be competent for performing duties of the state administration in the area of several counties. The new model will enable a more robust and more rational division of the activities the state administration is in charge of. By integrating administrative activities in a single body having a much wider jurisdiction with respect to the sector principle of organisation and operation, it will become easier to coordinate business activities and improve the efficiency of the offices. A wider territory under its jurisdiction, including several counties, will provide a more balanced workload in case settlement in the area of several counties and secure integration of administrative capacities and professional knowledge, which will, in turn, help with a more efficient provision of services. At the same time, services will be put at the citizens' disposal more easily and directly by establishing unique administrative points for state administration offices within all internal structure office units and making use of their expansion in space. A new organisational structure of state administration offices will also prove to be money-saving, particularly evident because of a reduced number of state administration offices that is a reduction in the number of internal organisation units and a smaller need for managerial work. What is more, by merging departments for joint affairs of state administration offices in counties into a single organisational unit within the state administration office, it will be possible to redistribute personnel with a university degree from the existing departments for joint affairs, which will, thus, make the personnel structure stronger for the performance of duties in the state administration office.

In 2013, the state inspectorate underwent transformation in order to improve the procedures of monitoring and collection of funds into the state budget in accordance with the consolidation model of inspection services, better efficiency and cost-effectiveness of inspection services operation and harmonization of the practices of management with the aim of protecting budget revenues as well as detecting and combating grey economy. Furthermore, the goal is to save money in respect of budgetary government expenditures in such a way that inspection bodies do not overlap in their operation and authorisations, but that the existing network of already organised inspections in competent ministries is expanded in area of competence and, by means of a comprehensive management model, that their competences are perfected within a single field of control.

With the aim of future rationalisation of state administration and integration of administrative capacities and various areas of professional knowledge, better efficiency, reduction of material expenses and costs related to the employees, and without prejudice to the availability and quality of services at offer to the citizens, various institutions have been or are currently being merged (e.g. the Croatian Post and Electronic Communications Agency and the Rail Market Regulatory Agency into the Croatian Regulatory Agency for Network Activities; the Agency for Investments and Competitiveness and the Agency for Public Private Partnership into the Agency for Investments, Competitiveness and Public Private Partnership; HAMAG INVEST and BICRO into the Croatian Agency for SMEs, Innovation and Investments; the Croatian Standards Institute, the State Office for Metrology and the Croatian Accreditation Agency into the State Institute for Standardisation, Metrology and Accreditation; and the Croatian Food Agency and the Croatian Veterinary Institute).

There are several significant long-term measures of fiscal consolidation currently being implemented within the framework of this subcategory; more precisely, the public procurement procedure and accompanying services, as well as outsourcing services are being integrated.

In the context of growing co-financing possibilities, as secured with the EU funds, a significant measure being implemented is directed towards strengthening the absorption capacity of the EU funds by developing human resources in the system of management and use of resources, as well as developing mechanisms for the planning of funds absorption and project preparation.

3.4.3. Judiciary

FIGHT AGAINST CORRUPTION

Croatia is continuously working on improving the legal and institutional framework for the fight against corruption. The Strategy for the Suppression of Corruption, together with the corresponding Action Plan, makes for the fundamental anti-corruption document, defining anti-corruption measures, time frames, competent institutions and necessary implementation instruments. In the field of combating corruption, and on the basis of anti-corruption instruments already implemented in the field of criminal prosecution and confiscation of pecuniary gain, the legal framework has been additionally reinforced by means of the Criminal Code, in effect as of 1 January 2013, whereby new corruption-related criminal acts were defined, such as breach of trust in commercial operation, while sanctions regarding the criminal act of bribing were made more rigorous. The Office for the Suppression of Corruption and Organised Crime (USKOK) and the Police National Office For the Suppression of Corruption and Organized Crime (PNUSKOK) are in their operation now fully equipped for implementing efficient investigations, as evident in the success of a number of investigations and processed cases of high-ranking corruption on the state as well as local levels.

As regards the prevention of corruption, the legal framework has been improved with the new Act on the Right of Access to Information, passed in February 2013. A test of proportionality and public interest was introduced, enabling access to information, if in the particular case the public interest prevails, and, in October 2013, the Croatian Parliament appointed an Information Commissioner, whose task is to protect and promote the right of access to information, as guaranteed by the Constitution.

In 2013, the establishment of an independent and professional Commission for Resolution of Conflicts of Interest was finalized, which - together with additionally improved administrative capacities - resumed a proactive approach in the resolution of conflicts of interest in case of holders of public office.

In March 2013, the Act on Financing Political Activities and Election Campaigns was amended in order to improve monitoring financing political activities, while the administrative capacities of the State Electoral Commission, as the monitoring body, were further enhanced.

The Public Procurement Act has been amended, preventing government officials from winning (concluding) public procurement contracts or related jobs, which contributed to transparency in implementation of public procurement procedures and reinforced expert capacities of the State Office for Central Public Procurement. In order to reinforce integrity, responsibility and transparency in the operation of public authority bodies and strengthen the confidence the citizens have for the state institutions, there has been research conducted for the purpose of investigating the transparency of operation and resource utilization of the LC(R)SGU, trading companies whose founders, stockholders and shareholders in the LC(R)SGU, medical institutions, county tourist boards and the Croatian National Tourist Board, with the results made available on the website www.antikorupcija.hr.

A new Strategy for the Suppression of Corruption, together with the accompanying Action Plan, is planned for development in 2014 with the aim of advancing the legal and institutional framework of preventing and combating corruption; in that purpose, the competent authorities have deliver their proposals of new anti-corruption measures to the Ministry of Justice.

DEVELOPMENT OF JUDICIARY

For the purpose of implementing further reforms in the judiciary, a new The Strategy of the Development of the Judiciary in Croatia for the period of 2013–2018 was adopted on 14 December 2012. The Strategy takes five basic sectors as the foundations of future strategic planning: independence, impartiality and professionalism of the judiciary, efficiency, the Croatian judiciary as part of the European judiciary, human resource management and the utilisation of modern technology. An Action plan was adopted for this period as well.

A number of laws were altered in 2013 for the purpose of speeding up court proceedings and reducing court delays, improving the efficiency of the judiciary as whole, but also in the sectors of civil and commercial judicial settlements with a reduction in court delays and faster proceedings (Box 3.7 Improving the efficiency of the judiciary). The systematic monitoring of all relevant data, their analysis, planning and implementing further measures ensure the establishment of an appropriate level of efficiency of the judiciary in the areas where this level has not yet been attained.

The normative framework for the strengthening of the system of responsibility of the judicial officials and greater transparency of the operations of the judiciary has been amended. The obligations of the president of the court have been increased by the new Law on Courts³⁴. An application for protection of the right of trial within a reasonable time period will be submitted directly to the court president of the court conducting the proceedings, and the function of a court administration director in courts with over 40 judges will be implemented. The Law lists many cases and types of cases that the judicial advisors are authorized to handle independently, and defines the conditions and operation modes of the judicial inspection. The novelties in the State Judicial Council Act³⁵ ensure a greater mobility of judges and a greater transparency in passing the decisions of relocating judges. The framework criteria for the assessment of the judges' performance, implemented in December 2012, provide a further assessment of the performance of judges in dealing with cases older than 5 years and civil matters older than 10 years, in such a way that each matter is counted as double. The aim of

³⁴ OG 28/13

³⁵ OG 116/10, 57/11, 130/11, 13/13, 28/13

this measure is to encourage judges to handle older matters and to make a fair assessment of their performance.

The informatization of the judiciary is planned in order to finalize the introduction of central applications of the Integrated Case Management System (ICMS) to all municipal, county and commercial courts, the High Commercial Court and the Supreme Court of Croatia, case monitoring systems in all municipal and county State Attorney's Offices, including USKOK and the State Attorney's Office of Croatia (DORH), Joint Information System, the central application of misdemeanour courts, the development and implementation of the central application for the prison system. At the same time, efforts are made in connecting the existing registries and the interoperability of the systems, and implementing an e-service for citizens that should aid in providing a greater transparency and ensuring a better communication with the citizens. The informatization of the judiciary should contribute to a greater efficiency of judicial authorities and better resources' management.

Enforcement regulations have been amended with the aim of increasing enforcement efficiency and protecting the dignity of debtors. The public enforcement service has been revoked due to its incompatibility with the agency enforcement system developed in Croatia in the meantime, which has been in use since 2011. Based on the personal identification number and single registry data, it represents an efficient, simple and quick system which accomplishes the specified goals of relieving courts and provides simplification, better management, speeding up and efficiency of the enforcement procedure. The Enforcement Act³⁶ prescribes direct collection based on certain enforceable documents in the process before the Financial Agency. The subject-matter jurisdiction of commercial courts in enforcement procedures is abandoned and the powers of notaries public are increased. The Enforcement Act creates the legal framework for the improvement and further development of out-of-court enforcement. The process of mandatory realisation of the claims and the process of voluntary judicial and notary-public security of claims is regulated, as well as the matter of substantive law relations based on enforcement procedures. The expansion of the grounds for payment and the establishment of clear procedural regulations ensure an exceptional efficiency of out-of-court enforcement carried out by the Financial Agency.

Further Amendments of the Enforcement Act will enable a more efficient implementation of the enforcement procedure in terms of reducing the possibility of abuse of the delivery service institute in the enforcement procedure in the way that judges and notaries public will have access to information in the records of the Ministry of Internal Affairs. Introducing a council of three judges that will make second instance decisions at first instance courts will also speed up the process. Furthermore, the expansion of the contents of an enforcement decision will provide the debtor with basic and clear information on the results of the decision itself, resulting in a greater transparency of the procedure. The elimination of unfavourable effects for the debtor will be accomplished by the debtor having the option, in a legally prescribed time limit and under certain conditions, to propose a different object for enforcement to settle the creditor's claims. The transparency, efficiency and promptness of the implementation (sales) of the enforcement of property will be achieved by introducing the Financial Agency into the enforcement on property proceedings (public electronic auction). To this effect, the adoption of the Act on Sales of Immovable and Movable Property in the enforcement procedure has been proposed.

The Act on Personal Bankruptcy, currently in the making and which is planned to be passed in the first half of 2014, will offer a private debt reduction model through the settlement of

³⁶ OG 57/96,139/10, 112/12, 25/13

debts in a realistic time frame and through a proportionate write-off by agreement with the aim of further exemption from financial flow, stimulating economic activity and a resultant increase in budget revenue.

Amendments to the Bankruptcy Act³⁷ introduce the sales of the bankruptcy debtor's assets as a whole, as well as the option of initiating bankruptcy proceedings without the preceding procedure. The final hearing has to be determined not later than one year and a half after the beginning of the procedure, that is, the procedure must be completed within two years.

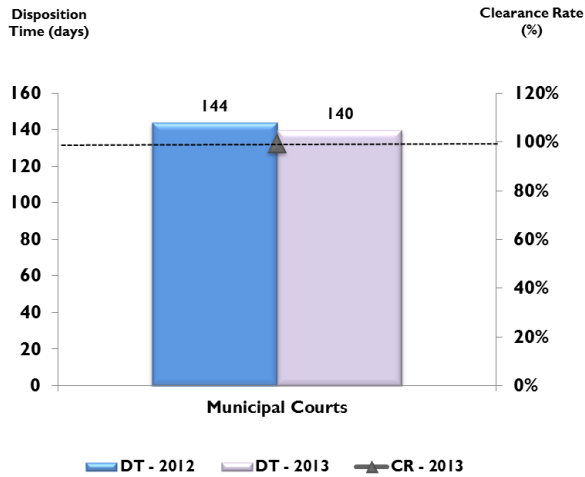
³⁷ OG 44/96, 29/99, 129/00, 123/03, 82/06, 116/10, 25/12, 133/12

Box 3.7. Improving the efficiency of the judiciary

The number of cases in courts keeps falling, which is visible from data and illustrations below for the past four-year period.

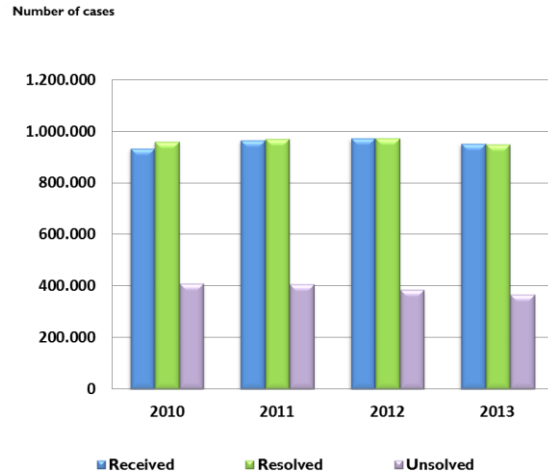
Graph 1:

Graph 2: The number of cases in municipal courts



Source: Ministry of Justice

Clearance Rate and Disposition Time – municipal courts



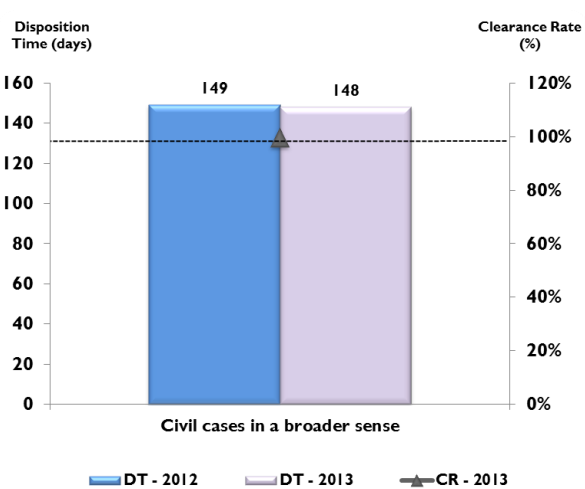
Source: Ministry of Justice

During 2010, 933,810 cases were received by municipal courts and 959,764 of them were resolved, in 2011 there were 964,770 cases received and 970,150 resolved, in 2012 there were 972,672 cases received and 971,771 resolved, while in 2013 there were 951,625 cases received and 949,600 cases resolved. At the end of 2010, there were 408,198 pending cases, in 2011 there were 404,166 cases, in 2012 there were 383,586 cases, and at the end of 2013 there were 363,492 pending cases, therefore, the number of pending cases continued to decline.

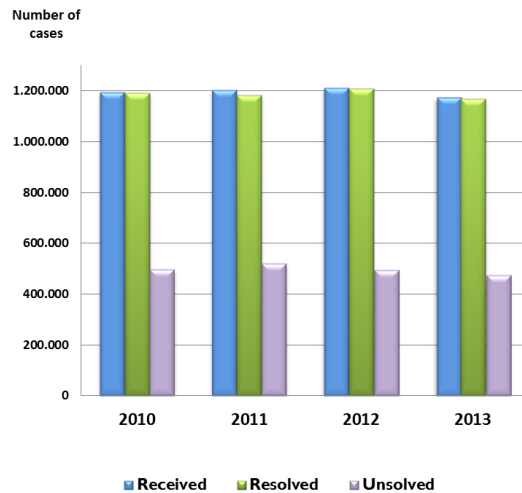
A positive trend in the successful resolution of cases by type is visible especially in the resolution of civil cases in a broader sense, which included civil cases in a narrower sense, commercial, enforcement and land register cases, regardless of their increased inflow.

Graph 3: Clearance Rate and Disposition Time – civil cases in a broader sense

Graph 4: The number of civil cases in a broader sense



Source: Ministry of Justice



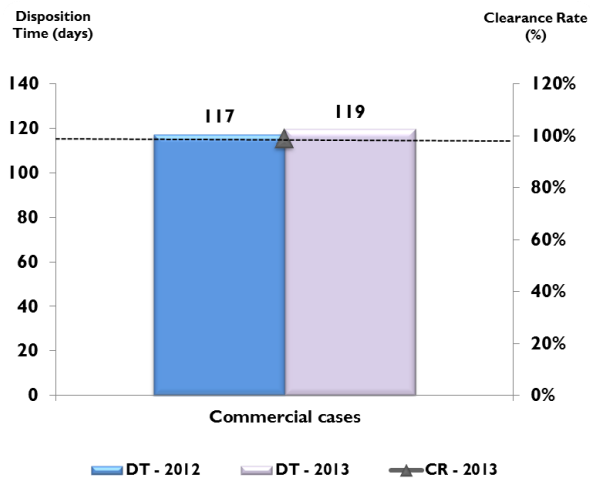
Source: Ministry of Justice

During 2013, in all courts in Croatia a total of 1,172,940 civil cases were received (civil cases in a narrower sense, commercial cases, enforcement cases and LR cases). During the same year, a total of 1,168,058 cases were resolved. In 2010, the total number of pending civil cases (civil cases in a narrower sense, commercial cases,

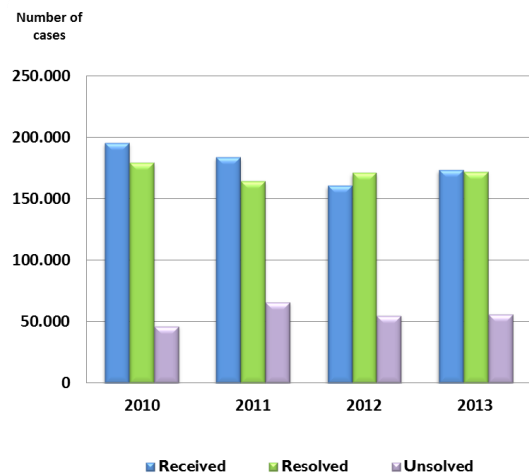
Positive trends in commercial cases are also evident from the data on the number and resolution of these cases.

Graph 5: Clearance Rate and Disposition Time – commercial cases
 Graph 6: The number of commercial cases

Clearance Rate and Disposition Time – commercial cases



Source: Ministry of Justice



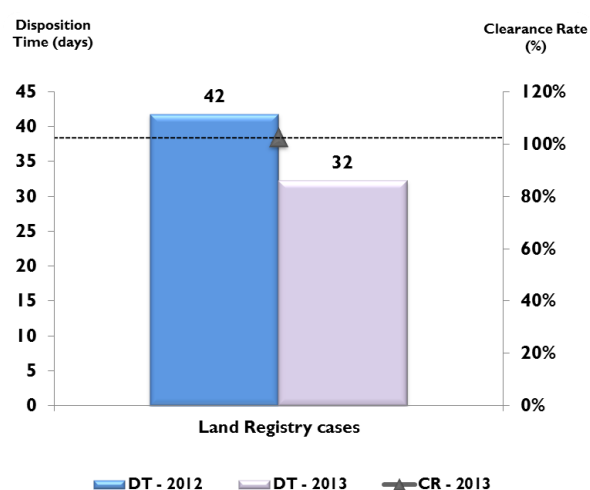
Source: Ministry of Justice

In 2010, 195,588 commercial cases were received and 179,546 cases resolved. In 2011, 183,777 cases were received and 164,505 resolved. In 2012, 160,935 commercial cases were received and 171,159 resolved and in 2013 173,672 commercial cases were received and 171,873 resolved. There was a decrease in the pending cases number at the first instance commercial courts, which in 2010 amounted to 44,369, in 2011 to 60,280, in 2012 to 46,864. In 2013 the number fell to 40,514 pending cases.

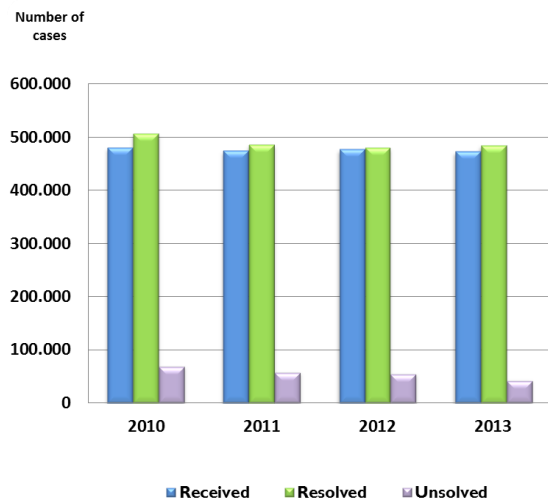
Progress in the field of land registry proceedings as a result of organizational, technical and normative measures may be seen from the chart and the accompanying data:

Graph 7: Clearance Rate and Disposition Time – land registry cases
 Graph 8: The number of land registry cases

Clearance Rate and Disposition Time – land registry cases



Source: Ministry of Justice

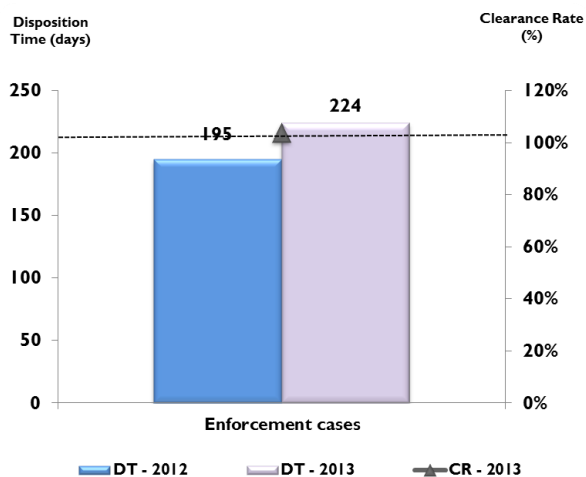


Source: Ministry of Justice

In 2010, 480,096 land register cases were received and 506,113 cases resolved. In 2011, 473,774 cases were received and 485,421 cases resolved. In 2012, 476,543 cases were received and 479,810 cases resolved, and in 2013 there were 472,363 cases received and 484,480 cases resolved. By solving a higher number of cases than were received, the corresponding rate of solving has been achieved, with a considerable reduction in solving time.

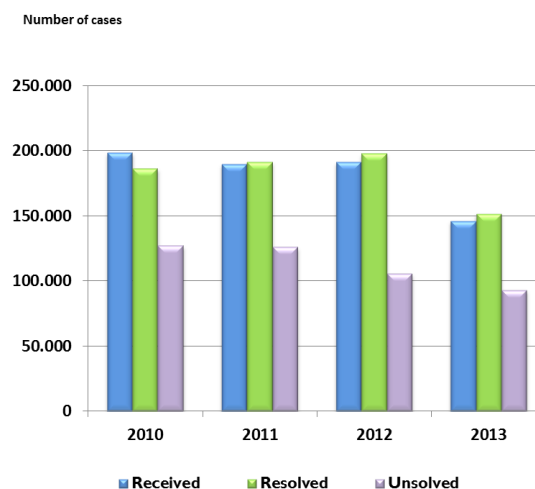
The progress made in the area of enforcement proceedings in courts is a reflection of the changed approach to enforcement proceedings with emphasis on acceleration and efficiency of the system.

Graph 9: enforcement proceedings



Source: Ministry of Justice

Clearance Rate and Disposition Time - Graph 10: The number of enforcement cases



Source: Ministry of Justice

In 2010, 198,718 enforcement cases were received and 186,664 of them resolved. In 2011, 189,900 enforcement cases were received and 191,650 cases resolved. In 2012, 191,514 were received and 197,993 resolved and in 2013 there were 146,309 of cases received and 151,733 enforcement cases resolved. The unsolved cases which in 2010 amounted to 127,074, in 2011 to 125,949 and in 2012 to 105,713 decreased to

3.4.4. Research and development

Investments in the development of the scientific, technological and innovation system are a prerequisite to ensure a stable society, and the added value will be completely evident in the upcoming - medium-term and long-term - period. This added value can enable the development of Croatia as a country oriented towards knowledge and innovation, with the overall aim of increasing competitiveness, productivity and employment and, in accordance, achieving stable and sustainable economic growth.

The development of the science and innovation system is based primarily on the growth and increased efficiency of the existing infrastructure and human scientific resources. Their continued strive towards greater scientific excellence, importance and structure, are all prerequisites of establishing the Croatian scientific research and higher education space.

Appropriate measures have been taken in 2013 in order to improve the quality, management and funding systems of scientific organisations and encourage scientific excellence. In order to increase scientific quality and excellence, the National Science Council adopted criteria to found Scientific centres of excellence in 2013. Scientific centres of excellence will increase the international visibility required for the successful defining of research programmes in the framework of the European Research Area and advance the scientific, industrial and social connections and establish the framework for a successful funding system that will not depend merely on public investments. By encouraging scientific excellence and focusing on scientific results and encouraging innovation, the creation of human resources and results related to the economy is made possible. This will make society, and the economy as a whole, more

competitive and will create new workplaces as well as improve the standard of living in general.

In connection with the indicated goals, the Act on the Amendments of the Act on Scientific Activity and Higher Education³⁸ and the Act on the Amendments of the Act on Croatian Science Foundation³⁹ were passed, accomplishing the prerequisites for a comprehensive reform of the scientific system and higher education funding, with the aim of increasing quality, competitiveness and scientific excellence. Furthermore, the said Act on Scientific Activity strengthens the role of the National Council for Science, Higher Education and Technological Development as the highest authority taking care of the development and quality of the entire scientific activity and systems of science, higher education and technological development, and thus, the employment system, in accordance with the European Charter and Code for Researchers, is open to the international labour market. A clearer procedure for the advancement in scientific and research and teaching professions (including the abolition of mandatory promotion) is also prescribed.

Pursuant to the Decision on multi-annual institutional funding of research activities in public research institutes and universities⁴⁰ 2013-2015, and planned funds in the state budget, multi-annual agreements on the financing of scientific activity were agreed with all public universities and public scientific institutes. The said Agreements are the basis for the introduction of comprehensive programme agreements that would continue the clear and transparent financing of scientific activity with the goal of maximizing social responsibility when spending public funds. An amount of HRK 150 million to fund exclusively scientific activities was provided for this purpose for a three-year period, and the amount of provided funds for specific institutions are determined based on the indicators of scientific activities of the institution, ensuring a more transparent management and funding system based on the criteria of scientific excellence. When the national project financing of scientific activities was passed over fully to the Croatian Science Foundation in 2013, inviting tenders for scientific projects and establishing support for young researchers has been made possible. Additionally, the process of re-accrediting public scientific institutes was initiated as the basis for the restructuring of public scientific institutes' network, and a thematic evaluation of postgraduate doctoral studies in Croatia was conducted and it would serve as the start of the restructuring process of postgraduate doctoral studies. The restructuring of the institutes' network, with the resultant mutual consolidation of the scientific resources of institutes and universities, will increase competitiveness and scientific productivity.

A comprehensive audit of the system of state incentives for research, development and innovations has started. The audit includes the harmonisation of criteria to award incentives with guidelines from the European Union, change of procedures and regulations on the awarding of state incentives and the definition of the monitoring, evaluation and state incentive refund system. The audit of the regulations on state incentives is encouraging a sustainable, intelligent and inclusive development, and will simplify the incentive awarding regulations and focus on cases that have the greatest impact on the integral market.

The goal of the national project of scientific mapping and forecasting, as the grounds for the drafting of future strategic documents based on the new Scientific Platform for the Transfer of Knowledge, is to produce the methodology and the instrument of establishing common positions on the future goals of the development of science and technology and in the design of policies in the field of research, development and innovations. It is expected that the results

³⁸ OG 139/13

³⁹ OG 78/12

⁴⁰ OG 69/13

of the project will define the scientific priorities in the next 10 to 15 years, but also create a system of scientific forecasting for future generations.

4. PROGRESS TOWARDS NATIONAL EUROPE 2020 TARGETS

Croatia initially determined the national values of the Europe 2020 headline targets in the 2013 Economic Programme of Croatia. In this National Reform Programme, the targets have been revised in order to become more ambitious; there is an increased value of the employment target (with the increase of the employment rate of the population aged 20 - 64 from 59% to 62.9%) and a further reduction of poverty and social exclusion target (an expected reduction of persons threaten by poverty and social exclusion by 150,000). A comparative display of national headline targets and EU headline targets is given in Table 3.

Table 3: Distance to Europe 2020 Strategy headline targets

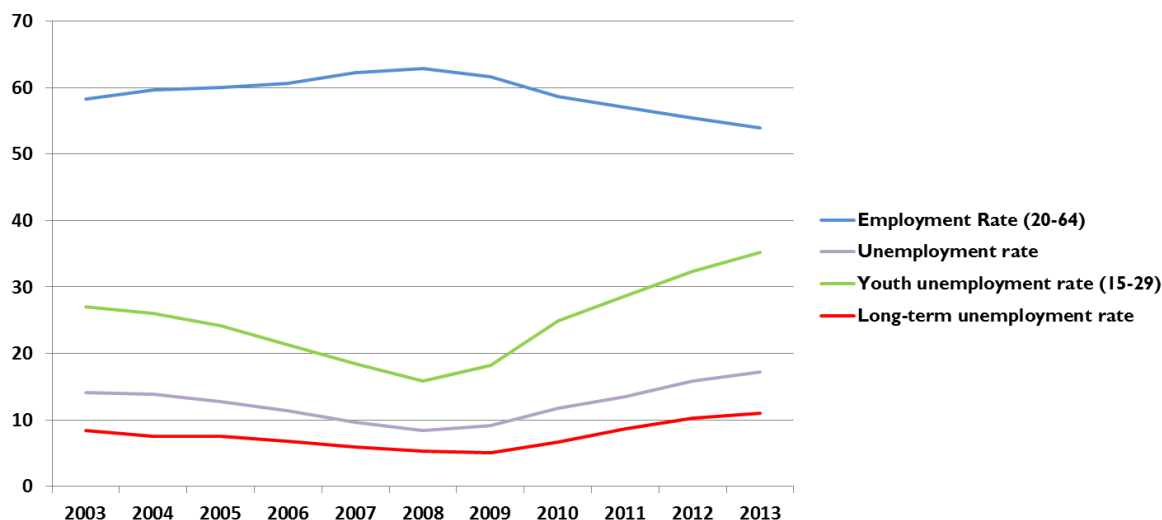
	EU-27 2012	EU 2020	Croatia 2012	Croatia 2020
Employment				
Employment rate (age group 20 – 64), <i>share of population</i>	68.5	75	55.4	62.9
Research and Development				
Total domestic expenditure for R&D, <i>share of GDP</i>	2.06 ^e	3	0.75	1.4
Climate change / Energy				
Greenhouse gas emission, <i>index 1990 = 100</i>	83.07 [*]	80	89.85 [*]	106
Share of renewable energy sources in final energy consumption, %	13.0 [*]	20	15.7 [*]	20
Primary energy consumption, <i>TOE</i>	1.593.0 [*]	1.474	7.9 [*]	
Final energy consumption, <i>TOE</i>	1.103.3 [*]	1.078	6.2 [*]	
Education				
Early school leaving, <i>share of population</i>	12.8	10	4.2	4
Tertiary education, <i>share of population</i>	35.8	40	23.7	35
Reduction of poverty and social exclusion				
People at risk of poverty and social exclusion, <i>thousands</i>	123.104 ^e	103.104	1.370	1.220

* = Data in 2011, e = estimated

4.1. Employment

The current situation on the labour market in Croatia today is a result of a number of social-economic developments over the past two decades, indicating that the current imbalance of the market is of a structural nature and that a structural reform of the labour market is necessary. Negative trends that started at the beginning of the economic crisis in 2008 are still present. Since 2009, the employment rate in Croatia is the lowest in the EU and has remained low during the entire economic cycle, dropping to 53.9% in 2013. The unemployment rate equals 17.2%, double than in 2008. A high level of long-term unemployment reduces the employability of the work force, even in a period of increased economic activity, due to a lack of skills, barriers to employment or a combination of these two factors. The young and low-skilled workers are struck hardest by the economic crisis, and it is extremely difficult for older unemployed persons to find a job. The youth unemployment rate doubled between 2008-2013 as well and amounted to 35.2%, the third worst rate in the EU, after Greece (48.7%) and Spain (43%).

Graph 11: Employment and unemployment trends in Croatia in the 2003-2013 period



Source: Eurostat

On a structural level, smart specialisation and development strategies will contribute the most to an improvement in this sphere. The draft Industrial Strategies⁴¹ assumes the addition of 85,619 - 102,742 workplaces in the processing industry sector (C)⁴², construction (F) and communication and information (J), leading to a 3.4 - 4.0% contribution towards achieving the target employment rate. Also, the Tourism Development Strategy⁴³ assumes the creation of 22,000 workplaces in tourism and around 10,000 workplaces in non-tourist activities induced by tourist activity, leading to a 1.3% contribution towards achieving the target employment rate. For a full effect of these strategies, a synergy with the measures related to further advancement of the connection of the education system with the labour market is required.

It is expected that the pension legislation reform will have a positive effect in keeping insured persons in work longer and retiring later, affected by: gradual scaling-up of the age

⁴¹ <http://www.mingo.hr/default.aspx?id=4980>

⁴² Classification by activity sector in accordance with the National Classification of Activities

⁴³ <http://www.mint.hr/UserDocImages/130426-Strategija-turizam-2020.pdf>

requirement for old-age pension and early retirement pension for women, appropriate penalisation for early retirement, and increasing the replacement rate for later retirement, broadening the option of old-age pension beneficiaries to work part-time, changing the definition of disability, changes in acquiring and controlling disability pensions and a broader application of vocational rehabilitation of beneficiaries with partial loss of working ability. It is estimated that the pension system reform will lead to an increase of at least 0.9%, or 24,000, towards achieving the target employment rate.

By strengthening the administrative capacities of the CES, by increasing the efficiency and offering new services, a reduction in frictional unemployment is expected in medium-term, that is a 10% reduction in the unemployment rate compared to similar economic conditions with current capacities (13.0% instead of 14.4% in 2020), implying an increase in employment by 24,000 (+0.9%) by 2020.

For the purpose of promoting employment, the Ministry of Labour and Pension System in cooperation with CES, as an implementing body, started on 15 January 2013 a new approach to implementing the ALMP measures. The measures are aimed at certain target groups of unemployed persons that are in an unfavourable position on the labour market, as well as employed persons at risk of losing their job. The ALMP measures are an instrument to achieve a more developed and competitive labour market and they present a direct intervention on the labour market, aimed at the elimination of short-term, but also long-term problems of employment and on the labour market. The following groups of measure are carried out in Croatia:

- Employment support,
- Self-employment support,
- Professional development support,
- Education of the unemployed, and
- Vocational training without commencing employment.

The ALMP measures were used by a total of 53,656 persons in 2013, the highest number on record (the measures were used by 41,450 persons in 2011 and 41,555 persons in 2012).

Since 2011, Croatia has been continuously investing a significant portion of the funds to implement the ALMP measures, so in 2014, a total of HRK 336,564,000⁴⁴ were secured. The government will continue to invest in the ALMP measures in order to include as many unemployed persons as possible. The ALMP measures, assuming a 5% increase in unemployment or retaining participants in the work force under assumption of 30,000 new participants per year, would lead to an employment increase of 10,500 by 2020, i.e. a contribution of 0.4% towards achieving the target employment rate of 62.9% in 2020.

Preparations for a comprehensive external evaluation of the previous cycle of ALMP measures will be started by the CES in the second half of 2014, in the framework of the "External Evaluation of the Active Labour Market Policy" project. The aim is to improve the efficiency of the ALMP measures, while establishing reporting based on standardised categories and outcomes. Also, the projects of active labour market policies that are to be co-financed by ESF in 2014 contain an evaluation component.

Financial incentives that employers can use through ALMP measures are linked to unemployed persons in target groups designated by the European Commission and employers can use them

⁴⁴ The amount stated for ALMP is the amount for this purpose in the state budget, but does not include financial incentives and benefits given to persons included in ALMP measures.

exclusively based on an employment contract or a contract for vocational training without commencing employment, for which they pay the same compulsory health and pension insurance contributions. This way, measures contribute to a reduced number of unemployed persons and to an increased total number of employed persons. At the same time, the said financial incentives are restored to the budget through consumption, or increased purchase power of the employed persons, via public charges for taxes, surtaxes and benefits and via the reduced usage of social welfare and social payments. Since the proposal of the Industrial Strategies and the Tourism Development Strategy assumes the creation of new workplaces, employment with said measures and incentives will free additional financial assets for employers to use for investments, as well as for new, incentive-free employments.

The government pays special attention to combating youth unemployment and has accepted a recommendation of the European Commission for drafting the Youth Guarantee Implementation Plan. The Youth Guarantee Implementation Plan contains measures that aim to, once the required capacities are established, give a quality offer of employment, traineeship, action learning, apprenticeship and a continuation of education to each person by the time they are 30 years old. The Youth Guarantee Implementation Plan includes an analysis of the position of youth on the Croatian labour market, the analysis of the gap between the existing state and the required expansion of the support system for their inclusion in further education or the labour market. Furthermore, the Plan recognises the measures and reforms that will be carried out for the purpose of establishing a quality support system through the cooperation of all institutions and partners acting as stakeholders on the labour market. It also includes the financial allocations of instruments by each specific measure, with a detailed monitoring and reporting system, for both national and EU needs.

The Council of the Minister of Labour and Pension System, composed of relevant state and public bodies, chambers, social partners and non-governmental organisations that deal with youth, was in charge of drafting the Plan. The Council will continue its work through a new body that will be in charge of monitoring the implementation and providing support to the implementation of the Youth Guarantee, while an Interdepartmental working group for the monitoring of the implementation of the Recommendation of the Council of the European Union - Youth Guarantee⁴⁵ was formed. The expected result for the short-term period (2014-2015) is primarily to create the capacities in the CES and other stakeholders for the implementation of the measures in the Youth Guarantee, and increase the share of youth aged 15-30 taking part in the ALMP measures, traineeship schemes and action learning. A greater share of youth entering self-employment is expected, as well as maintaining or increasing the number of students that take part in apprenticeships, i.e. an overall strengthening of the cooperation of the education system and the labour market. The expected results for the 2015-2017 period refer to a reduction of the overall unemployment rate and of inactive persons aged 15 - 25, and an increased activity of persons aged 15-30.

4.2. Research and development

In the context of successful implementation of envisaged reform measures in the area of research and development (R&D) and of achieving the national R&D target, the current level of investments for R&D activities is characterized as not sufficient enough. Therefore, in the upcoming 2014-2020 period Croatia recognized the necessity for an increase in the level of investments by combining the national sources of financing together with the international

⁴⁵ OG 20/14

funds and programmes. Investments in R&D in Croatia in 2013 amounted to 0.77% of the GDP, consisting of 0.42% of GDP invested from the public sector, and 0.35% of GDP from the private sector. The objective of the National Reform Programme in the field of R&D is an increase in the share of overall domestic expenditure for R&D to 1.4% of the GDP by 2020 (0.7% from both the public and private sector), while ensuring efficient contribution of the R&D activities to the economic development and positive spillover effects. In 2014 annual investments in R&D are expected to increase to 0.85% of GDP, based on a forecasted growth rate of investments of 8%.

Table 4: Overview of investments in R&D at the national level, in the 2005-2013 period

	2005	2006	2007	2008	2009	2010	2011	2012	2013 ^e
Public sector (GOVERD and HERD), <i>share of GDP</i>	0.51	0.48	0.47	0.5	0.51	0.42	0.42	0.41	0.42
Private sector (BERD or BES), <i>share of GDP</i>	0.36	0.27	0.33	0.4	0.34	0.33	0.34	0.34	0.35
Total (GERD), <i>share of GDP</i>	0.87	0.75	0.8	0.9	0.85	0.75	0.76	0.75	0.77

e = estimated

Source: Eurostat, CBS, Ministry of Science, Education and Sports

In the context of strengthening the national innovation system and the innovation potential of the economy, several strategic documents are being developed, primarily the National Innovation Strategy of the Republic of Croatia 2014 - 2020, and the Smart Specialisation Strategy of the Republic of Croatia. These two strategic documents will ensure a reference framework and prerequisites for the improvement of the national innovation management system, strengthening the cooperation between science and the business sector, the economy innovation potential and human innovation resources, and also streamlining the legal and fiscal innovation framework.

Furthermore, the adoption of the Strategy for Education, Science and Technology in 2014 will set the framework for the development of science and higher education in the period up to 2020, with the emphasis placed on transforming the science system in order to ensure closer link with the economy. It should also ensure the increase of investments in R&D by upgrading the public funding system and the promotion of investments by the business and social sectors in R&D.

In 2013 the Research Infrastructures Roadmap in the Republic of Croatia 2014-2020 was completed as a response to the challenge of investments in fields where the needs and potentials for the development of knowledge, improvement and growth are the greatest. The Plan will function as a roadmap for future investments in large national or pan-European scientific research infrastructures in accordance with specific scientific priorities and available financial resources. The Plan also assumes joining additional ERIC initiatives: ESS, SHARE and ELIXIR depending on available resources.

A call for proposals has been put out for NEWFELPRO, a programme for encouraging the mobility of young and experienced scientists in the framework of the Marie Curie/COFUND - FP7 programme. A grant scheme has been prepared in the framework of the Human Resources Development Operational Programme 2007-2013. In the framework of the Regional Competitiveness Operational Programme, the "Biosciences Technology Commercialisation and Incubation Centre - BIOCentre" project is being implemented. It is designed as an active factor in ensuring a productive relationship between basic and applied scientific research and the economy, technological infrastructure and new biotechnology companies in the process of developing new products. In addition, a tender has been put out for the construction/reconstruction of scientific research infrastructure of public scientific organisations - "The Development of the Research Infrastructure at the University of Rijeka Campus".

In order to increase the capacities for the R&D and innovation institutions in Croatia, a call for proposals has been launched - "Preparation of Infrastructure Projects Pipeline for ERDF 2014-2020" and a loan was granted by The World Bank for the implementation of "Second Science and Technology Project (STP II)".

Project contracting in the framework of the "Strengthening Research, Development and Innovation Capacities for Collaborative Projects of Scientific Research and High Education Institutions in Partnership with the Private Sector" tender is expected in 2014. Also, in 2014 it is planned to actively participate in the so-called "widening" in the framework of Horizon 2020 and to strengthen capacities for Croatian scientists to participate in other activities of Horizon 2020. Participation in similar initiatives at the EU level will continue.

4.3. Climate change and energy

INCREASING ENERGY EFFICIENCY

In the field of energy efficiency, changes to the Act on Energy End-use Efficiency have been made⁴⁶ and a new Building Act⁴⁷ has been adopted. In the framework of the energy reconstruction of buildings the Retrofitting Programme for Public Sector Buildings 2014-2015 has been adopted and five buildings have been reconstructed in accordance with the Programme in the 2012-2013 period. The Retrofitting Programme for Residential Buildings 2014-2020 and Retrofitting Programme for Commercial Buildings 2014-2015 have been prepared. On the local level, there is recognition of the need to encourage the construction of buildings with energy characteristics better than prescribed, which is reflected in the way that some local self-government units have reduced the amounts of municipal charges for those buildings. On the level of business entities, there has also been recognition of the need to encourage the construction of buildings with better energy characteristics, so commercial banks grant so called "green loans" to investors that choose such construction.

By implementing measures in the field of energy efficiency, the following are expected: a rationality and efficiency in using energy and energy products, raising the general awareness of the need and models of energy saving in all sectors, reducing the dependence on imported energy products and achieving target values of energy savings by 2020. In accordance with the Second National Energy Efficiency Action Plan of the Republic of Croatia up to 2014,

⁴⁶ OG 153/13, 14/14

⁴⁷ OG 153/13

energy reconstruction of buildings will be implemented and the increase of the number of zero-energy buildings will be stimulated. The aim is to improve energy characteristics in accordance with the requirements of the 2010/31/EU Directive on the energy efficiency in buildings.

From the aspect of energy certification, data is continuously updated and imported to the registry of reports on energy audits and energy certificates of buildings, consumption levels and authorized physical and legal person that carry out the energy certification. Data of the Statement from the Register of Persons Authorised for Energy Audits and Energy Certification of Buildings are available to the public since 2010. The methodology that contains the algorithm to calculate energy characteristics of buildings at the primary energy level has been completed. Additionally, the development of computer programmes for the needs of the energy certification of buildings will be started. This will have a significant impact on the disburdening of the public administration, speeding up operations, better availability and transparency of data to users, simplification of the certification scheme, control and balance of quality in the energy certification market.

The harmonisation of the institutional and legal frameworks for the development of the energy market should enable and universally regulate energy efficiency in all segments; production, distribution and energy transfer, transport with an emphasis on alternative fuel vehicles and energy product consumption in housing and consumption and use of quality environmental products, achieving in general goals set on the national level. The setting up of new legal and institutional framework also lays the foundation for the energy policy of Croatia and for the guidelines to develop relations with other Member States of the EU. Furthermore, there will be stimulation envisaged for investments in projects to increase energy efficiency in all economy segments, in industrial and technological development projects with an emphasis on low-carbon characteristics and effects, and the development of a single comprehensive national programme for monitoring, measuring, analysis and control of the wholesome energy market that will make reports to bodies on the integral market possible.

The new legal framework and the national and institutional programmes in the energy sector encourage the development of overall management of energy and energy products, with the aim of reductions of energy prices and expenditures, consumer protection, creating a system of national safety in energy product provision, establishing a regional and international cooperation in creating an integral energy market in order to increase the competitiveness of the economy and creating new jobs.

INCREASE OF RENEWABLE ENERGY SHARE IN TOTAL CONSUMPTION

In the context of increasing the share of renewable energy sources (RES) in total consumption, the expert analysis for the National Energy Efficiency Action Plan was prepared and the measures for the implementation of energy efficiency in the field of energy use were defined. The National Action Plan for Renewable Energy Sources by 2020 was adopted in October 2013. In addition, several energy efficiency projects in the LC(R)SGU have been realized.

With the aim to achieve the headline target, the existing energy framework in the field of RES shall be enhanced. The construction of power plants in electricity production from renewable energy shall continue to be encouraged, as well as construction and use of cogeneration plants, establishment of system of use of renewable energy for natural persons, use of fuels from waste in the cement industry, obligation to place bio fuels on the Croatian market, liabilities of procurement or rent of vehicles that can run on alternative fuels in public transport and public sector and the production of alternative fuels.

GREENHOUSE GAS EMISSION REDUCTION

By the establishment and implementation of the legal framework for mitigation and adaptation to the climate changes and the protection of the air, and the adoption and implementation of strategic documents, Croatia focuses its development on the economy with low emissions of greenhouse gases and creates a framework for encouraging the use of green technology and innovations, energy efficiency and use of RES. It also seeks to provide risk and damage avoidance due to the impact of climate change.

In April 2014 The Act on Amendments to the Air Protection Act⁴⁸ was adopted, which forms the legal basis for the adoption of strategic documents in the framework of adaptation to climate change and air protection. In 2013, in cooperation with the United Nations Development Program "Framework for Low-Emission Development Strategy for Croatia" was completed, with the aim to develop a long-term strategy of low-carbon development of Croatia. With the funds of Global Environment Fund, the implementation of the project "Integration of Climate Variability and Change in the Integrated Coastal Zone Management" has started. Also, the framework was designed to develop a National Plan for Emission Reduction from Transport with an analysis of the fleet, and the study "Model for Collecting Fees for CO₂ Emissions into the Air from Road Motor Vehicles" was constructed under the "polluter pays principle."

The Strategy for the Management of the Marine Environment and Coastal Zone in Croatia is being drafted, with the legal basis contained in the Environmental Protection Act⁴⁹ and Regulation on Establishing a Framework for Action of Croatia in the Field of Marine Environment Protection⁵⁰. The Strategy consists of preparatory documents and action programmes, and the document Initial Assessment was drafted and adopted in 2012. Also, the economic and social analysis is being drafted as well as determining of Good Environmental Status of Marine Waters and Set of Targets and System of Monitoring and Assessment. By achieving and maintaining good status of the marine environment and coastal zones the conditions for sustainable management of the area shall be achieved in terms of responsible and sustainable planning and development of area, and appropriate use of potentials of the Croatian coast and the Adriatic Sea, taking into account existing challenges (infrastructure, construction, population, economic activities) and the obligation to implement the appropriate safety measures.

Within the framework of waste management, a new Act on Sustainable Waste Management⁵¹ was adopted. The new implementing regulations with the aim of establishing a new legal framework for progress in the functioning of the management system of special waste categories according to the market principles, are being prepared as well as regulations with the aim to regulate the management and establishment of system for municipal waste in the area of units of local self -government. The aforementioned aims to encourage sustainable development of Croatia by establishing more efficient and financially more sustainable waste management system. The main objective is to establish a waste management system that uses the resources from waste more efficiently in an environmentally acceptable manner.

⁴⁸ OG 47/14

⁴⁹ OG 80/13

⁵⁰ OG 136/11

⁵¹ OG 94/13

4.4. Education

In the area of education the headline targets are keeping the level of early school leaving at no more than 4% and an increase of the share of persons with completed tertiary education at the age of 30-34 to 35%. In the context of the education system reform, which shall contribute to achieving the set objectives, in the coming period measures for improving the quality and efficiency of the education system, increase of availability of education by easier access to education at all levels and improvement of coordination of the education system and labour market needs shall be implemented. The activities related to the achievement of this goal, and in particular to improvement of quality and efficiency of the education system, are aimed at establishment of a comprehensive and effective system of quality assurance of education at all levels, including external evaluation and self-evaluation of educational institutions, and then at encouragement of adaptability of educational programmes to the needs of the labour market and, the establishment of an effective network of educational institutions and qualifications / programmes / curricula aligned with the needs of the labour market and human resource development, improvement of the system of vocational education through the development of new vocational curriculum aligned with the needs of modern society, especially in terms of the development of key competencies (functional literacy, numeracy, digital competence, foreign languages, entrepreneurship, mathematics and natural sciences, interpersonal and social skills, learning to learn, general culture), and the adoption and implementation of new programmes and curricula based on learning outcomes.

Given that the existing Network of Primary and Secondary Schools, Student Dormitories and Educational Programmes⁵² does not meet the needs of the education system and does not ensure uniform conditions and access to education, it is necessary to restructure and establish efficient and effective network of schools and educational programmes, according to which, with the greater autonomy, the available financial resources shall be managed reasonably. The preliminary analysis related to the legal provisions relating to the establishment, termination and status change of schools has been implemented. The analysis of the existing Network of schools and educational programmes, and preparation of a draft guidelines for the development of rational and effective network of schools and educational programmes are in the course of drafting.

In accordance with the objectives of the draft Strategy for Education, Science and Technology a complete implementation of curricular reform and connection of the components of the educational system in a coherent, connected, flexible and efficient unit, based on common educational values, principles and objectives is being planned. With the same objective, the Act on Amendments to the Preschool Education Act⁵³ and the Act on Amendments to the Primary and Secondary Education Act⁵⁴ have been enacted. In parallel with the development and adoption of curricular documents, the strengthening of material, infrastructural and personnel requirements necessary for the success of process of introducing the curriculum shall continue to be made. All these activities lead to reform of educational hierarchy in a way to ultimately acquire relevant competencies and skills in line with labour market needs.

Within the reform of the education system it is planned to early involve children in the education system, or to extend compulsory education. In addition to assuring the viability and effectiveness of the system and raising the level of participation in adult education programmes, the same will provide better conditions for improving the quality of pre-tertiary

⁵² OG 70/11

⁵³ NN 94/13

⁵⁴ NN 94/13

education, i.e. the acquisition of key competences for lifelong learning, strengthening social cohesion and preventing social exclusion and increasing the competitiveness of Croatian society and economy.

In order to prevent early school leaving, especially with children from poor families and other vulnerable groups having a much higher likelihood of early school leaving, or who fall into the category of young people who are unemployed and are Not in Education, Employment, or Training (NEET), and ensuring the acquisition of minimum educational standards and additional competencies for vulnerable students, a number of measures such as (co-)funding of textbooks for elementary and high school students who live in poor socio-economic conditions, (co-)funding of textbooks for blind high school students, (co-)funding of transportation for elementary and high school students who live in poor socio-economic conditions and funding of continuing education for students who have completed the two-year and three-year vocational programmes to ensure vertical mobility, shall be implemented.

The relevance of higher education qualifications in relation to the needs of the labour market shall be increased by the implementation of Croatian Qualifications Framework, as well as by encouraging academic programmes in technical, biomedical, biotechnological and natural (STEM) fields, and in the information and communication field. Regarding the development of a quality assurance system of higher education a five-year cycle of re-accreditation of all higher education institutions, is being conducted, and the procedures of external evaluation of foreign universities by the Agency for Science and Higher Education were launched. An analysis of the implementation of the Action Plan for Removing Obstacles to Mobility for the period from 2010 to 2012 was drafted and based on the same draft of Action Plan for the Internationalization of Higher Education was made. Reforms in the field of higher education in Croatia are aimed at increase of relevance, quality, efficiency and availability of higher education, with the aim to provide quality and socially equitable system of higher education, to realize the strategic goal of 35 % of persons with completed tertiary education at the age of 30-34 by 2020 and acquisition of competences in accordance with the needs of the labour market. Further activities in this area shall seek to improve the quality of higher education and quality assurance system as national, institutional and individual priorities and to shorten the period of acquiring qualifications. Also, the Ordinance on the conditions and manner of exercising the right of state scholarship⁵⁵ is provided to increase funds for scholarships for students of lower socioeconomic status. Providing direct support for students of lower socioeconomic status, the improvement of high educational infrastructure (particularly institutions related to the students' standard, such as student dormitories and restaurants), and subsidizing of successful students in order to increase motivation, will result in increase of the number of higher educated persons in the total population. Also, such activities assure the availability of higher education in accordance with the personal abilities and the conditions for its successful completion.

4.5. Reduction of poverty and social exclusion

In the second half of 2013 preparation started on the draft of Strategy on Combating Poverty and Social Exclusion in Croatia (2014-2020), the fundamental document that should provide a systematic and common approach of the relevant stakeholders in tackling poverty and social exclusion. Drafting of the Strategy is in its final phase.

⁵⁵ OG 159/13

In order to provide the conditions for a successful fight against poverty and social exclusion and reducing inequalities in society, and in accordance with the headline target of the Europe 2020 strategy, Croatia will, by 2020 strive to reduce the number of people at risk of poverty and the unemployment rate and insufficient participation in the labour market. Strategic activities of the Strategy are defined in accordance with the current socio-demographic trends, assuming economic growth, positive trends of the labour market and assurance of the conditions for opening new jobs, creation of measures aimed at long-term unemployed persons and other vulnerable groups (the youth, persons with disabilities, the Roma) and investing more effort into increase of adequacy of social benefits in the social welfare system, standardized availability of education, health, social and other services, availability of housing, reducing regional disparities and tackling debt and financial dependence. It is estimated that, by the implementation of thereof, the number of people living at risk of poverty and social exclusion shall be lowered for 150,000 by 2020.

The Strategy defines the following key objectives:

- Fight against poverty and social exclusion and reducing inequalities in society,
- Preventing emergence of new categories of the poor as well as reducing the number of poor and socially excluded people, and
- Establishing a coordinated system of support groups at risk of poverty and social exclusion.

The Strategy also defines the vulnerable groups and eight strategic areas of activity:

- Education and lifelong learning,
- Employment and access to employment,
- Housing and the availability of energy,
- Access to social benefits and services,
- Access to the health system and long-term care,
- Care for the elderly,
- Regional approach to tackling poverty and social exclusion, and
- Tackling debt and the financial independence.

The Strategy has indicated the role of stakeholders, monitoring of implementation and reporting.

Meanwhile, the drafting of an action plan developed for the three-year period has started. The plan sets the manner of monitoring and adaptation of adopted measures to the new circumstances and changes, assessment of effectiveness of the proposed measures and policies through clearly defined indicators, which shall enable the comparability of data for Croatia with EU member states. Progress on the implementation of measures shall be reported to the government on an annual basis.

5. ADDITIONAL REFORM MEASURES AND THE USE OF STRUCTURAL FUNDS

The accession to the EU has enabled Croatia to use the Structural Funds and the Cohesion Fund for the first time. Approval for the use of EU funds for the financial period from 2007 to 2013 Croatia received in 2014, in the areas of environment, transport, development of human resources and regional competitiveness. In the area of transport, investments are aimed at railways and inland waterways, in the area of environment at the development of infrastructure for waste management and integrated waste management systems, as well as the water sector. Support to regional competitiveness through EU funds involves improvement

of regional business and tourism infrastructure, raise of the attractiveness of regions, direct encouragement of entrepreneurs and investment in research and innovation. The development of human resources is supported through measures for employment and increasing the adaptability of the workforce, strengthening of social inclusion and integration of the persons in an unfavourable situation, strengthening of abilities and skills through better education and R&D, and strengthening of the role of civil society for better management. Support to the effective management of funds and institutions in the management and control system is provided through technical assistance.

In 2012, the government has adopted two important decisions related to the provision of sufficient capacity for managing the funds to enable employment of additional staff on the positions of management of EU funds⁵⁶. According to the decision of 6 December 2012, 204 new servants and employees were to be hired until 31 March 2013 in the bodies of the system. The Coordinating body regularly monitors the implementation of these decisions. The collected data show that in the period from 1 November 2012 until 1 October 1 2013, 148 people were employed and that there were 26 applications in progress. In the period from March 31, 2013 until October 1, 2013, 24 civil servants and/or employees were transferred internally, while a total of 32 servants and employees left the bodies of the system. Additional staff trainings relating to specific responsibilities within the management and control system are envisaged for the 2014. Special attention shall be paid to the development of competencies in the field of public procurement and state aid.

The main strategic document for the use of EU funds in the period of 2014-2020 – the Partnership Agreement – has been officially submitted by Croatia to the European Commission in April of 2014; formal negotiations on the content of the programming documents will follow. The approval of the Partnership Agreement and the related operational programmes by the European Commission is expected by the end of 2014, as well as notification to the European Commission for a new management and control system for the period of 2014-2020. Croatia has decided to implement all 11 thematic objectives of the Regulation (EU) no. 1293/2013⁵⁷, while the majority of European funds shall be focused on the development goal for growth and jobs. In such a way, the ESI funds shall, among others, support the further development of the capital market in terms of providing adequate sources of financing for small and medium-sized enterprises (strengthening the system of credit guarantees, micro-financing of start-up companies, loan lines for encouragement of exports, seed and venture capital, especially in terms of support of the commercialization of promising technologies, etc.), ALMP measures, particularly with regard to addressing youth unemployment (the implementation of the Youth Employment Initiative, activation of the Youth Guarantee, etc.) and long-term unemployed (through enhancement of the effectiveness of labour market institutions and higher efficiency of educational programmes, such as requalification and professional advancement in the field of adult education, etc.). Croatia also plans to invest substantial funds from the ESI funds in the period of 2014 to 2020 in research and innovation, with the aim to ensure long-term sustainable growth. In this regard, R&D in the business

⁵⁶ Decision concerning the activities which the ministries and other institutions included in the IPA programmes implementation need to carry out in 2012 in order to obtain the licence to operate the EU pre-accession programmes management system without the *ex-ante* control by the EU Delegation, as well as the licence to operate the EU funds implementation system in the Republic of Croatia, Class: 400-01/05-02/01, Reg. No.: 5030125-12-13, of 26 July 2012, and Decision concerning employment through the public tender procedure at ministries and other institutions included in the IPA programmes implementation for the purpose of obtaining the licence to operate the EU pre-accession programmes management system without the *ex-ante* control by the EU Delegation, as well as the licence to operate the EU funds implementation system in the Republic of Croatia, Class: 400-01/12-01/13, Reg. No.: 50301-25/25-12-5, of 6 December 2012

⁵⁷ Regulation (EU) no. 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No. 1083/2006

sector shall be especially supported, as well as scientific excellence in the areas of smart specialisation and strengthened cooperation between academic and business sectors.

In the field of education Croatia will direct ESI funds to improve the availability, quality and relevance of tertiary education, to increase the quality, relevance and attractiveness of vocational education programmes, to increase participation in lifelong learning and, by using the potentials of information and communication technologies, to improve methods and contents for learning and support to equal access to quality primary and secondary education, through the national project of e-school.

In the field of network and transport infrastructure, ESI funds, together with other funding sources, shall contribute to a balanced coverage of Croatian territory with fast and ultra-fast broadband access in accordance with the objectives of the Digital Agenda for Europe, better transport connections within the Single European Transport Area, with an emphasis on multimodality and interoperability, addressing bottlenecks on the main traffic routes in the country and further development of railway transport.

The ESI funds shall also be directed to the fulfilment of the obligations under the Treaty of Croatia's Accession to the EU in the field of environmental protection (water and waste). Croatia has a substantial need to reduce energy consumption and increase use of renewable energy sources in final consumption. In this respect, part of the resources from the ESI funds shall be focused on promotion of energy efficiency and energy savings in buildings and industry, increase of the share of renewable energy use in district heating and transport sector and encouragement of public transport and mobility with zero emissions.

Finally, through ESI funds in the period from 2014 to 2020 , Croatia intends to support the reform processes, especially in the field of implementation of reform of public administration and the judiciary (evidence-based policy-making, monitoring and analysis of impacts, greater transparency and effectiveness of treatment, the improvement of human resource development system, improvement of social dialogue, etc.), reorganization of the hospital system and the transition from institutional to community-based social care and healthcare.

Box 5.1. Use of the Structural Funds and the Cohesion Fund in the 2007-2013 period

Main projects being prepared for financing in the following period or being implemented already:

- Water supply systems, sewerage and wastewater treatment systems in Osijek, Poreč, Vukovar and Čakovec,
- Construction of a new suburban railway line on the sections Gradec - Sveti Ivan Žabno and Podsused - Samobor - Perivoj,
- Construction of a second track and railway reconstruction on the section Dugo Selo - Križevci,
- Construction and equipping of the Marko Marulić Polytechnic Innovation Centre, and
- Development of research infrastructure at the Rijeka University Campus.

Grant schemes:

- Business infrastructure,
- Preparation of regional projects,
- Strengthening the competitiveness of small and medium enterprises (production and tourism),
- Business process analysis and innovation with the help of ICT,
- Research, development and innovation capacity building,
- Preparing the stock of infrastructure projects for the 2014-2020 period,
- Improvement of labour market access for persons with disabilities,
- Expanding the network of social services in the community,
- Social dialogue strengthening,
- Local employment development initiatives,
- Direct grants for the CES,
- Education for entrepreneurship and trades and crafts,
- Microprojects for the financing of innovative activities of small non-governmental organisations at the local level,
- Capacity building of non-governmental organisations active in the area of social services,
- Support to non-governmental organisation programmes in the fields of advocacy and motivation for socially excluded groups,
- Support to non-governmental organisation programmes for the purpose of strengthening economic and social cohesion,
- Modernisation of school curricula in vocational education and training schools in accordance with variable labour market needs,
- Improving the quality of higher education through the use of the Croatian Qualifications Framework,

6. INSTITUTIONAL ISSUES AND STAKEHOLDER INVOLVMENT

The social partners and civil society were included in the definition of major reform measures introduced in the National Reform Programme, through the process of designing key legislative packages and the process of consultation with the interested public, especially in the case of drafting sectoral development strategies.

In the context of the preparation of long-term fiscal consolidation measures for outsourcing, i.e. the separation of services of supporting activities, the dialogue with both social partners is being held, as well as with all trade unions and employers' association. A conference shall be organized, with the aim of the government to jointly discuss the models and sign a tripartite agreement. For the SPC and reform of social contracting, a public debate related to the Social Welfare Act was held, while the other consultation is being held at the multilateral level with all stakeholders. A public debate was also carried out regarding the extent of the reorganization of the judicial system. Furthermore, with regard to one of the key reform measures, the 2014-2016 National Development Plan of clinical centers, clinical hospitals, clinics and general hospitals in Croatia, directors or remediation hospital managers, were the key stakeholders during the expert consultations in the final stages of drafting of the National Plan. Their contribution was crucial in the validation of quantitative data and analysis and in clarification of the local/regional circumstances and specifics which were taken into account while planning the development of hospitals, or drafting of the National Plan. The National Plan was presented to the public through the website www.zdravlje.hr where the public debate on the contents of the same was conducted until April 18.

During 2013, the Ministry of Science, Education and Sports conducted consultation with the interested public and the social partners regarding the adoption of the Strategy for Education, Science and Technology, amendments to the Science and Higher Education Act, amendments to the Ordinance on State Aid for Research and Development Projects, and drafting of a National Plan for scientific-research infrastructure in Croatia. All the proposed documents, which were forwarded for public discussion, were made available to all stakeholders, which proved to be an excellent practice of open dialogue, cooperation and partnership with citizens, public and private institutions, and generally, the interested public. The final versions of all documents were aligned in accordance with the collected constructive suggestions and comments.

The consultation was conducted for the industrial strategy during February and March of 2014, and comments received from the public are being aligned. For the purposes of the Innovation Strategy of Croatia from 2014 to 2020, an Internet consultation with the interested public was conducted in December 2013, and the Report on the conducted consultation was published on the website www.mingo.hr. In the process of preparation of the Smart Specialization Strategy, private and research sectors were continuously consulted, and five regional workshops (Partnership Consultations) were held. After the ex-ante evaluation of Smart Specialization Strategy by the European Commission, the workshops with interested public and partners shall be organized again.

The Ministry of Labour and Pension System, in order to develop new Act on Pension Insurance, during the 2013 conducted a public consultation on the Draft Proposal Act, through the site www.mrms.hr. Within the framework of the drafting of hereof, the public presentations were held on Draft Statement Proposal on RIA and Thesis for the new Act on Pension Insurance on the sessions of the Council for Labour, Active Aging and Employment and the National Council for Retired and Seniors. Public forums on proposals to create a new act were presented as well in the Faculty of Law in Split, and in the county chambers of the Croatian Chamber of

Economy in Rijeka and Osijek. Information about thesis and conducted consultations on the Draft Statement Proposal on RIA of the Draft Proposal Act on Pension Insurance were presented at the meeting of the Economic and Social Council, while the Croatian Academy of Arts and Sciences and the Ministry jointly organized roundtable entitled "Population Policy and Labour Market" where the news anticipated by the reform of the pension system were presented.

In order to draft the new Labour Act during 2013, all forms of consultation with the interested public were conducted, and on several occasions public presentations were held with representatives of the academic community and the Croatian Chamber of Economy in Zagreb, Split, Rijeka and Osijek. The Draft Act was further discussed on the meetings with the judicial officials and the relevant inspection services, while in separate consultations with the social partners more than fifty hours of intensive conversations and consultation were spent.

Draft Proposal Act on Aid for Job Preservation was also the subject of consultation, in accordance with the regulations governing the assessment of the effects of regulations, while the public debate on the Draft Proposal Act on Aid for Job Preservation and Proposed testimony about RIA was carried out in the form of a round table.

Also, during the 2013 the similar was done within the framework of the draft of Act on Vocational Rehabilitation and Employment of Persons with Disabilities, when all forms of consultation were performed in accordance with the regulations governing RIA. Draft proposal was presented at the conference "Vocational Rehabilitation - Challenges and Opportunities", and in February of 2014 consultations on proposals of related ordinances for the implementation of this Act were conducted.

An Internet consultation was conducted with the interested public for the Programme of energy renovation of commercial non-residential buildings for the 2014-2020 and for the Programme of energy renovation of residential buildings for the 2014-2020. Based on the public debate on the Programme of energy renovation of residential buildings, the Programme of energy renovation of family houses was deducted from the Programme of energy renovation of multi-residential buildings and has been adopted as a separate document.

A significant interaction of key stakeholders took place in the framework of the preparation of the Youth Guarantee Implementation Plan (YGIP) primarily through the work of the Council of the Minister of Labour and Pension System for creation of that document, and this process of involving key stakeholders was on several occasions highlighted by the European Commission as an example of good practice of a social dialogue.