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

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Executive summary

This is the third specific monitoring report on Croatia under the macroeconomic imbalances procedure (MIP). It reviews economic developments in Croatia since the publication of the previous report in February 2015 and assesses the main policy measures taken to correct the country's macroeconomic imbalances. It takes into account the findings of a visit to Croatia by a team from the European Commission on 12-14 October 2015.

With the run-up to the parliamentary elections, the implementation of the reform agenda has suffered significant delays. The elections were held on 8 November and at the time of writing a new government had yet to be formed. In the period under review, the authorities advanced on reforms in some areas, notably as regards the insolvency framework. However, some decisive reforms remain in preparatory phase and other policy decisions were put on hold because of the elections.

After six years of recession, Croatia's economy has started to grow again in 2015. Real GDP growth in the first three quarters of the year turned out significantly higher than expected, as the contraction in domestic demand came to a halt and exports continued to show healthy growth. Growth in 2015 as a whole is expected at well above 1 %, marking the first year of positive growth since 2008, but still leaving real economic output some 11 % below 2008 levels. The turnaround in the current account that started in 2013 has not yet resulted in an improvement in Croatia's net international investment position and the underlying gross external debt is still growing.

The rising general government debt is a source of concern. According to the Commission's 2015 autumn forecast, it will reach 89.2 % in 2015 and increase further to 92.9 % by 2017. While the general government deficit is expected to fall to 4.9 % of GDP in 2015, it will likely be the highest deficit ratio in the EU. Some steps have been taken to improve budgetary planning and tighten expenditure control, but measures to strengthen the fiscal framework are facing delays. Moreover, plans to introduce a proper recurrent property tax, to which the authorities committed themselves in 2014, have been put aside. Some of the savings measures identified in the spending review (the findings of which are yet to be published) are being implemented, notably in healthcare and the rationalisation of state agencies, but at a slow pace. Lastly, although Croatia's increasing financing needs highlight the importance of developing and maintaining reliable financing sources, no steps have been taken to reinforce public debt management.

The decrease in the unemployment rate initiated in 2014 continued in 2015, but the rate remains very high. The labour market shows some positive developments. The first monitoring report of the 2014 labour market reform draws a mixed picture on the take-up and impact of the new provisions. In other areas too, the picture is at best mixed. Preparatory steps have been taken towards reform of the wage-setting framework in the public sector, but concrete measures have yet to be adopted. Recent measures in support of youth employment are starting to bear fruit and steps have been taken to combat undeclared work. The authorities completed a review of the tax and benefits system, but this has not translated into concrete reform plans to streamline social benefits. Finally, the number of people retiring early decreased in the first half of 2015, but policy action aimed at encouraging particular categories of workers to stay in employment longer has been put on hold.

Weaknesses remain in public sector governance. A comprehensive reform of local governance to overcome fragmentation and administrative weaknesses is not in sight, although limited action was taken to establish a legal framework for the merger of local government units and streamline the state agency system. The procedure for selecting SOE board members has been made more transparent, but measures in the field of public corporate sector that were planned for the autumn (in particular, the adoption of a corporate governance code, the revision of remuneration rules for SOE board members and the development of a framework for setting company-specific objectives) were delayed in the run-up to the elections. The listing of minority packages of public companies' shares and privatisations did not advance significantly.

The business environment will benefit from recent steps to reduce administrative burdens and reform the insolvency framework. There was some progress in decreasing the burden of parafiscal charges on businesses and first concrete steps were taken to reduce the administrative burden on business. On the other hand, the use of regulatory impact assessment (RIA) has not been scaled up, although some measures are being taken to strengthen the RIA framework. Lengthy court proceedings and sizeable backlogs still hamper the efficiency and quality of the justice system, despite improvement in some areas. The effective implementation of the recently reformed corporate insolvency framework and the new personal insolvency legislation will help speed up liquidation and restructuring proceedings and allow citizens to discharge their debts.

The prolonged recession, together with recent policy action, has weakened the capacity of the financial sector to support the recovery. Banks' lending activity remains subdued, also owing due to the still high rate of non-performing loans. The new insolvency framework should eventually contribute to their resolution, but a more comprehensive strategy to accelerate their reduction would help to revive lending to the real economy. Banking sector profitability is being affected by the new legislation allowing conversion of CHF-denominated loans into EUR-denominated loans at historic rates, which weighs on their capacity to support the nascent recovery and creates negative implications for public finances. The measure may also adversely affect investor sentiment and pose a challenge for exchange rate management. Finally, the authorities' plan to conduct an independent asset quality review of HBOR's credit portfolio in 2017 is welcome, given the crucial role that the Bank is having in the economy and the fact that it increasingly engages in direct lending activity. However, speeding up the envisaged timeline could be considered.

The nascent economic recovery provides an opportunity to step up the reform momentum decisively. The new government will be faced with major policy challenges, ranging from high public and external debt to high unemployment and weak governance. Much of the preparatory work for the requisite structural reforms and fiscal adjustment has been done, but the authorities' commitment to the reform agenda needs to be re-affirmed ad implementation stepped-up (see Table 1).

Table 1: Key findings on implementation of reforms[1]

On track	Wait and see	Action wanted
• Insolvency framework • Measures in support of youth employment • Reduction in administrative burden on business • Improving tax compliance	• Budgetary planning • Revision of fiscal rules • Healthcare efficiency • Wage-setting framework • Reduction in inflows into early retirement • Reductions of parafiscal charges • Improvements in the transparency and accountability in the public corporate sector • Improving the efficiency and quality of the justice system • Strengthening governance in HBOR	• Fiscal consolidation to enable reduction of public debt • Public debt management reinforcement • Reform of public administration • Introduction of a recurrent property tax • Improvements to legislative planning • Listing of minority packages of SOE shares and privatisations • Streamlining of social benefits

1 Introduction

On 28 November 2014, the European Commission presented, in the context of the macroeconomic imbalances procedure (MIP), its fourth Alert Mechanism Report[2] which concluded that an in-depth analysis was required to understand whether macroeconomic imbalances exist in Croatia. The subsequent country report on Croatia – published on 26 February 2015[3] – examined the nature, origin and severity of macroeconomic imbalances and risks in Croatia. In this report, the Commission concluded that "Croatia is experiencing excessive macroeconomic imbalances, which require decisive policy action and specific monitoring." In particular, the Commission emphasised risks related to weak competitiveness, large external liabilities and rising public debt in a context of weak public sector governance.

[1] The table classifies reforms under review on the basis of their adoption and implementation status, credibility and level of detail, as follows:
- 'on track': measures for which the legislative or implementation process has been completed or is on schedule, and which are expected to be sufficiently effective;
- 'wait and see': measures for which the legislative process is ongoing, but is still in a relatively early phase, or for which there is still uncertainty as to complete implementation and effectiveness; and
- 'action wanted': measures for which limited or no action has been taken, or which have been announced but are as yet insufficiently detailed to be assessed.

[2] http://ec.europa.eu/europe2020/pdf/2015/amr2015_en.pdf

[3] Subsequently republished as "Macroeconomic Imbalances country report – Croatia 2015", Economy Occasional Paper no. 218: http://ec.europa.eu/economy_finance/publications/occasional_paper/2015/pdf/ocp218_en.pdf

On 23 April 2015, Croatia submitted to the Commission its national reform programme (NRP).[4] It describes the measures taken and planned by the Government to achieve sustainable economic growth and create jobs, while pursuing sound public finances and a sustainable level of public debt. On 30 April 2015, Croatia submitted to the Commission its convergence programme,[5] covering the period 2015-2018 and setting out the fiscal adjustment strategy. Taking into account the circumstances and commitments outlined in these documents, in May the Commission recommended[6] and in July the Council adopted[7] six country-specific recommendations (CSRs) for Croatia. All of these recommendations were considered MIP-relevant, and they focus on the policy areas of public finances and taxation, labour market, public administration and business environment and financial sector. On 30 July 2015, the government adopted a plan for the implementation of the NRP and the CSRs (hereafter referred to as the "implementation plan"). An overview (timeline) of the measures that were announced, adopted and implemented under the NRP and the implementation plan is provided in Annex 1.

Croatia has been in the corrective arm of the Stability and Growth Pact since January 2014, when the Council opened the excessive deficit procedure. Croatia is requested to correct the excessive deficit by 2016. The procedure has been held in abeyance since June 2014. The latest report on progress made in the implementation of the procedure was submitted on 30 October 2015.[8]

This report assesses policy progress by Croatia regarding the adjustment of the identified macroeconomic imbalances. It incorporates the findings of a specific monitoring mission to Croatia conducted on 12-14 October 2015. The report does not provide an assessment of fiscal policy, in order to avoid an overlap of surveillance processes.

This report follows two previous such reports, namely the 1st monitoring report from October 2014 and the aforementioned 2015 country report. An update to this report will be made early in 2016, which will be integrated in the 2016 country report on Croatia.

The cut-off date of the report is 2 December 2015.

2 Macroeconomic context

After six years of recession, Croatia is set to return to positive growth in 2015. Economic activity picked up strongly in the first three quarters of the year. On 27 November, real GDP growth was reported at 0.3 %, 1 % and 1.3 % quarter-on-quarter, in the first, second and third quarter, respectively. The third quarter came in significantly stronger than previously expected and is set to entail an upward revision for 2015 as a whole as well as 2016 compared to the Commission's 2015 autumn forecast (according to the latter forecast growth

[4] http://ec.europa.eu/europe2020/pdf/csr2015/nrp2015_croatia_en.pdf
[5] http://ec.europa.eu/europe2020/pdf/csr2015/cp2015_croatia_en.pdf
[6] http://ec.europa.eu/europe2020/pdf/csr2015/csr2015_croatia_en.pdf
[7] http://ec.europa.eu/europe2020/pdf/csr2015/csr2015_council_croatia_en.pdf
[8] Croatia was requested to provide such report every six months by the Council Recommendation of 21 January 2014 with a view to bringing an end to the situation of an excessive government deficit in Croatia.

was forecast at 1.1 % and 1.4 %, for 2015 and 2016 respectively, which already represented a substantial upward revision with respect to previous forecast). Growth in goods exports continued to be buoyant, while domestic demand also contributed positively to growth. Lower energy prices and a reduction in personal income tax boosted private consumption and investment appears to be picking up. A good tourist season contributed to the strong outcome in the third quarter. Overall, these are welcome developments after the prolonged recession, although potential growth remains rather subdued for a catching up economy.

The rebalancing of the external sector is progressing, with exports growing at double digit figures for two years in a row. The volume of exports of goods in the first semester of 2015 was over 10 % higher than in the previous year. This strong increase followed the good performance recorded already in 2014 (11 % year-on-year) and signals that Croatia is not only benefiting from the recovery of its trading partners, but also regaining some of the market shares lost in the years before the crisis. Imports of goods in the first half of the year were also sustained and grew above that of internal demand. All in all the dynamics and structure of exports and imports seem to suggest that Croatia is benefiting from increased integration in the single market. With oil prices declining, the balance of goods and services is set to improve to 3.2 % of GDP in 2015. The improvement in the current account has been less substantial so far, on the back of a mild deterioration of the balance of primary and secondary incomes in the course of 2014. In 2015 it is expected to reach a record high of 4.4 % of GDP as temporary effects related to the conversion of CHF-denominated loans influence the repatriation of banking sector profits.[9]

The turnaround in the current account has not yet resulted in a significant improvement in the ratio of the net international investment position to GDP. Having reached a peak value of -99 % of GDP in the first quarter of 2011, the net international investment position (NIIP) reached -88 % of GDP in the course of 2013, on the back of valuation effects. In the context of a relatively stable HRK (both with respect to the EUR and in terms of nominal effective exchange rate), these figures have so far reflected a deterioration of confidence in the Croatian economy as well as the good performance of most EU stock markets. The NIIP has since stabilised at around – 90 % of GDP, while gross external debt continues to rise (it reached 112 % of GDP in the second quarter of 2015, from 107 % in the same quarter of previous year), as the general government is increasingly borrowing on external markets[10]. Adverse dynamics in real growth and prices, through the denominator effect, continued to slow down the reduction of the NIIP to GDP ratio.

Going forward, internal demand is set to become the main growth driver. Continuous contractions in private consumption and especially investment have detracted from growth over the past years. In 2015, the contribution from internal demand is set to turn positive and strengthen over the forecast horizon. The dynamic of private investment is nevertheless

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[9] Specifically, losses suffered by the primarily foreign-owned banking sector will result in a negative flow of retained earnings corresponding to about HRK 5 bn, i.e. 1.5 % of GDP.

[10] Negative valuation effects linked to exchange rate movements also contribute to the increasing gross external debt, while they did not affect NIIP, as hedging instruments are also accounted for the in the NIIP and not in the gross external debt.

expected to be subdued, as relatively high debt levels still weigh on households and corporations. A major contribution to investment is therefore expected to come from the government sector, which is set to benefit from an enhanced absorption of EU funds.

The reduction in the unemployment rate initiated in 2014 continued in 2015. The registered unemployment rate (non-seasonally adjusted) fell from 18.7 % in October 2014 to 17.2 % in October 2015, the lowest October result since 2009. The Labour Force Survey (LFS) confirms this picture: the unemployment rate stood at 15.4 % in the third quarter of 2015, down from 17.1 % and 16.1 % in the first and second quarter respectively (seasonally adjusted rates). The contraction in the unemployment rate is driven by the shrinking pool of unemployed, whereas previous contractions were mainly affected by a surge in the activity rate. As for employment, different sources point to contrasting developments, something that continues to pose a challenge for the monitoring of labour market trends.

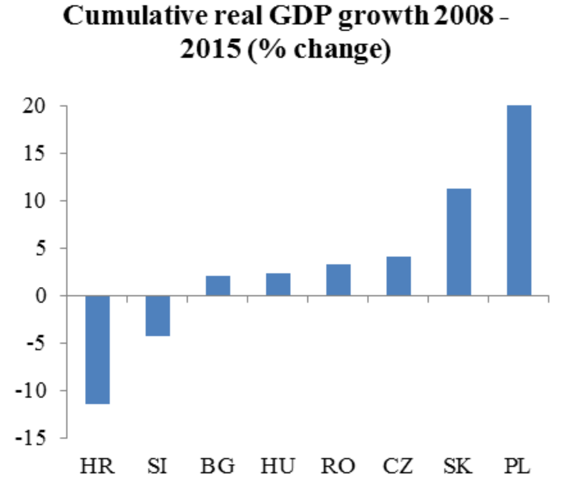
Real unit labour costs are expected to remain broadly stable in 2015, as declining prices offset the impact of the nominal wage adjustment. Productivity is set to marginally increase in 2015, as GDP growth outpaces employment growth. After the strong decrease registered between 2010 and 2014, real unit labour costs (ULC) are set to broadly stabilise. In the period from January to August 2015, the average monthly gross earnings amounted to HRK 8036 (EUR 1056). This represents a nominal increase of 1.1 %, but a real increase of 1.4 % from the levels recorded in the same period of 2014, since prices continued to decline, with the HICP index falling by 0.5 % year-on-year in October 2015.

Household debt-to-GDP ratio remains stable at around the 2014 values, whereas for corporates it continues to decrease. Credit growth continues to be negative, as both, the volume of household loans and corporate loans continue to contract, albeit at a slower pace overall (according to ECB data in September 2015 the contraction of corporate loans year-on-year was -2.2 %, versus -4.5 % a year before). Interest rates on corporate loans are on a slightly decreasing trend, while those for households are stable, according to the Croatian National Bank. Hampered credit growth can also be attributed to the continuously increasing non-performing loans (NPLs). In June 2015, the share of NPLs in total loans reached 17.3 %, driven by the corporate sector (see Section 3.4).

General government debt is set to increase further. Thanks to the improving macroeconomic situation and some containment of expenditure growth, the general government deficit in 2015 is expected to fall to 4.9 % of GDP, from 5.6 % in the previous year. Still, according to the Commission's 2015 autumn forecast, in the period 2015-2017 Croatia will record the highest deficit ratio in the EU. As the primary balance remains negative and nominal growth is subdued, the debt-to-GDP ratio is expected to continue rising to 89.2 % of GDP in 2015 and to 92.9 % of GDP by 2017. The forecast rests on a no-policy-change assumption. In particular, it does not incorporate new policy measures that might be presented in the 2016 budget, which is yet to be adopted by a government that will be formed on the basis of the recent parliamentary election.

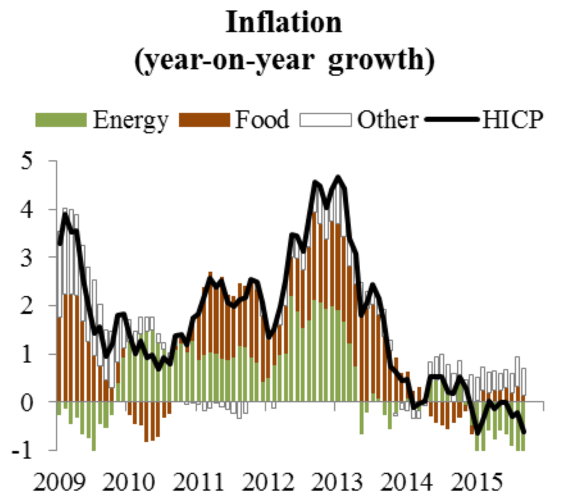
Overall, recent indicators suggest that the recession may be over, but vulnerabilities inherent in the large internal and external debt positions persist. Whereas the external adjustment has progressed swiftly, debt in the private sector is still holding back investment and consumption and leverage ratios will need time to adjust in a context of low growth and subdued inflation. Rising debt in the public sector remains a source of concern.

Recent macroeconomic developments



Source: Eurostat, ECFIN AF2015

Source: Eurostat, ECFIN AF2015



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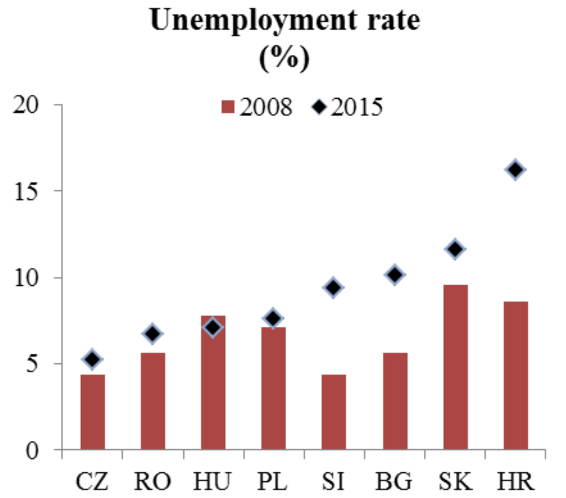
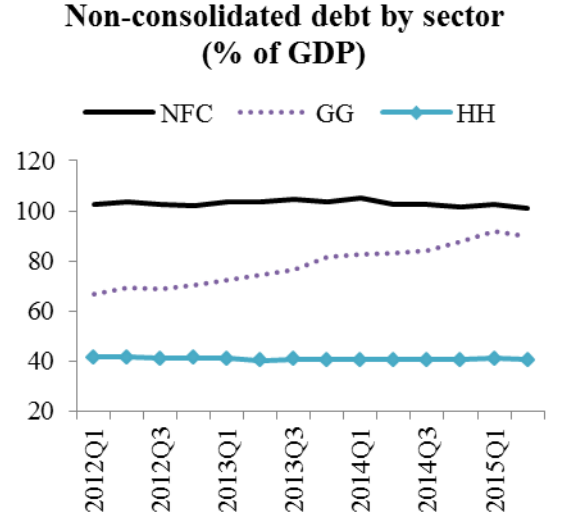


Source: Eurostat, ECFIN AF2015



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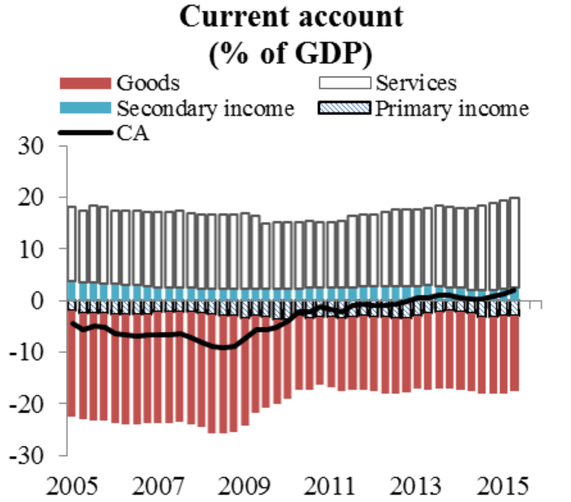

Source: Eurostat

3 State of play with MIP-related reforms

This section gives an update of policy measures taken since the last country report on Croatia, published in February 2015.

3.1 Measures related to public finances and taxation

The authorities have taken some steps to improve the accuracy of budgetary planning and tighten control over expenditure. Responsible fiscal policy requires careful costing of ongoing government programmes and new policy proposals. In Croatia, the fiscal impact assessment of new legislation tends to follow a formalistic approach with very little informative content. In October, the government adopted a new standard form for the fiscal impact assessment of new legislation, which somewhat strengthens the position of the Ministry of Finance in the process.[11] This is a welcome step, but whether or not it will effectively overcome the formalistic approach observed on some of the recent pieces of legislation is yet to be shown. The new assessment form also allows reporting funding from deficit-neutral sources (e.g. EU Funds). This increases transparency and may further assist budgetary planning, but caution will be required to avoid budgetary surprises as the eligibility for EU funds may not always be clear *ex ante*. The authorities secured additional funding for the State Audit Office (SAO) to hire new staff in 2015-17 and are considering introducing sanctions for non-compliance with SAO's recommendations. Moreover, the Public Internal Control System Act adopted in July 2015 subjected public companies, including those owned at local level, to the internal audit rules applicable in the public sector. This is expected to increase transparency in the use of public funds.

A new Fiscal Responsibility Act, which is expected to strengthen the framework for fiscal discipline, has not yet been adopted. The Act has the potential to contribute to sound fiscal policy making in the long run. However, further work will be required on the draft Act to effectively implement the Directive 2011/85/EU on budgetary frameworks. This concerns in particular (i) putting in place adequate safeguards for the political, financial and functional independence of the Fiscal Policy Committee (FPC), (ii) granting the FPC the required mandate for the assessment of fiscal rules and forecasts, and (iii) ensuring full consistency of domestic numerical fiscal rules with the EU framework.

Croatia has the lowest share of property taxes in GDP in the EU.[12] This is due to the lack of recurrent taxation on immovable property. Recurrent taxes on immovable property have a number of desirable features. First, from an economic efficiency point of view, they are generally considered the least detrimental to growth, as they affect savings and investment decisions as well as labour supply less than other taxes. Second, since real estate property is by nature immovable, the tax revenue generated from it is rather predictable and the tax

[11] The Ministry of Finance will be expected to give explicit approval – rather than just an opinion – on the proposed estimate of the fiscal impact. In cases when the proposing body claims that the new measure has no impact, the Ministry of Finance continues to give an opinion.

[12] In 2012, property taxes amounted to 0.3 % of GDP in comparison to the EU average of approximately 2.3 %. See http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structures/2014/report.pdf.

harder to evade than other taxes. Third, if properly designed to take into account the social situation of the payer, recurrent property taxes can also be justified from a distributional point of view, since they act as a tax on wealth (Croatia currently does not apply any tax on wealth). Finally, for a country in the excessive deficit procedure, higher property taxation could support the government's consolidation efforts. For all these reasons, Croatia was recommended to introduce a recurrent property tax, following the commitment taken by the authorities in the 2014 convergence programme.

Despite some preparatory work, the introduction of a recurrent property tax is no longer planned and the authorities are focusing on upgrading the existing system of communal fees instead. A framework law for real-estate valuation was adopted in July, but the actual property valuation method is yet to be established. Indeed, the policy focus has shifted on the upgrade of the existing system of communal fees, but also in this area there have been delays as the adoption of the key Local Utilities Act, which determines the way local units set the level of the communal fee, has slipped to the term of office of the next government. Update of records on utility fees payers and the register of properties is underway. The authorities expect that the harmonisation of communal fees may have a revenue-increasing impact of 0.1 % of GDP.[13] This is still well below the 0.4 % of GDP that was expected from a recurrent property tax in the convergence programme. While there would be a benefit in harmonising the fragmented and costly system of communal fees, with every municipality determining its own parameters, communal fees are inherently different from property taxes. Such fees are directly linked to the cost of providing a service, which suggests earmarking of revenues, while the primary purpose of a tax is raising revenue. Moreover, similarly to parafiscal charges, vaguely-defined service fees may act as hidden taxes, interfere with the distributional objectives of general taxation and add to the complexity of the tax system.

The publication of the spending review and implementation of its findings have been delayed. In 2014, public spending in Croatia (48.2 % of GDP) was considerably higher than the non-weighted average of other new Member States (41.9 % of GDP) and somewhat above that of all EU Member States (46.4 % of GDP). While public spending in Croatia exceeded the average of its peer countries already in 2008, nominal growth of primary expenditure has been very subdued since the onset of the protracted recession. Against this background and with the aim to achieve efficiency savings, Croatia carried out an expenditure review in early 2015. The review focused on five expenditure categories, covering almost half of total general government expenditure in 2014, and aimed at delivering a package of measures from which the government could choose with a view to reducing public spending by 10 %. The five categories are: wages in the state budget, health care, subsidies except for agriculture, operational expenditure of public agencies and tax expenditure. The findings of the review have not been published yet, despite the call to do so in the country-specific recommendation of July 2015. However, some of the identified saving

[13] Revenue from communal fees amounted to around 0.6 % of GDP in 2012. See http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/article_5985_en.htm. According to the authorities, the revenue remained at this level also in 2014.

measures are being implemented, namely in the area of health care and the rationalisation of public agencies, while preparatory work has been undertaken in the area of wage setting in the public sector (see below). Overall, progress has been stalling in the run up to the general elections.

The authorities are taking measures to improve tax compliance. A Compliance and Risk Management System (CRMS) for the assessment of risks pertaining to tax liabilities and tax payers is gradually being developed with a view to being fully operational in June 2016. The system is part of an action plan to improve VAT compliance. It aims to address a number of risks related mainly, but not exclusively, to VAT refunds and the application of the reverse charge mechanism. There have been implementation delays in the development of the CRMS. The Tax Authority carried out several broad-based inspections with respect to the use of cash registers and introduced lottery-based awards to improve tax compliance. The Tax Authority is yet to put in place a VAT gap measuring system for the monitoring of the effectiveness of measures aimed at tackling tax fraud and evasion.

Continuous rise in public debt calls for a more engaged approach to public debt management. Croatia's increasing financing needs and high dependence on external financing highlight the importance of developing and maintaining reliable financing sources, subject to a cautious assumption of risk and consistent with maintaining debt sustainability. To this end, Croatia was recommended to reinforce its public debt management. To date, Croatia has not defined a medium to long term debt strategy. The debt issuance plan for 2016 will be prepared in conjunction with the budget for 2016 after the new government is formed, while the convergence programme 2015 announces the production of a public debt management strategy for the period 2017-2019 by the end of 2016. No significant steps have been taken to ensure adequate resourcing and to reinforce debt management function.

The implementation of efficiency-improving reforms in the health care sector is ongoing but faces delays. The implementation of a number of measures envisaged in the National Development Plan for Hospitals has been postponed, including the adoption of the Quality Act (which sets requirements for tendered inputs). The authorities have completed the consultations with all hospitals in view of their planned functional integration. Some initial steps have been taken towards such integration, with four hospitals already in the implementation phase. The reform of hospital financing started to be phased-in in April this year, with the aim *inter alia* to decrease the proportion of advance payments based on past spending. The initial target of the reform was a 65 % decrease in the share of advances to hospitals by the end of the 2015, but its implementation is being slowed down to allow for a longer transition period.

The reduction in arrears in the health care system is not proceeding according to plan. The authorities committed in the NRP to reduce arrears by 25 % in 2015 (from 0.8 % of GDP at the end of 2014). However, in September 2015, the stock of arrears remained broadly unchanged as a result of their decrease on the part of the Health Insurance Fund and continued accumulation of arrears at hospitals. According to the authorities, the slower-than-planned reduction in arrears is mainly caused by the revenue side of the healthcare system.

The reasons are partly related to the gradual introduction of the above-mentioned new hospital financing model. The authorities remain confident that the ambitious end-2015 target will be met despite the delays recorded so far.

3.2 Measures to improve the functioning of the labour market and the effectiveness of social protection

The Croatian labour market shows some positive developments, although different data sources point to diverging trends. The first monitoring report of the 2014 Labour Act draws a mixed picture on the take-up of the new provisions in the law and their effects on the labour market. The report indicates that few new collective agreements make use of the greater flexibility allowed in the organisation of working time. It should nevertheless be noted that many collective agreements – including in the public sector – will be renegotiated over the next couple of years, and the take-up of these provisions may increase thereafter. The Labour Act extended the maximum employment period for work through temporary agencies, which has resulted in an increase of this type of contracts. Part-time work (which was made less costly with the new law by becoming pro-rata based) has become more frequent in the private sector. The time to process collective dismissal procedures has been significantly reduced, while provisions for voluntary arbitration, as foreseen by the Act, are yet to be introduced. Beyond these clear developments and the short time span, inconsistencies across the available data sources hinder a more detailed monitoring of the impact of the labour market reform. Namely, the Labour Force Survey (LFS), the register of affiliates to social security (Pension Insurance Institute) and the survey of establishments, all point to different employment dynamics, with the first two indicating employment growth (although at different rates) and the latter showing that employment destruction continued in the third quarter of 2015. According to the authorities, the inconsistency between the LFS and the database of the Croatian Pension Insurance Institute applies also to the composition of fixed-term and open-ended contracts. Continued monitoring and further work aimed at reconciling the findings from different data sources appear warranted.

Preparatory steps have been taken towards the reform of the wage-setting framework, but concrete measures are yet to be adopted. The planned reform of the wage-setting framework covers three broad areas: public administration and public services; SOEs; and the private sector. Following the review of wage-setting and the spending review conducted in early 2015 (see Section 3.2), a draft law on wages in the public sector is currently under preparation. Its main objective is to address the high degree of heterogeneity and inconsistency of wage determination across the public services. The authorities reported that the new law aims at harmonising the wage regulatory framework across public administrations and public services, *inter alia* by introducing a universal system of wage grades. In the area of SOEs, the Ministry of Labour carried out a detailed analysis of all existing collective agreements concluded by state companies. The analysis highlights elements that hinder SOEs' restructuring processes (such as open-ended collective agreements and the existence of privileged rights granted to certain categories of workers) and addresses a set of recommendations to the State Property Management Administration (DUUDI), which is in charge of the follow-up. As part of the effort to set up a more harmonized and coordinated system of wage-setting, four large SOEs have established an employer association, with membership open to all SOEs on a voluntary basis. As for the private sector, the authorities have tasked an expert team to analyse the coverage and effects of minimum wage in terms of employment, productivity and social exclusion. The research will focus on sectors with the highest incidence of minimum wage.

Measures in support of youth employment are starting to show first results. The youth unemployment rate (of people between the age of 15 and 24) peaked at 50 % in 2013. Although it declined thereafter (with 43 % in September 2015) it remains among the highest in the EU. In line with the national guidelines for the development and implementation of active labour market policies (ALMPs) for the period 2015–2017, the ALMPs interventions in 2015 continued to focus on youth. The two most used measures for youth (15-29) are hiring subsidies and occupational training, both targeting people without work experience. Following the introduction in early 2015 of employers' contributions exemptions for new hires aged under 30, about 26 000 young persons have been hired on a permanent contract, which is well above the initial target of 12 500. The decline in the number of unemployed youth over the last year may owe to these measures; at the same time, hiring subsidies may be associated with substantial deadweight losses, as the targeted groups may have found employment anyway thanks to the nascent recovery. The Youth Guarantee Implementation Plan (YGIP) is currently being revised and a new plan should be adopted by the end of 2015. Finally, the development of a system to monitor youth who are not in employment, education nor training (NEETs) is facing delays, with the first step in setting up data exchanges and collection taken in November 2015.

Incremental steps are being taken in combating undeclared work. The authorities reported a decline in the incidence of undeclared work, also thanks to measures introduced in 2014. These include the mandatory registration of workers 24 hours before starting employment[14] and the possibility for full-time workers to take up contingent work with different employers[15]. The difficulty to detect envelope wages (especially among young workers) and undeclared overtime work remains an issue. The Commission for Combating Undeclared Work – established in 2014 – continued to carry out activities in the areas identified as the most vulnerable, including cooperatives, the fisheries sector and student work[16].Amendments to the Act on Prohibition of and Prevention of Unregistered Activities are planned before the end of 2015.

In June 2015, the authorities completed an analytical review of the tax and benefits system, which however has not translated into concrete reform plans. The review analyses the social protection system in Croatia through a wealth of detailed data and information from both the central and local government levels. It is meant to inform the design of policy action aimed at addressing the fragmentation and inefficiency of social

[14] Introduced by the Pension Insurance Act in 2014.
[15] Based on the new provisions of the 2014 Labour Act.
[16] A new ordinance will prescribe measures on protection of students' occupational safety and health, rules on organisation of working time, new criteria for financial monitoring and the use of student contracts.

protection, as also recommended by the Council in June. However, the related Action Plan outlining concrete reform steps – planned for the summer of 2015 – was put on hold, also in view of the autumn parliamentary elections. Thus, the only notable policy progress in this area is the legal establishment of 127 one-stop-shops (OSS), which will serve as the single administrative point for the provision of social services. The OSS are expected to relieve the Social Welfare Centres from the administration of social benefits, allowing them to focus on their core functions. The measure is a welcome step, although its implementation is proceeding slowly. In particular, the full functional transfer of the Guaranteed Minimum Benefit (GMB) to the OSS has been postponed from March to June 2016, while the transfer of other benefits into the OSS (i.e. all child allowances, the unemployment allowance and five different maternity benefits) is planned for end 2016 and early 2017. While the recommended rationalisation of the social protection system has not yet started, some recent measures aim at improving the adequacy and expanding the coverage of social assistance for the most vulnerable. These include a 15 % increase of the GMB for some vulnerable groups, the abolition of the two-year limit for receipt of GMB, and the introduction of a new benefit for 73 000 vulnerable energy consumers. According to the authorities, the cost of the latter benefit will be borne by electricity distributors, without in principle increasing the electricity bill (see Section 3.3).

Inflows into early retirement decreased in the first half of 2015, however vulnerabilities in the system remain. The latest trends in early retirement could be partly related to the improved situation on the labour market, but also to the policy measures[17] taken over the past two years. Awareness raising campaigns have been carried out throughout Croatia, and the authorities report increased interest and understanding among citizens of the financial implications of early retirement for their future pensions. Meanwhile, policy action aimed at streamlining the list of arduous or hazardous professions[18] benefitting from a lower retirement age has been put on hold. The same applies to policies aimed at incentivising special categories of workers[19] to stay in employment after maturing their pension rights. Finally, the authorities acknowledged that future reform plans would have to take into consideration concerns about adequacy of pensions in the long term, as highlighted in the European Commission 2015 Pension Adequacy Report.

3.3 Measures to enhance the functioning of the public administration and improve the business environment

Progress in executing the reform agenda in the public administration remains uncertain. The reform of governance at local level to overcome fragmentation and administrative weaknesses, as planned in the NRP, is still not in sight. Over the past year the authorities have mainly focused on gathering data and information for the analysis of the

[17] These include: the compulsory registration to the Croatian Pension Insurance Institute upon taking employment; the harmonisation of pension rights between men and women (which nevertheless is proceeding very slowly); and the newly introduced medical controls for disability pensions.
[18] Progress was made in analysing and monitoring 11 professions and 14 jobs, out of the 74 selected.
[19] This refers to the planned Act on Pension Insurance Rights for Active Military Personnel and Police Officers. The Act would *inter alia* also regulate the transfer of funds from the 2nd to the 1st pillar for certain groups of prospective pensioners.

functional distribution, costs and capacities of local government units. The Action Plan for the Modernisation of the Public Administration, adopted in September 2015, is only a starting point for the development of appropriate measures and intermediary steps. A number of other initiatives have been put on hold, including: the planned 20 % reduction in the number of state offices in local units; the merging of the management structures of regional administration offices, with a view to reducing them from 20 to 5; and the amendments to the Civil Servants Act aimed at redefining accountability and decision-making in the civil service as well as simplifying recruitment and dismissal procedures. In September 2015, the parliament adopted a law which establishes the legal framework for the voluntary mergers of local government units. While this is a welcome step, the law does not establish the envisaged financial incentives. As for the rationalisation of the state agencies system, new legislation regulating the establishment of state agencies and introducing a higher degree of homogeneity within the system is being drafted. Out of the nine identified agencies to be merged by the end of 2015, the merger of two is being implemented. Finally, the E-citizens portal (a platform used for providing e-administration services for citizens) has been further developed, facilitating digital certification and communication between the citizens and the public administration.

There was some progress in decreasing the burden of parafiscal charges on businesses, but a new charge was introduced in September. On 23 April, the government adopted the decision to decrease the amount collected by nine parafiscal charges. Of these, seven were eventually cut as planned. In addition, the government decreased the amount collected by five other parafiscal charges. The authorities estimate that the burden on businesses will have decreased by around HRK 300 million as a result, or just above 5.5 % of the overall burden imposed on businesses through parafiscal charges in 2014. This would come very close to meeting the target set by the authorities in the national reform programme (0.1 % of GDP). Another welcome step is the publication of a comprehensive Register of non-tax charges in September, which will be updated quarterly. Finally, the groundwork for reductions in two more charges is underway, and consultations with the business community aimed at identifying scope for further reductions are on-going. At the same time, the ‘Solidarity fee’ recently introduced to finance the new social benefit for low-income households (see Section 3.2) has, according to the authorities, all the elements of a parafiscal charge and will therefore be included in the new edition of the aforementioned Register. Although imposed as a surcharge to electricity bills for household consumers, the cost of this charge (estimated at HRK 130 million by the Ministry of Social Policy and Youth) is in practice being borne by electricity distributors, which have initially agreed to cut their tariffs in order to offset the effect of the surcharge on the final price for consumers.

First concrete steps were taken under the Action Plan for reducing the administrative burden on business. Following the Standard Cost Model (SCM) measurement of the administrative burden carried out during 2015, the authorities have started implementing some measures in the pilot areas of retail and real estate sector. The implementation of the remaining envisaged reductions in these areas is scheduled to last until the end of 2015. In parallel, measurements using the same SCM methodology are being conducted in the remaining six regulatory areas outlined by the Plan (establishment and starting a business, construction, safety at work, renewable energy sources, sanitary and health inspections). According to the Plan, a further 20 % reduction in these areas will be achieved in 2016. The authorities have emphasised the benefits of SCM methodology in informing policy design for the future. They announced a roll-out of SCM methodology to other areas, but also liaison with the Government Office for Legislation to include SCM as an integral part of Regulatory Impact Assessment.

Some initial progress is recorded in the development of electronic tools to enhance communication between the public administration and businesses. Specifically, the functionality of the point of single contact is being strengthened with the development of E-procedures, which is scheduled to last until end-2016. Modelled on the E-citizen platform, an E-business module has been launched.

The use of Regulatory Impact Assessment (RIA) has not been scaled up, but the RIA framework is being strengthened. Only 5.9 % of all legislation underwent RIA this year, even lower than the 7.2 % recorded last year. The authorities identified lack of funding as the main obstacle to improving the quality of RIA. Besides the initial steps taken to improve the quality of fiscal impact assessment (see section 3.1), other positive developments include the completed training in cooperation with UK authorities. Also, the Office for Legislation is preparing a triennial report containing an evaluation of their work in the area of RIA over the past three years, based on which they will recommend legislative changes aimed at strengthening the overall RIA framework.

Lengthy court proceedings and sizeable backlogs still hamper the efficiency and quality of the justice system, but some improvements took place. The backlog in civil, commercial and enforcement cases decreased between January and September 2015 (-8 % compared to end-2014) but this can be mostly attributed to a decrease in workload, as the number of resolved cases did not increase. The average duration of proceedings is actually increasing, with litigious civil and commercial cases at first instance courts taking 756 days and enforcement cases taking 522 days to resolve, on average. In 2015, additional judges have been allocated to the first instance administrative courts. The introduction of ICT in courts is on track, with the last two remaining courts (High Commercial Court and Supreme Court) expected to be included into the unified "e-file" system in the near future. However, the use of ICT in communication with parties remains underdeveloped. The alternative dispute resolution methods appear to be promoted, but remain underutilised.

The new insolvency framework will take time to deliver concrete results. The effective implementation of the recently reformed corporate insolvency framework will help speed up liquidation and restructuring proceedings. The amended law entered into force in September 2015, bringing pre-insolvency cases under stronger control by the commercial courts, with the objective of preventing abuses. According to the authorities, the new rules will allow the state payment agency (FINA) to initiate liquidation for thousands of companies with blocked accounts. The Personal Insolvency Act will enter into force as of January 2016, allowing citizens to discharge their debts. However, lack of experience in this area by the municipal courts may hamper the efficiency of proceedings. Hence, the implementation and impact of this new legislation will require careful monitoring.

A number of measures in the field of public corporate sector have been put on hold, whereas accountability and transparency have somewhat improved. New regulations adopted since the summer on the selection of supervisory and managerial board members have the potential to improve transparency in the selection process and accountability of the boards. In particular, the regulations formalise the selection process and introduce clearer competency requirements for board membership candidates. For management boards, the regulation includes professional staffing agencies in the selection process but their contribution remains somewhat limited. The adoption of the implementing regulation on the organisation and establishment of a central register of state assets was a step in the right direction, while the adoption of a corporate governance code and the revision of remuneration rules for SOEs' board members have been postponed to the end of 2015. The pilot project to develop a standard framework for setting company-specific objectives, scheduled in the NRP between May and October, has been delayed. These objectives should include financial and non-commercial targets that the SOEs' boards are expected to deliver and based on which their performance can be evaluated.

The listing of minority packages of shares of public companies and privatisations did not advance significantly. The successful public offering of shares of the state-owned bank HPB resulted in a capital injection that decreased state ownership, while ensuring compliance with the regulatory requirements for capital adequacy of the banks. For the remaining companies, there has been less progress. Preparations for the listing of the electricity company HEP and the highway management company HAC ONC are proceeding, but the initial public offering procedures have been postponed. One company (Luka Vukovar, administering the port of Vukovar) is in the process of price determination and some other companies are in the phase of examination of investors' interest (e.g. Croatia Airlines). In general, the list of companies in which the State has a strategic or special interest, which are managed by the State Property Management Administration (DUUDI), has decreased from 59 to 56.

The supervision of publicly owned enterprises remains fragmented. The monitoring framework currently in place allows for statistical and budgetary control, but may not be broad enough given the role these companies play on the labour and product market. Nevertheless, the above-mentioned new legislation subjecting SOEs to internal audit requirements (see Section 3.1) is expected to improve transparency and accountability in the public corporate sector.

3.4 Measures to strengthen the financial sector's capacity to support economic recovery

In spite of positive economic growth in 2015, the rate of non-performing loans (NPLs) remains very high, as the broad process of corporate restructuring continues. In June 2015, NPLs reached 30.9 % in the corporate and 12.1 % in the household sector for an overall ratio of 17.3 %. Nevertheless, the coverage of NPLs with provisions has also increased, thanks to automatic measures introduced by the CNB, in addition to international financial reporting standards provisioning rules. In June 2015, the provision coverage ratio stood at 53 %. The implementation of the amended corporate insolvency legislation should contribute to the faster resolution of corporate NPLs, although this will take some time. Also, the resolution of household NPLs should benefit from the new personal insolvency legislation coming into force in January 2016 (see Section 3.3). Specialised distressed assets' investors have so far shown limited interest in Croatian NPLs. This is possibly due to the small size of individual banks' portfolios, although during the first half of 2015 more NPL sale activity has been registered, especially in the retail segment (for about 1 % of total non-performing loans). There may be additional room for improving the low take-up of NPL write-offs, which are in general tax deductible. The current tax regulation related to NPL write-offs leaves room for interpretation, which entails legal risks for banks.

The Croatian banking sector and economy as a whole will be affected by the conversion of CHF-denominated loans into EUR-denominated loans. The Croatian parliament passed legislation in mid-September requiring banks to propose to the borrowers the conversion of their outstanding CHF-denominated loans into EUR-denominated loans. The loans are converted using a model that applies the exchange rates and interest rates that were applied to corresponding EUR-denominated loans in the period from the origination of the loan until the date of its conversion.[20] The sudden appreciation of the CHF in January 2015 provided grounds for a public intervention to reduce the financial stress facing many Croatian households. However, the adopted measure does not appear proportionate as it places most of the burden of the conversion on the banks, and its equitability is uncertain as all borrowers that have CHF-denominated loans receive relief, regardless of their socio-financial circumstances. From a macro-financial perspective, the adopted solution will hit banks' profitability and capital base: according to estimates by the Croatian National Bank[21], the losses will amount to around HRK 8 bn, corresponding to around three years of banks' profit before taxes. While the banking sector and financial system as a whole are expected to withstand this hit, as the banks' capital base remains strong,[22] this will weigh on their capacity to support the nascent recovery. The measure also undermines legal certainty in the country and may thus adversely affect investor sentiment. Furthermore, the international reserves will have to serve as a buffer to defend the current exchange rate levels, and this might cause a loss of over EUR 1 billion in reserves (around 8 % of gross reserves), posing a challenge for exchange rate management. Moreover, the measure will put a strain on Croatian public finances, as the losses incurred by the banks will be tax deductible and result in lower

[20] If after conversion, the total amount that debtor with a CHF-denominated loan paid exceeds the total amount he would have paid on the corresponding EUR-denominated loan, this excess (over-payment) will decrease his future instalments by up to 50 % per month, until this excess is used up. The new repayment plan could also result in an under-payment, if the total amount repaid so far on CHF-denominated loan is lower than the amount that would have been repaid had the loan been denominated in EUR. However, borrowers are not obliged to accept the conversion.

[21] http://www.hnb.hr/priopc/2015/hrv/hp15092015_CHF.pdf, September 2015

[22] The capital adequacy ratio is estimated to decrease from 23.5 % (at the end of June 2015) to 19.7 %, still above the levels in many other EU countries and well above the minimum regulatory requirements.

revenues for the government. Finally, the banks have challenged the new legislation in court, and the favourable outcome for banks may have further negative implications for public finances.

The Croatian Bank for Reconstruction and Development (HBOR) could play a crucial role in supporting the economic recovery and is to become a key partner in the EU investment plan. The mission of the national promotional bank HBOR is to support exports, finance infrastructure and provide credit to SMEs. In doing so, the Bank increasingly engages in direct lending activity. Like for any other promotional bank with a public mandate, its economic rationale is to overcome market failures that may lead to less investment than would be economically efficient. However, as stressed in the Commission Communication on the role of National Promotional Banks (NPBs) in supporting the Investment Plan for Europe,[23] NPBs need appropriate legal and regulatory frameworks and governance structures to avoid the possible negative side effects of NPB action, such as the misallocation of investment and preservation of inefficient market structures due to political interference; the crowding out of private sector financing alternatives, where these exist; and losses to the guarantor governments stemming from substandard underwriting. The Communication sets out some guiding principles in this area, by way of best practices. Namely, these include high standards of transparency and accountability, professional management, and prudential supervision exercised independently by a separate entity. While the announcement by the authorities to perform an independent asset quality review of HBOR's credit portfolio in the second quarter of 2017 is a welcome development, the envisaged timeline appears to lack ambition. Furthermore, there are currently no precise plans to subject HBOR to prudential supervision by the CNB. Similarly, fitness and probity requirements for HBOR's management currently do not require prior experience in HBOR's areas of operations.

[23] , http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0361&from=EN , 22 June

4 Annex Table

Ensuring stable public finances			
Public finance and taxation			
Fiscal policy and fiscal governance			
Announced measures	***Adopted measures***	***Implemented measures***	**Source of commitment**
Expenditure review July 2015: Publication of results of the in-depth analysis of public expenditures *Fiscal rules* September 2015: Adoption of the new Fiscal Responsibility Act. *Improving control over expenditure and budgetary planning* For the 2016 budget: Provision of guarantees will be made stricter and conditional upon presentation of a restructuring plan of companies applying for guarantees. *Strengthening the State Audit Office* End-2015: Introduction of sanctions in case of non-compliance with SAO's recommendations.	*Improving control over expenditure and budgetary planning* July 2015: Adoption of the Public Internal Control System Act. The most important novelty is that companies owned by the government and local entities are now subject to the law and thus need to develop a robust internal audit function. The Act implements the provisions of the Fiscal Responsibility Act, under which the mentioned companies shall provide a Statement of Fiscal Responsibility to the competent authority. November 2015: Adoption of a new standard form for fiscal impact assessment. The new form will enter into force in January 2016. 3rd quarter 2015: New guidelines on expenditure planning for entities drawing funds from the state budget were prepared and will be used for the preparation of the 2016 budget.	*Strengthening the State Audit Office* September 2015: Increase in budgeted resources for the SAO. Adoption of an action plan to increase its capacity.	**CSR 1: "Publish and implement the findings of the expenditure review. Improve control over expenditure at central and local level, in particular by establishing a sanctioning mechanism for entities breaching budgetary limits. Adopt the Fiscal Responsibility Act and strengthen the capacity and role of the State Audit Office. Reinforce public debt management, in particular by publishing on an annual basis a debt management strategy and ensuring adequate resourcing."**
Broaden tax bases			

Recurrent property tax <u>September 2015</u>: Harmonisation of the level of charges and their collection rate across local units. • Sept: An action plan is planned to be adopted • End-year: Implementation *Tax (VAT) compliance* <u>2015</u>: Further upgrade of IT communication channels with taxpayers – identification of obstacles, provision of additional electronic payment channels.	*Recurrent property tax* <u>July 2015</u>: Adoption of the Real Estates' Valuation Act, which establishes a system for determining property values based on housing market data. The Act gives a mandate to the government to adopt, within a year from the entry into force of this act, a decree determining the method for mass property valuation. *Tax (VAT) compliance* <u>2015</u>: Automated Compliance and Risk Management System for the assessment of risks pertaining to tax liabilities and tax payers is being introduced with a view of being fully operational in June 2016.		**CSR 1: "Introduce a recurrent property tax and improve VAT compliance."**
Long-term sustainability of public finances, including pensions			
Definition of arduous and hazardous professions <u>October 2015</u>: Revision of the list of arduous and hazardous professions, with a view to reducing the number of professions by 50 %. <u>December 2015</u>: Adoption of the Job Categorisation Act. *Special pensions/transfers of pension assets* <u>October 2015:</u> Harmonisation of the criteria for special pension rights of military, police and authorized officials.			**CSR 2: "Discourage early retirement by raising penalties for early exits. Improve the adequacy and efficiency of pension spending by tightening the definition of arduous and hazardous professions."**

Transfer of funds from the second pillar to the first of HRK 1 bn. *Healthcare* <u>October 2015</u>: Revision of health care laws (Health Care Act, Compulsory Insurance Act) introducing a separation of financial and medical management functions in hospitals and revising remuneration rules. <u>October 2015</u>: Adoption of the Quality Act (setting requirements for tendered inputs). <u>November 2015</u>: Implementation of new public procurement systems in state hospitals (to cover 30 % of total purchases of medicines and consumables). <u>December 2015</u>: Introduction of e-referral, e-medical findings form and e-discharge forms to 90 % of entities. <u>January 2016</u>: Start of functional integration of hospital units.	*Healthcare* <u>April 2015</u>: Adoption of a national human resources development plan. <u>June 2015</u>: Adoption of a specialisation plan for hospitals.	*Healthcare* <u>Apr-Dec 2015</u>: Implementation of a new contracting model for hospitals ('money follows the patient' concept). <u>July 2015</u>: Interconnection of financial applications used by hospitals. <u>August 2015</u>: New collective agreement in healthcare sector.	*Healthcare* **CSR 2: "Tackle the fiscal risks in healthcare."**
Reducing unemployment			
Labour market			
Employment protection legislation & framework for labour contracts			
Announced measures	***Adopted measures***	***Implemented measures***	**Source of commitment**

Wage-setting system March 2016: adoption by the parliament of the new Act on Wages in the Public Sector. March-June 2016: competences and needs analysis in the public administration. December 2016: Publication of the new 'competences framework' for civil servants. Inclusion of the identified competences in the internal acts of public entities and systematisation of posts. December 2016: completion of collective agreements with civil servants.	*Wage-setting system* August 2015: Adoption of the Action Plan on the reform of the wage system.	*Wage-setting system* September 2015: Analysis of existing collective agreements in the public sector and SOEs. September 2015: Establishment of an employers association for SOEs.	**CSR 3: "Tackle the weaknesses in the wage-setting framework, in consultation with the social partners and in accordance with national practices, to foster the alignment of wages with productivity and macroeconomic conditions."**
Incentives to work, job creation, labour market participation			
December 2015: Adoption of the Action Plan for the consolidation and reform of social security systems. December 2015: Adoption of amendments to the law on social welfare. December 2015: Amendments to the law on maternity and parental support; Amendments to the Act on Employment Mediation and rights during unemployment; Amendments to the Law on allowances for children. March 2016: transfer of the Guaranteed Minimum Benefit to the one-stop-shop	June 2015: Amendment of the ALMP measure “Coordinators for Community Work” aimed at activating work-capable beneficiaries of social assistance. September 2015: Adoption of the Amendments to the Law on Social Protection, which legally establish the one-stop-shop (OSS) as the single administrative point for the provision of social services.	June 2015: Completion of the analytical review of the tax and benefits system.	**CSR 3: "Strengthen incentives for the unemployed and inactive to take up paid employment. Based on the 2014 review, carry out the reform of the social security system and further consolidate social benefits by improving targeting and eliminating overlaps."**

(OSS). June 2016: implementation of the IT-infrastructure MISSOS for the central management of benefits; OSS administration of maternity and parental benefits. October 2016: Transfer to the OSS the administration of unemployment benefits. March 2017: Transfer to the OSS the administration of child allowance.			
Increasing efficiency and competitiveness			
Public administration and business environment			
Public administration			
Announced measures	***Adopted measures***	***Implemented measures***	**Source of commitment**
December 2015: Adoption of amendments to the Public Servants Act. December 2015: Finalisation of the analysis for the establishment of a new model of distribution of competences among self-government units based on the assessment of fiscal capacity and size. End 2015: Reduction in number of agencies for at least –15 % in 2015; nine agencies identified in the NRP to be merged. October-November 2015: Amendment to the Regulations governing the establishment of agencies and other	June-September 2015: Adoption of the Strategy for Development of the Public Administration and the relevant Action Plan. May 2015: Adoption of the Action Plan to implement the rationalisation of the system of agencies, institutes, funds and other legal persons with public powers. September 2015: Adoption of relevant legislation for the merger of 2 agencies. September 2015: Setting up of legal mechanisms to allow voluntary		**CSR 4: "Reduce the extent of fragmentation and overlap between levels of central and local government by putting forward a new model for functional distribution of competencies and by rationalising the system of state agencies."**

legal persons with public powers; Establishment of a central control of financial operations of agencies and other legal persons with public powers. October 2015: Amendment of the relevant regulation in order to reduce (of at least 20 %) the number of regional units of central state administration bodies by merging them to the counties state administration offices. Finalisation of the functional and fiscal analysis of regional units and establishment of a plan for further rationalization. January 2016: Implementation of the merger of regional units of the central state administration with the counties state administration offices. March 2016: Adoption of the Act regulating in a unified manner the system of legal entities (including state agencies).	mergers and improved coordination between local self-government units. October 2015: establishment of new criteria, and standards aimed at reduction in expenditure in state agencies.		
State-owned enterprises			
September 2015: Recodification of the Management and Disposal of State Assets Act. September 2015: Identification of additional options to offer minority packages of shares of companies of strategic interest. November 2015: Data and software upgrades for the central register of state assets. November 2015: Implementation of the pilot project on one or two majority state-owned companies focused on a comparison of performance indicators		July 2015: Reclassification of selected SOEs of special state interest (their number decreased from 59 to 56.) September 2015: The adoption of a new regulation concerning managerial appointments. Preparation of guidelines for SOEs and remuneration decisions. September 2015: Adoption of the implementing regulations on the organisation, mode of operation and a central register of state assets.	**CSR 4: "Increase transparency and accountability in the public corporate sector, in particular as regards managerial appointments and competency requirements. Advance the listing of minority packages of shares of public companies and privatisations."**

with similar companies. December 2015: Adoption of an action plan for the establishment of medium-term targets. December 2015: Adoption of corporate governance codes. March 2016: Submission of business reports on SOEs owned at local level.			
Business environment			
Parafiscal charges & excessive barriers to service providers September 2015: Identification of parafiscal charges whose value will be decreased in 2016 so as to accomplish the 0.1 % of GDP reduction in that year, giving priority to charges paid regularly by a high number of companies. December 2015: Identification of opportunities to harmonise collection of charges levied by different authorities. 2016: Legislative amendments implementing the 2016 reduction in parafiscal charges (entry into force January 2017). November 2015: Government decision to oblige relevant public bodies to implement online procedures.	*Parafiscal charges & excessive barriers to service providers* April 2015: Adoption of a government decision to decrease parafiscal charges by 0.1 % of GDP in 2015 and 2016 and to establish a Committee responsible for the monitoring and implementing of the decision. September 2015: Publication of the register of non-tax charges. July 2015: Action plan to reduce administrative burden on the economy.	*Parafiscal charges & excessive barriers to service providers* June-September 2015: Legislative amendments following the government's decision from April to reduce parafiscal charges with an estimated effect of reduction for business ca. HRK 300m (entry into force October 2015-January 2016).	**CSR 5: "Significantly reduce para-fiscal charges and remove excessive barriers for service providers."**
Legislative planning and Regulatory impact assessment May 2015: Amendments to the Rules of	*Legislative planning and Regulatory impact assessment*	*Legislative planning and Regulatory impact assessment*	**NRP 4.3 - Improving the quality of new legislation:** **"Measures 1. Strengthening the legislative planning and coordination in the**

Procedure of the GRC with the aim of reducing the number of acts that do not undergo RIA by 25 % and 50 % in 2015 and 2016, respectively (base values from 2014). July 2015: Introduction of ex-post Regulatory Impact Assessment mechanisms for relevant acts (and amendments). December 2015: Introduction of mandatory application of the SME test on the legislation from the domain of SMEs.	October 2015: Evaluation of implementation of the RIA Act for the period 2013-2015 and formulation of recommendations for improvements.	October 2015: Implementation of educational cycles on the application of analytical tools for RIA (impact analysis; cost and benefit analysis) through the Twinning light project	**adoption of regulations on a national level; 2. Strengthening the Regulatory Impact Assessment system"**
		Insolvency framework	
January 2016: Establishment of a working group for monitoring and analysing the application of the act according to pre-defined indicators September 2015: Setting up of a monitoring system suitable to perform an analysis of effectiveness and efficiency of the new (corporate) insolvency act and monitoring its application by courts.	September 2015: Consumer insolvency act (entry into force January 2016).	June 2015: Adoption of the (Corporate) Insolvency Act	**CSR 6: "Reinforce the pre-insolvency and insolvency frameworks for businesses in order to facilitate debt restructuring. Put in place a personal insolvency procedure."**
		Civil justice	
December 2015: Revision of the Civil Procedure Act. December 2015: Decision of the State Judicial Council on the appointment of judges of other courts in administrative courts in Zagreb, Split and Rijeka.			**CSR 5: "Identify and implement steps to improve the efficiency and quality of the justice system, in particular commercial courts."**

Financial sector

Financial services			
Announced measures	***Adopted measures***	***Implemented measures***	**Source of commitment**
			CSR 6: "Strengthen the capacity of the financial sector to support the recovery in view of challenges from high non-performing corporate loans."
Private indebtedness			
Announced measures	***Adopted measures***	***Implemented measures***	**Source of commitment**
		September 2015: Amendments to the Consumer loans Act	**CSR 6: "Strengthen the capacity of the financial sector to support the recovery in view of challenges foreign currency mortgage loans."**
Access to finance			
Announced measures	***Adopted measures***	***Implemented measures***	**Source of commitment**
Amendments to the HBOR Act			**CSR 6: "Strengthen the capacity of the financial sector to support the recovery in view of challenges from weak governance practices in some institutions."**