



**CROATIA**





## Summary

The government has acted on the more stable macroeconomic environment to introduce structural reforms designed mainly to improve fiscal sustainability, a strategy developed in co-operation with the IMF and the World Bank with whom loan agreements have been concluded recently. The challenge for the government is to maintain tight control over public finances, while also attending to short term adjustment problems that the strategy may cause, notably increases in unemployment and pressure to preserve social security entitlements.

*Improving the fiscal balance and developing institutions to promote long-term sustainability.* In the search for a more sustainable fiscal balance, a number of policy priorities stand out. In the area of fiscal policy, the creation of a single Treasury account and the closure of all other government accounts is seen as a major step in controlling outflows and avoiding the build up of arrears in different branches of the public administration. A mechanism for monitoring government guarantees and limiting exposure will also be introduced. Isolation and liquidation of loss-making public enterprises and consolidation of residual government stocks (many in loss-making companies) within a single agency (the Privatisation Fund) are also important initiatives to control outflows.

*Preparing major public utilities for privatisation and completing sales of other key assets.* The first phase, necessary for the forthcoming privatisation – unbundling of core activities and unbundling of core activities from non-core businesses – should take place this year for the electricity (HEP) and oil & gas (INA) companies. Before the end of the year, laws for privatisation of HEP, INA and JANAF (pipeline) will be prepared. The laws, which aim to liberalise markets in the energy sector, are already in parliamentary procedure. The non-core businesses in the energy sector will be ready for privatisation next year. It is expected that the process of privatisation of unbundled core activities will start next year. Other upcoming privatisations include the two remaining state-owned banks, the main insurance company, hotel complexes, and an additional 16 per cent share of Croatia Telecom. The sale of tourist facilities (the majority of which are still publicly owned) should be helped by ongoing work to clear up disputed property rights which is currently impeding investment in the sector.

*Developing a more active policy towards small and medium-sized enterprises.* Following the creation of a separate government Ministry for Crafts and SMEs, the key upcoming initiatives involve preparation of a new law on SMEs and amendments to legislation on craft industries and co-operatives, further enlargement of the regional small business centres and the network of SME consultants, development of training programmes for entrepreneurs, and expansion of the current opportunities for financing for SMEs.

*Strengthening regulatory/supervisory mechanism in the financial sector.* A new law on Banks is being prepared that will strengthen the supervisory role of the Croatian National Bank over the banking sector, including reinforcing measures against banks not in compliance with regulations.

*Building a network of reciprocal trade agreements in line with EU/WTO standards.* Accession to WTO and completion of the negotiation of the Stabilisation and Association Agreement with the EU, which was initialled recently, have provided the impetus for more intensive negotiation of trade agreements with the EU, EFTA, CEFTA, and a large number of bilateral partners, with the aim that 80 per cent of Croatia's foreign trade will be covered by free trade conditions by the end of 2001.

Policy Objective	Planned Actions	Activities Implemented to Date	Remarks	Responsibility for Action	Target Date for Completion
<b>1. FOREIGN DIRECT INVESTMENT POLICIES</b>					
<b>To complete/refine instruments to encourage FDI</b>	Preparation and adoption of a Law establishing a Real Estate Fund	Drafting of the legislation has been completed and the procedure for adoption is in progress	This Fund will be used to facilitate allocation of land for lease by foreign investors	Ministry of Economy	
	Preparation and adoption of the Law on Fund for the Stimulation of Job Creation and Re-training	Drafting of the legislation has been completed and the procedure for adoption is in progress			
	Evaluation of recommendations made in recent FIAS studies	The reports have been submitted to the Government by FIAS for consideration and implementation	The reports assess: 1) Investment Incentives and Related Business Taxes and 2) Administrative Barriers to Investment	Ministry of Economy	
	Ministry of Economy in co-operation with FIAS will organise three workshops on the elimination of the administrative barriers to Foreign Investment (June 2001)	Technical preparation concerning the workshops facilities and participants is in progress	→ I workshop is aimed at ministerial level (policy makers) → II workshop is aimed at middle level government officials → III workshop is aimed at public&private business sector	Ministry of Economy	June 2001

	Preparation and adoption of a new Law on Free Zones designed to unify special regulations applying in these areas within one single legal act	Drafting of the legislation has been completed and the procedure for adoption is in progress Several new sites are under consideration for development as Free Zones	Current discussion revolves around how to maximise employment creation potential of Free Zones, and whether they should be located in target areas (e.g., war-affected regions)	Ministry of Economy	End of the year 2001
<b>To make progress on land and property title issues</b>	Continuation of work on reconstituting cadastral registers and settling outstanding ownership cases in the courts	This is an ongoing process	This issue is crucial because it is difficult to invest in property when legal title is unclear. This also has an impact on the extent and pace of privatisation		Ongoing
<b>To establish functioning institutions for delivery of FDI facilitation services</b>	Establishment of a One-Stop Shop for investors	Drafting of the proposal in progress		Ministry of Economy	End 2001
<b>2. SME SUPPORT POLICIES</b>					
To improve the legal framework for micro-enterprises and SMEs	Preparation and adoption of a new Law on SMEs	Legislation currently being drafted		Ministry for Crafts and SMEs	3rd quarter 2001
	Amendment of the existing Law on Craft Enterprises	Legislation currently being drafted		Ministry for Crafts and SMEs	3rd quarter 2001
	Amendments of the existing Law on Co-operatives	Legislation currently being drafted		Ministry for Crafts and SMEs	3rd quarter 2001
<b>To improve reporting and monitoring of the SME sector</b>	Preparation of a model for follow-up, analysis and reporting on small business			Ministry for Crafts and SMEs	End 2001

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<b>To introduce a range of advisory and technical services for SMEs</b>	Establishment of the national network of small business centres	An operational model for regional business centres has been developed with the World Bank and the county administrations	Projects are to be implemented with assistance from local community funds, state budget and other sources	Ministry for Crafts and SMEs	End 2001
	Training of teachers, advisors and promoters of entrepreneurship	An operational model has been developed with the help of Dutch Government	Training is carried out continuously	Ministry for Crafts and SMEs	Ongoing
	Improvement of the national network of small business consultants	Selection of a consultant firm that will act as the network co-ordinator	Functioning of the network is to be substantially improved	Ministry for Crafts and SMEs	Ongoing
<b>To popularise entrepreneurship</b>	Promotion of entrepreneurship and small business creation	Continuous activities in increasing the share of start-up entrepreneurs	Program is carried out in cooperation with counties	Ministry for Crafts and SMEs	Ongoing
<b>To target financing to key areas of the SME sector</b>	Development of SMEs	Credit line established	Loans initiated by the Ministry and provided by the commercial banks	Ministry for Crafts and SMEs	Ongoing
	Commercialisation of innovations	Credit line established	Loans initiated by the Ministry and provided by the commercial banks	Ministry for Crafts and SMEs	Ongoing
	Support to export-oriented SMEs	Credit line established	Loans initiated by the Ministry and provided by the commercial banks	Ministry for Crafts and SMEs	Ongoing
	Restructuring of SMEs	Credit line established	Loans initiated by the Ministry and provided by the commercial banks	Ministry for Crafts and SMEs	Ongoing

Support to entrepreneurs in tourism	Credit line established	Loans initiated by the Ministry and provided by the commercial banks	Ministry for Crafts and SMEs	Ongoing
Implementation of new technologies	Credit line established	Loans initiated by the Ministry and provided by the commercial banks	Ministry for Crafts and SMEs	Ongoing

### 3. PRIVATISATION

	Preparation and enactment of a new Privatisation Law		Croatian Privatisation Fund		
	Liquidation of persistently loss-making companies	Bankruptcy proceedings have been initiated in a large number of cases	The legal process is taking longer than expected and a backlog of cases has built up	Croatian Privatisation Fund	Ongoing
<b>To extend privatisation to the major utilities and initiate market liberalisation</b>	Preparation of the largest publicly-owned energy enterprises for privatisation: → HEP (electricity), → INA (oil and Gas), → JANAF (pipeline) and → HZ (railways)	Legal instruments for first phase (energy) are already in procedure. The drafts of laws about privatisation will be prepared at the end of 2001. In the case of public energy utilities, additional legislation on market liberalisation and establishment of regulatory bodies is already in parliament procedure (deadline December 2001)	A two-phase approach has been adopted in each case: 1) unbundling of core activities and unbundling core activities from non-core activities and beginning of sale of subsidiary (non-core activities) enterprises in 2002 2) preparation of core business for privatisation in 2002	Ministry of Economy	June 2002
<b>To complete privatisation in the telecom sector</b>	Privatisation of final 16 per cent of Croatia Telecom		The first 35 per cent of stock was sold last year to Deutsche Telecom. This sale will take the company out of state majority control	Ministry of Economy	

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<b>To complete privatisation of the banking / financial sector</b>	Privatisation of the two state-owned banks (Dubrovacka Bank and Croatia Bank)			State Agency for Deposit Insurance and Bank Rehabilitation (BRA)	June 2001
	Privatisation of the state-owned insurance company (Osiguranje)			Ministry of Economy	
<b>To make progress with privatisation of tourist facilities</b>	Privatisation of state-owned hotel complexes (which represent a high percentage of beds in coastal areas)	Some progress has been made, but as yet only around 10 per cent of total publicly owned assets have been transferred	Issues of land ownership complicate sale of some properties. There is concern that these assets be privatised only when title disputes have been resolved		Ongoing

#### 4. COMPETITION POLICY

Institutional strengthening of the Agency for the Protection of Market Competition			The authority of the APMC is currently restricted in certain areas, notably as regards monitoring of public utility markets		
Harmonisation of the current Competition Law and related legislation with EU norms	Review of the Competition Law and Bylaws is underway involving working groups with experts from German Ministry of Justice and Competition Authority. The first draft of the Competition Law is going to be delivered to the Agency by the end of May 2001		This initiative is supported by the IRZ Stiftung	Agency for the Protection of Market Competition, IRZ Stiftung	26 May 2001

## 5. FISCAL POLICY AND TAX ES

<b>To take steps to control public spending</b>	Preparation of legislation and reorganisation of the Ministry of Finance to reflect creation of a specific Treasury function and closure of all relevant accounts of line Ministries	Adequate legislative provisions now in place to effect Treasury establishment	This action is intended to avoid over-spending and increase predictability of outflows by consolidating disbursement authority within the Ministry of Finance  This was a key requirement of the recent IMF stand-by loan agreement	Ministry of Finance	1 July 2001
<b>To reform the tax system to promote lower rates but broader tax base</b>	Amendment of the legislation governing personal income tax and profit tax	Legislative changes approved and operational for the current year		Ministry of Finance	1 January 2001
<b>To reduce customs tariffs, in line with WTO</b>	Enactment of legislation to alter current tariff levels	Legislative amendments lowering tariffs enacted in June 2000	New tariff regime took effect on 1 July 2000. Further tariff reductions for agricultural products took effect on 1 January 2001 in line with WTO accession agreement	Ministry of Finance, Customs Administration	1 January 2001

## 6. BRIBERY AND CORRUPTION

<b>To strengthen legislation relating to corruption</b>	Adoption and implementation of a new Police Law			Ministry of the Interior	
	Law on special Office for fighting corruption			Ministry of the Interior	End June 2001
	Law on conflict of interest			Ministry of the Interior	End June 2001

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<b>To elaborate national strategy and create implementing institutions</b>	Preparation of National Anti-Corruption Program with Action Plan			Ministry of the Interior	End June 2001
	Creation of a Special Anti-Corruption Office	Legislation creating the Office adopted		Ministry of the Interior	
	Creation of a police anti-corruption unit				
<b>To accede to relevant international instruments</b>	Criminal Law Convention on Corruption				
	GRECO agreement				
	Civil Law Convention on Corruption				
	OECD Convention on Corruption				

## 7. FINANCIAL SECTOR REFORM

### **To introduce new laws for the banking sector**

<i>Law on the Central Bank</i>	Introduce the new central bank law (i.e. the Law on the Croatian National Bank) to adopt price stability as the central bank primary objective, give the CNB the exclusive responsibility for monetary and exchange rate policy, ensure independence of the central bank, prohibit lending to the government, formalise the procedures for consultation and information sharing between the CNB and the MoF	Law passed by Parliament in April 2001		Ministry of Finances	
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<i>The Law on Banks</i>	Adopt new regulations to allow for CNB's automatic response to banks not in compliance and ensure prompt bank resolution, lengthen the transitional period for adjusting bank exposure, clarify and strengthen the procedures pertaining to the insolvency of banks a) Submit draft law to the Parliament	Drafting of the new law under way		Ministry of Finances	December 2001
<i>Exchange restrictions: The Law on Foreign Exchange Operations</i>	Adopt new regulations to allow enterprises to hold all types of foreign exchange deposits, and allow banks to lend residents in foreign exchange	Law passed by Parliament in April 2001		Ministry of Finances	June 2001 March 2001
<i>Payment System Reform</i>	Implement the new clearing system that will enable banks to operate intrabank payments by themselves. Interbank payments will be operated by the CNB	The new clearing system is in operation as of February 2001	Banks must obtain the CNB approval to operate intrabank payments	Croatian National Bank	February 2001
<i>Monetary Policy Reform</i>	Preparations for issuing Treasury bills by the CNB Gradually reduce the role of CNB bills and replace them with Treasury bills after the new central bank law is passed			Croatian National Bank	End of 2001
<b>To complete privatisation in the banking/financial sector</b>			See under Privatisation		

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**8. OTHER POLICIES**

**A. STABILISATION AND ASSOCIATION**

**To improve the investment climate (enhancing regional stability and cooperation, and removing barriers to investment and trade) via concluding and implementing the Stabilisation and Association Agreement**

Ministry for European Integration (MEI) and Ministry of Foreign Affairs

**B. EXPORT PROMOTION**

**To strengthen instruments to facilitate exports including credit facilities and guarantees**

Croatian Bank for Reconstruction and Development (HBOR)

