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EXECUTIVE SUMMARY

Croatia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank.

Croatia is on course to become a member of the European Union on 1 July 2013, subject to ratification by the Member States of the Accession Treaty. Croatia’s accession to the EU will be an important landmark, rewarding many years of comprehensive reforms and opening new possibilities for accelerated development in many areas. EU membership is however not in itself a guarantee that economic conditions will be improving and that the country will attract foreign investment. The continuation of the prudent economic policies and an accelerated implementation of the reform agenda are essential conditions for Croatia to make full use of the accession opportunities and the EBRD stands ready to assist it in this direction.

In the past four years, Croatia has experienced a protracted period of economic stagnation or recession, largely a result of the global financial crisis. After two years of declining output in 2009-10 and zero GDP growth in 2011, the country re-entered recession in 2012. The unemployment rate reached 17.5 per cent of the labour force by end-2012 and further layoffs are likely in the short-term as some major publicly owned companies face significant restructuring and reduction of staff numbers. The banking system is well-developed by regional standards, liquid and well-capitalized (the capital adequacy ratio is strong at above 20 per cent as of June 2012). However, the level of non-performing loans has been rising, reaching around 14 per cent of total loans by end-2012. Deleveraging pressures intensified in the second quarter of 2012, although they have since abated.

The short-term economic outlook is uncertain and will be related to the pace of the overall economic growth in the Eurozone. Under current baseline projections, the economy is likely to start growing again in 2013 but at a very slow rate, probably at or below one per cent. Over the medium term, Croatia’s economy will be boosted by EU accession and perhaps by the introduction of long-awaited reforms to public administration and the labour market. The downside risks are significant, however. Croatia is a small open economy with strong trade and investment ties to the Eurozone and a high level of external debt. As a result, the country is vulnerable to further deterioration in economic conditions in this region.

Croatia has made significant progress in transition but the process remains unfinished. Although the country is assessed as quite advanced in certain areas, it still faces significant transition challenges in key sectors. The economy is broadly liberalised and exhibits a relatively high degree of sophistication in financial services. There has also been progress over the years on infrastructure reform. The banking sector weathered the financial crisis well and remains sound and liquid. However, the role of the state remains large compared with many other transition countries. Major reforms are still pending in areas such as public administration, labour market flexibility, and land registry and cadastre reform. Although various reforms have been introduced over the years to improve the quality of the business environment, Croatia continues to face significant challenges in this area, as revealed in several cross-country surveys and analyses of competitiveness and ease of doing business.

In short, although reforms have advanced significantly in a number of areas since the mid-1990s, the economy still faces a number of fundamental restructuring challenges, both in the
public sector, which remains large and inefficient, and in the private sector. In the forthcoming strategy period, therefore, the Bank’s main strategic directions will include:

- **Mitigating the impact of the crisis and restoring sustainable growth.** Croatia was one of the worst-hit countries in the region by the global crisis of 2008-09, and has struggled towards recovery ever since. In the context of the new joint IFI action plan for growth in central and south-eastern Europe, the Bank will tailor its financing to meet potential demand for long-term investment as well as working capital financing, operational/financial restructuring. Support to the corporate sector will be aimed both at foreign investors and local companies, including through financial intermediaries for SMEs. The Bank’s investments will be strengthened by policy dialogue to promote economic restructuring, diversification and improved business climate conditions and corporate governance.

- **Leveraging the benefits of EU accession to advance transition.** EU accession is expected to bring substantial benefits to Croatia, but these will depend in part on further developing the country’s administrative capacity and deepening structural reforms. Once Croatia joins the EU it will have access to substantial amounts of EU structural funds, but experience shows that new members often have difficulty absorbing these funds effectively. In addition, private sector companies may find it difficult to meet the challenge of enhanced competition in the single market. The Bank will work closely with the authorities and the EU in selected areas with significant transition gaps where structural funds can be blended with those of the Bank to accelerate transition, including in the municipal sector where the Bank will seek to facilitate the consolidation process. The Bank will also provide financing, mainly through financial intermediaries, to facilitate investments by corporates to enhance their competitiveness in EU markets.

- **Restructuring and commercialising public sector enterprises.** One of the reasons for the economy’s continued stagnation is the failure to restructure large infrastructure utilities. The government has started addressing this problem, with the first restructuring steps taken with Croatian Railways. Croatia’s EU accession makes reforming public sector entities an even more urgent task, as the country’s absorption capacity for EU structural funds is conditioned on capacity enhancement, financial and operational improvement at public utilities. The Bank will work with the authorities to accelerate the reform of publicly-owned companies in the infrastructure sector.

In all these activities the Bank will seek to align its operations with the priorities of the Government of Croatia and will work closely with other international financial institutions, multilateral and bilateral donors, including the European Union. The Bank will engage in active policy dialogue and continue to provide technical assistance to maximise transition impact in Croatia.
1. THE BANK’S PORTFOLIO

1.1 Overview over Bank activities to date

As of 31 December 2012 the Bank signed 148 projects, including debt, mezzanine, equity finance and trade finance guarantee facilities for an aggregate amount of EUR 2.74 billion. During the same period, the Bank implemented EUR 7.14 million in donor-funded technical co-operation projects through its Legal Transition programme, Enterprise Growth Programme (EGP) and Small Business Support (SBS) and other programmes.

In the Strategy period 2010-2012, the Bank’s engagement in Croatia signed 34 projects for a cumulative amount of EUR 755 million. The average transaction size was EUR 18 million, excluding the largest transaction of EUR 150 million for the modernisation of refineries at INA.

During the Strategy period, EBRD’s operating assets have grown to EUR 1.057 billion. The Bank’s current portfolio of projects is well diversified with 29 per cent in the industry, commerce, agribusiness sectors, 15 per cent in the energy sector, 30 per cent in the financial institutions sector and 27 per cent in the infrastructure sectors.

The private sector share in the portfolio has not changed materially during the Strategy period (67 per cent in 2009 and 65 per cent in 2012). The non-sovereign share of the portfolio has also remained broadly the same (72 per cent in 2009 and 75 per cent in 2012).

Table 1: Portfolio Development in Croatia as at 31 December 2012

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>NET CUMULATIVE BUSINESS VOLUME</th>
<th>CURRENT PORTFOLIO STOCK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount in EUR million</td>
<td>Number of projects</td>
</tr>
<tr>
<td>Energy</td>
<td>10</td>
<td>382</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>5</td>
<td>262</td>
</tr>
<tr>
<td>Power and Energy</td>
<td>5</td>
<td>120</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>46</td>
<td>799</td>
</tr>
<tr>
<td>Bank Equity</td>
<td>8</td>
<td>199</td>
</tr>
<tr>
<td>Bank Lending</td>
<td>30</td>
<td>548</td>
</tr>
<tr>
<td>Insurance, Fin Services</td>
<td>7</td>
<td>46</td>
</tr>
<tr>
<td>Small Business</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Industry, Commerce &amp; Agribusiness</td>
<td>64</td>
<td>848</td>
</tr>
<tr>
<td>Agribusiness</td>
<td>17</td>
<td>474</td>
</tr>
<tr>
<td>Equity Funds</td>
<td>20</td>
<td>64</td>
</tr>
<tr>
<td>ICT</td>
<td>11</td>
<td>63</td>
</tr>
<tr>
<td>Manufacturing &amp; Services</td>
<td>5</td>
<td>117</td>
</tr>
<tr>
<td>Property &amp; Tourism</td>
<td>11</td>
<td>131</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>28</td>
<td>720</td>
</tr>
<tr>
<td>Municipal</td>
<td>12</td>
<td>203</td>
</tr>
<tr>
<td>Transport</td>
<td>16</td>
<td>516</td>
</tr>
<tr>
<td>TOTAL</td>
<td>148</td>
<td>2,749</td>
</tr>
</tbody>
</table>
Table 2: Portfolio Development in Croatia from 2009-2012

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Cumulative Business Volume</td>
<td>2,082</td>
<td>2,463</td>
<td>2,619</td>
<td>2,749</td>
<td>+ EUR 667 million</td>
</tr>
<tr>
<td>Current Portfolio Stock</td>
<td>1,178</td>
<td>1,410</td>
<td>1,401</td>
<td>1,366</td>
<td>+ EUR 188 million</td>
</tr>
<tr>
<td>Number of Operations</td>
<td>75</td>
<td>84</td>
<td>80</td>
<td>82</td>
<td>+ 7 operations</td>
</tr>
<tr>
<td>Operating Assets</td>
<td>1,033</td>
<td>1,204</td>
<td>1,102</td>
<td>1,057</td>
<td>+ EUR 24 million</td>
</tr>
<tr>
<td>% Undrawn</td>
<td>12%</td>
<td>15%</td>
<td>21%</td>
<td>22%</td>
<td></td>
</tr>
<tr>
<td>Annual Business Volume</td>
<td>248</td>
<td>387</td>
<td>158</td>
<td>210</td>
<td>+ EUR 755 million</td>
</tr>
<tr>
<td>Number of Operations</td>
<td>12</td>
<td>13</td>
<td>8</td>
<td>13</td>
<td>+ 34 operations</td>
</tr>
<tr>
<td>Gross disbursements</td>
<td>259</td>
<td>307</td>
<td>45</td>
<td>125</td>
<td>+ EUR 477 million</td>
</tr>
<tr>
<td>Annual Cancellations</td>
<td>8</td>
<td>15</td>
<td>18</td>
<td>14</td>
<td>EUR 47 million</td>
</tr>
<tr>
<td>Active Pipeline Stock</td>
<td>664</td>
<td>741</td>
<td>326</td>
<td>539</td>
<td></td>
</tr>
<tr>
<td>Private Sector Share (% Portfolio)</td>
<td>67%</td>
<td>70%</td>
<td>64%</td>
<td>65%</td>
<td></td>
</tr>
<tr>
<td>Non Sovereign (% Portfolio)</td>
<td>72%</td>
<td>74%</td>
<td>73%</td>
<td>75%</td>
<td></td>
</tr>
</tbody>
</table>

*Note: * It is mostly the infrastructure projects were slow to disburse. Main reasons: significant savings achieved due to lower prices in the crisis and slow decisions on use of such savings; quite a few contractors are either in financial distress (contracts need to be cancelled) or have withdrawn from contracts already signed.

1.2 Implementation of the previous Country Strategy

The previous Country Strategy was approved in May 2010 and identified the following strategic priorities:

- Support privatisation and restructuring of state enterprises, including in the tourism industry, and strengthen competitiveness.

- Improve access to finance for SMEs, including through private equity.

- Invest in renewable energy and energy efficiency projects to improve energy security, reduce waste and diversify energy supply.

- Finance priority infrastructure including regional transport networks and environmental projects

- Assist in deepening and further development of local capital markets.

The Bank’s active engagement in Croatia in the previous Strategy period delivered transition benefits in a country where challenges are still significant. This was achieved against a backdrop of economic recession and political stalemate around the national elections in December 2011. Since the Strategy was approved, the Bank has signed 34 projects with a total volume in excess of €755 million as of November 2012.

Although the country faced significant macroeconomic and other challenges during the Strategy period, the Bank effectively addressed many of the main strategic objectives over the three-year period.

The privatisation process in general was put on hold during the Strategy period. The Government only recently decided to proceed with the privatisation of two financial institutions, and the Bank indicated its willingness to consider its involvement in one such
transaction (Croatia Osiguranje, the largest insurance company). Other than that, market constraints, as well as individual banks’ shareholder considerations, have prevented the Bank from achieving results in promoting banking sector consolidation.

The Bank helped the regional expansion of Croatian companies, including through financing landmark cross-border acquisitions (i.e., Atlantic Grupa’s acquisition of Droga Kolinska, Slovenia and AD Plastik rouble financing for Russian subsidiaries). Major resource efficiency and competitiveness enhancement investments have been implemented with Bank financing of two local oil refineries. The Bank also successfully implemented SME competitiveness credit lines and provided financing to two local companies under the Local Enterprise Facility (financing for the first highest standard data centre and the largest private sector postal operator in Croatia).

The Bank financed the country’s first independent biomass power plant project through the Western Balkans Sustainable Energy Direct Financing Facility (WeBSEDFF). The Bank also committed financing to the first investment in Croatia in a decade in power generation, a renewable energy project by the local power utility. In this transaction, the Bank’s support was instrumental in launching the first EU Habitat biodiversity study in the country, included as a pre-condition to disbursement for construction.

Good progress has been made helping Croatia develop its regional transport infrastructure, including through road, port and air navigation modernisation. Investments were supported by corporate governance and regulatory improvements supported with technical assistance. The Bank has been in the forefront of co-financing water/waste water projects with EU Instruments of Pre-Accession (IPA) funding, having signed the two largest investments in the sector and prepared a programme for further such investments in co-operation with the Croatian Water Agency. These projects were structured as corporate loans, and therefore did not place a burden on the country’s public debt capacity. However, the absence of reforms in infrastructure – in the railways sector as a whole, in financial/operational improvements in the municipal and road sectors, introducing regulatory changes and capacity enhancement to manage PPP structures, etc – made it difficult to attract the private sector to infrastructure operations and investments. As a result, the Bank was less successful in financing infrastructure with private sector involvement, as opportunities have been scarce.

EBRD led a highly successful refinancing for the regional champion, Atlantic Grupa, demonstrating that a sound company, adequately responding to the current economic challenges can get access to longer term financing and even lower its financing costs. The Bank has responded to financial restructuring needs at some of its existing clients. Zagreb Holding loan restructuring supported the continuation of the water utilities investment programme aimed at improving waste water services in the Croatian capital. City Center One Split retail center also benefitted from EBRD led financial restructuring to give this well-managed company some breathing space at the time of the crisis.

1.3 Transition impact of the Bank's portfolio

Since April 2010, when the previous Strategy was adopted, 15 transition-rated operations were signed by the Bank in Croatia. Around half of all rated operations were signed in the

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There were 7 additional operations which were not individually assessed for their transition; these are under framework which is assessed and monitored on facility level only (LEF, WeBSEDFF), as well as repeat operations with the existing client, transition impact for which is already captured by the original transaction.
infrastructure sector; another five operations were loans extended to the country’s financial institutions. Twelve of these projects (or 80 per cent) were rated with Good transition impact potential, which is in line with the institutional target of 80 per cent of projects to be assessed “Good” or better. Three remaining projects that were rated Satisfactory had less ambitious transition objectives.

The transition objectives of projects signed during the Strategy period reflect the Bank’s response to country challenges, namely, addressing institutional and corporate practice challenges through provision of loans to players in the infrastructure and energy sectors, and increasing outreach through investments to financial intermediaries. As a result, the key transition objective across projects was the introduction of higher business standards and corporate governance practices (around 60 per cent of all projects signed in Croatia in 2010 to 2012 address this objective). Forty per cent of projects addressed market expansion, including expansion to the country’s underserved areas. As Figure 1 shows, around a quarter of all projects targeted improvements in frameworks for markets and demonstration of new replicable financial products.

**Figure 1. Targeted transition objectives in Croatia (share of projects), April 2010 – 2012**

The projects in the Bank’s active TIMS portfolio in Croatia are performing well from the transition impact perspective. At end-2012, there were 32 active operations in the country’s stock, 13 out of which have already largely achieved their transition objectives. The remaining 19 operations in the Bank’s portfolio for this country are on their way to achieving their transition impact potential.

The expected transition impact indicated by average rank of the Croatia’s active TIMS portfolio at end-December 2012 stood at 3.84, significantly better when compared to the

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2 i.e. All active operations more than 6 months since signing and are monitored for their transition impact at least once, through Transition Impact Monitoring System (TIMS).

3 Rank a combination of the relevant rating for transition impact potential and risks to transition impact. Expected transition of operations is usually monitored once a year and is ranked numerically from 1 to 8, with 1 to 3 indicating the mostly realised impact, 3 to 6 – generally on track to achieve transition objectives, and 7 to 8 – minimum transition impact or excessive risks.
average score for all operations of the Bank (4.05). Apart from the overall good transition performance, the better performance may be explained by the country’s relatively mature portfolio (25 out of 32 operations have been signed over three years ago). Those projects in the advanced stage of their implementation have already achieved a number of the transition objectives, which was reflected in a rank upgrade.

Nine operations were completed during 2010-2012 and have exited the Bank’s active portfolio. Seven of them have fully achieved their desired transition objectives. These projects are evenly distributed across all sector groups. The remaining two completed operations only partially achieved their expected transition impact. This was mostly due to initial weak performance of a pension fund (as a result of increased commercial risks in the sector) and only a partial achievement of the targets related to the demonstration effects of privatisation of the sugar production company.

2. OPERATIONAL ENVIRONMENT

2.1 Political Context

The current Croatian government was formed at the end of 2011, following the victory of the opposition centre-left coalition in the December 2011 general elections. The governing four-party coalition is led by the centre-left Social Democratic Party (SDP). Elections to the European Parliament and local elections due in spring 2013 will be a test for the balance of political forces.

Efforts to deepen integration into the EU remain the main external anchor for comprehensive reforms. In December 2011, Croatia signed the EU Accession Treaty, which was subsequently endorsed in a nationwide referendum, where more than 60 per cent of citizens voted in favour, and ratified by the Croatian Parliament in March 2012. Croatia is on course for full EU membership starting 1 July 2013, pending completion of ratifications by the Member States. Due to remaining weaknesses in certain areas, Croatia was subject to a special pre-accession monitoring mechanism, established by the EC, which identified a number of areas where further efforts were necessary, including a reform of the judiciary and public administration and the business environment. Progress has been achieved across the board. The final monitoring report was issued at the end of March 2013. The EC concluded that Croatia completed the priority actions identified in the previous monitoring reports and demonstrated it ability to fulfil all other commitments in good time before accession. The European Union repeatedly made clear that Croatia should be ready to assume all responsibilities of membership by 1 July 2013 and that no post-membership monitoring mechanism is envisaged, unlike the arrangements made in the past for some previous accessions.

Regional and cross-border cooperation remains a priority of Croatian foreign policy. Croatia’s position as the newest EU member from the South-East Europe (SEE) region may strengthen its role as a potential bridge between the EU and the Western Balkans and should encourage further regional cooperation in SEE.

2.2 Macroeconomic context

In the past four years, Croatia has experienced a protracted period of economic stagnation or recession, largely a result of the global financial crisis. After two years of declining output in 2009-10 and zero GDP growth in 2011, the country re-entered recession in 2012. GDP
The output of the economy declined by 1.3 and 2.1 per cent y-o-y in Q1 and Q2 respectively on the back of falling external demand and weak domestic demand. For 2012 as a whole, output is provisionally estimated to have dropped by around 2 per cent. Recent trends reflect both spill-overs from the on-going Eurozone crisis, as well as the persistence of deep structural problems in the labour market and business environment. The unemployment rate reached 17.5 per cent of the labour force by end-2012 and further layoffs are likely in the short-term as some major publicly owned companies face significant restructuring and reduction of staff numbers.

Annual inflation was rising for a time since March 2012 and reached 5 per cent y-o-y in September 2012, falling slightly to around 4.5 per cent by end-year. The increase was partly related to a rise in the VAT rate by two percentage points to 25 per cent, which became effective in March 2012. Economic difficulties resulted in pressure on the kuna during 2012, and the Croatian National Bank, which maintains a tightly managed floating exchange rate policy, has intervened several times on FX markets to prop up the currency. Despite these interventions, the level of foreign reserves covers about seven months of imports, although coverage of short-term debt is relatively low at less than 80 per cent as of end-2012.

The government has begun to implement a fiscal consolidation plan. Changes in the tax system have been introduced. In addition to the aforementioned increase in the VAT rate, the government implemented a new tax on dividend payouts and abolished a tax on reinvested profits. Proposals for the introduction of a property tax are also in preparation. The general government deficit in 2011 was 4.7 per cent of GDP, slightly above target. In 2012, the government managed to reduce the deficit to 3.5 per cent of GDP, mainly on the back of improved revenues. However, the budget for 2013 envisages a slight increase to 3.8 per cent of GDP, which go against previous plans to cut government expenditure by one percentage point of GDP each year until a primary balance is reached.

Deleveraging and the rising level of NPLs reflect vulnerabilities in the financial sector. The banking system is well-developed by regional standards, liquid and well-capitalized (the capital adequacy ratio is strong at above 20 per cent as of June 2012). However, the level of non-performing loans has been rising, reaching around 14 per cent of total loans by end-2012. Deleveraging pressures intensified in the second quarter of 2012, and continued in the second half of the year.

The short-term economic outlook is uncertain and will be related to the pace of overall economic growth in the Eurozone. Under current baseline projections, the economy is likely to start growing again in 2013 but at a very slow rate, probably at or below one per cent. Over the medium term, Croatia’s economy will be boosted by EU accession and perhaps by the introduction of long-awaited reforms to public administration and the labour market. The downside risks are significant, however. Croatia is a small open economy with strong trade and investment ties to the Eurozone and a high level of external debt. As a result, the country is vulnerable to further deterioration in economic conditions in this region.

2.3 Structural reform context

In many respects, Croatia is an advanced transition country, but one that still faces significant transition challenges across the board. The economy is broadly liberalised and exhibits a relatively high degree of sophistication in financial services. There has also been progress over the years on infrastructure reform. The banking sector weathered the financial crisis well and remains sound and liquid. However, the role of the state remains large compared with
many other transition countries. Many enterprises remain under state control or have significant state shares, and the appetite of buyers for these assets has been limited. Efforts by successive governments to privatise the country’s shipyards have intensified in recent years, in the context of the country’s EU accession, and, as of early-2013, the process is nearing completion. However, major reforms are still pending in areas such as public utilities, public administration, labour market flexibility, and land registry and cadastre reform.

In the Bank’s annual assessment of transition challenges across 16 sectors (see the EBRD Transition Report 2012), Croatia lags behind most other countries in central Europe and the Baltic states – see Figure 2. The country scores well in the corporate sectors, where the remaining transition gaps are mostly assessed as small, and in some infrastructure sectors, reflecting the cumulative progress over the years, notably in the road sector. Even here, however, there are significant challenges ahead in promoting institutional reform and enhancing private sector involvement. The water and wastewater and railways sectors still present major challenges on the reform front. In the energy sector, the biggest transition gap concerns the electric power sector, particularly when it comes to market structure. In common with other advanced countries, the transition gaps in the financial sector mostly lie in improving access to finance for MSMEs and developing private equity markets. There also potentially important privatisations in the coming months in banking (the state postal bank) and insurance (Croatia Osiguranje).

Figure 2. Croatia Sector Transition Scores

See Annex 2 for a more detailed description of transition challenges in Croatia.

2.4 Business environment

Although various reforms have been introduced over the years to improve the quality of the business environment, Croatia continues to face significant challenges as shown on several cross-country surveys and analyses of competitiveness and ease of doing business. In the latest World Bank’s annual Doing Business report, Croatia ranks 80th in the world (out of 185
countries) in overall ease of doing business, down from 72\textsuperscript{nd} place the previous year. Indicators relating to construction permits and protecting investors are particularly low. A similar picture emerges from the World Economic Forum’s Global Competitiveness index 2012-13, where Croatia ranks 81\textsuperscript{st} out of 144 countries. In the 2008/09 EBRD/World Bank Business Environment and Enterprise performance Survey (BEEPS), enterprises in Croatia singled out tax administration, the judiciary and lack of appropriate skills in the workforce as the three most significant obstacles to doing business.

2.5 Social context

Over the past decade, living standards in Croatia have improved considerably and are among the highest in the transition region, as measured by conventional economic indices such as GDP per capita. Real GDP per capita rose by nearly a quarter between 2001 and 2011, and in PPP adjusted terms the average income has been gradually converging to EU standards, standing currently at about 60 per cent of the EU average, according to Eurostat estimates. Other development indicators such as life expectancy, infant mortality and child malnutrition also compare favourably with most of the transition region. However, there are significant disparities in income within the country, and poverty remains an issue in some rural areas.

Income inequality is still quite prominent. In 2011, the richest 10 per cent of Croatians accounted for 22.9 per cent of total national income while the richest 20 per cent accounted for nearly 40 per cent of the national income. By contrast, the share of total income belonging to the poorest 20 per cent of Croatians was a mere 7 per cent in 2011 and the bottom 40 per cent accounted for only 20 per cent of the national income. Income inequality has increased over the past few years. The Gini coefficient rose from 29 in 2003 to 31 in 2011.

The reduction in unemployment over the past decade has been very modest, because gains made in the pre-crisis period have been eroded by the deep and protracted recession of the past four years. Between 2001 and 2008, the unemployment rate nearly halved, declining from 14.8 per cent to 8.4 per cent of the total labour force. However, it has been rising sharply since the onset of the crisis in 2009, and by end-2012 it had reached 17.5 per cent.

Unemployment has a significant gender and age dimension. According to the Croatian statistics office, at 14.7 per cent, the unemployment rate among men is higher than the unemployment rate among women, which is currently at 14.3 per cent. However, this is, in part, due to the considerable gender gap in labour force participation (53.2 per cent for men vs. 40.4 per cent for women). The age unemployment gap is even more pronounced. Youth unemployment (among people aged 25 years and younger) stands currently at 36 per cent, compared with 11.2 per cent among the rest of the population.

Access to education is still below OECD standards. The primary school enrolment rate in Croatia is around 87 per cent, compared to the nearly universal access in the OECD. There are notable differences in educational attainment between men and women, especially at the higher levels. For example, for every 100 men with at least secondary education there are only 79 women with the same level qualification. Access to education also has a regional dimension. The ratio of people with no education is twice as high in rural areas as in urban. Finally, according to the OECDs 2009 Programme for International Students Assessment (PISA), Croatian students scored better compared to regional peers in the Western Balkans, but lower than the OECD average especially in the mathematics section.
The perceived impact from the global economic crisis on the citizens of Croatia has been quite high as evidenced by the 2010 EBRD-World Bank Life in Transition Survey (LiTS). Around 55 per cent of households reported that the crisis affected them either a great deal or a fair amount, compared with a transition region-wide average of 42 per cent. A large proportion of households reported having to cut back on essential expenditures like staple food and health care to cope with the crisis.

2.6 Legal context

Since the commencement of the EU accession process, Croatia has made significant improvements in numerous areas of commercial legislation. Although Croatia’s legislative framework is greatly compliant with the EU standards, some key challenges still remain.

Provisions on taking non-possessory pledge over movable assets and rights are currently part of the Croatian Enforcement Act, while the Property Law contains only provisions related to possessory pledge. This kind of fragmentation has resulted in increased and arguably unnecessary transaction costs. It is therefore recommended to consider a revamp of secured transactions by bringing them into the sphere of property law. Facilitating factoring transactions by factoring legislation might help improve overall access to finance by making factoring services more transparent and legally certain. Broadening the scope of information covered by the credit bureau (insurance, trade credit and utilities) would improve the quality of credit referencing and costs of information asymmetry.

Numerous improvements in Croatian corporate governance have taken place mainly as a result of compliance with the EU acquis communautaire. As a result, the corporate governance culture is improving, but some key challenges still remain.

In the area of insolvency law, the new Act on Financing and Pre-Bankruptcy Settlement introduces pre-bankruptcy settlement proceedings, aimed at operational and financial restructuring of a debtor in order to ensure survival of its operations following insolvency. The effectiveness of this regime remains to be tested.

Croatia has made significant improvements to its judicial system since the commencement of the EU accession process. Further areas of improvement include such measures as further systematic and specialised training of judges in commercial law matters, establishing comprehensive and up-to-date court judgment databases, further strengthening of the enforcement system and introduction of measures that encourage commercial mediation.

The country has made substantial progress towards creating a well-functioning energy efficiency sector, but further efforts should be undertaken towards creating a sector-specific energy efficiency framework, compliant with the EU standards, as well as putting in place necessary implementation arrangements and ensuring appropriate capacity building.

Finally, with a comprehensive government approach to PPP development and implementation and the new Concessions Act, PPPs have potential in the near future, although some important elements necessary for the financing of PPP projects are still missing.
2.7 Energy efficiency and climate change context

Croatia’s primary energy consumption per unit of GDP is about twice that of the EU-27 average. However, as Croatia will become a full EU member in July 2013, the country has implemented a strong programme of market liberalisation, reorganisation in the energy sector, with a strong focus on adapting its energy sector legislation to the acquis communautaire.

Croatia has been working in the recent years to enhance regional cooperation and interdependence, thereby increasing the security of energy supply and competition for the whole region and the EU. Nevertheless, Croatia still needs to improve the functioning of the gas and electricity markets, as well as the promotion of renewable energies.

Energy efficiency plays an important role in Croatian energy policy. In 2008, an energy efficiency master plan was finished and an Act on Energy End-use Efficiency adopted. The National Energy Efficiency Action Plan (NEEAP) was prepared to comply with the requirements of the EU directive on energy end-use efficiency and energy services. This plan sets energy savings targets and proposes concrete measures and actions that would contribute to meeting targets.

Croatia has also an extensive renewable energy potential with the target of 20 per cent of renewable electricity in gross final energy consumption. In 2010 the National Renewable Energy Action Plan (NREAP) was prepared to comply with the requirements of the EU Renewable Energy Directive (2009/28/EC). Nevertheless, many barriers still exist and prevent faster RES development in Croatia. These include (i) complex authorisation procedures with no simplified procedures for the development of renewable energy projects; (ii) lack of coordination between governmental agencies involved in renewable energy sources, with subsequent over-sophistication of procedures for policy definition, policy implementation, and project development; (iii) de-facto market monopoly of HEP, the state-owned vertically integrated utility, in the power sector, which constitutes a barrier for new independent power producers; and (iv) commercial banks appear to have a rather low level of awareness of and expertise in renewable energy projects.

Energy prices have been rising across the region including in Croatia and it is expected that this trend will continue in the near future. Energy price increases create an incentive for companies to improve energy efficiency, which is an effective response to reduce costs and mitigate the negative impacts of the crisis. Significant potential for energy efficiency investments remains untapped in Croatia and a number of barriers still remain in the market.

Climate change adaptation

Croatia is vulnerable to a range of projected climate change impacts, specifically on water resources and coastal areas. Croatia’s Fifth National Communication to the UNFCCC (2010) states that over the coming decades mean temperature increases are expected across the country. Reductions in annual precipitation are projected for coastal regions, with the reductions greatest in summer. These impacts have important implications for surface runoff and for water resources generally. Sea-level rise and associated impacts are also projected to affect coastal areas. Improvements in water supply infrastructure, and in water use efficiency in agriculture and industry, will be priorities. Hydropower generation is forecast to be affected by climate-driven shifts in hydrology and reductions in surface runoff, which will
need to be taken into account in investments. The energy sector may also be affected by shifts in seasonal peak demand caused by temperature shifts. Impacts on sea-level rise and coastal erosion will need to be taken into account in investments in coastal infrastructure such as ports.

3. STRATEGIC ORIENTATIONS

Croatia stands at an important crossroads. Membership of the European Union is imminent and will represent a major achievement for the country. However, it remains uncertain whether Croatia has the capacity to take full advantage of the many benefits that EU membership brings. The economy has been in recession or stagnation for the last four years, the level of investor confidence is low, and short-term growth prospects are modest. Although reforms have advanced significantly in a number of areas since the mid-1990s, the economy still faces a number of fundamental restructuring challenges, both in the public sector, which remains large and inefficient, and in the private sector. In the forthcoming Strategy period, therefore, the Bank will focus on the following strategic directions:

- **Mitigating the impact of the crisis and restoring sustainable growth.** Croatia was one of the worst-hit countries in the region by the global crisis of 2008-09, and has struggled towards recovery ever since. In the context of the new joint IFI action plan for growth in central and south-eastern Europe, the Bank will tailor its financing to meet potential demand for long-term investment as well as working capital financing, operational/financial restructuring. Support to the corporate sector will be aimed both at foreign investors and local companies, including through financial intermediaries for SMEs. The Bank’s investments will be strengthened by policy dialogue to promote economic restructuring, diversification and improved business climate conditions and corporate governance.

- **Leveraging the benefits of EU accession to advance transition.** EU accession is expected to bring substantial benefits to Croatia, but these will depend in part on further developing the country’s administrative capacity and deepening structural reforms. Once Croatia joins the EU it will have access to substantial amounts of EU structural funds, but experience shows that new members often have difficulty absorbing these funds effectively. In addition, private sector companies may find it difficult to meet the challenge of enhanced competition in the single market. The Bank will work closely with the authorities and the EU in selected areas with significant transition gaps where structural funds can be blended with those of the Bank to accelerate transition, including in the municipal sector where the Bank will seek to facilitate the consolidation process. The Bank will also provide financing, mainly through financial intermediaries, to facilitate investments by corporates to enhance their competitiveness in EU markets.

- **Restructuring and commercialising public sector enterprises.** One of the reasons for the economy’s continued stagnation is the failure to restructure large infrastructure utilities. The government has started addressing this problem, with the first restructuring steps taken with Croatian Railways. Croatia’s EU accession makes reforming public utilities an even more urgent task, as the country’s absorption capacity for EU structural funds is conditioned on capacity enhancement, financial and operational improvement at public sector entities. The Bank will work with the authorities to accelerate the reform of publicly-owned companies in the infrastructure sector.
Across these sectors, and in line with the implementation of the Bank’s relevant strategies and initiatives, the Bank will work with new clients as well as with the relevant Government agencies to promote resource efficiency through policy dialogue as well as financing schemes and direct investments in private corporates, through specifically tailored credit lines through the local commercial banks as well as within the framework of the Bank’s investments in public utilities. The Bank will also work with its new and existing clients to promote gender equality and women’s entrepreneurship. The Bank is currently engaged with one of the largest providers in the agribusiness sector in Croatia to support the promotion of equal opportunities in the company’s work place. The project is designed to have a significant demonstration effect in the sector. Overall, clients will be encouraged to promote equal opportunities in the work place and provided with support, where necessary.

3.1. **Key Challenges and Operational Responses**

3.1.1 **Mitigating the impact of the crisis and restoring sustainable growth**

**Transition challenges**

- Private sector development is held back by a difficult business climate, excessive bureaucracy and rigid labour market.
- A significant number of local corporates require financial and operational restructuring and lack access to longer-term financing, including working capital which hinders potential investment to improve competitiveness, enhance energy efficiency, and for technology renewal projects. Many private companies in Croatia have significant corporate governance problems.
- Foreign direct investment has been scarce for the last decade in Croatia. Improvement of investment climate as well as financial support, particularly for mid-sized companies, would be needed to attract foreign investors into brown-field or green-field projects, generating new jobs, as well as transferring technology and know-how.

**Operational Response**

**To facilitate restructuring and support the private sector**, the Bank will seek to provide longer term investment and working capital financing to sound local corporates, and seek to identify bankable opportunities for corporate financial and operational restructuring for debt and equity financing, including through the Local Enterprise Facility (LEF) and the new Enterprise Expansion Fund (ENEF) facility.

**To promote FDI**, the Bank will support foreign investors, particularly mid-sized companies that have the potential to transfer know-how and technology as well as create sustainable jobs in Croatia. In parallel, the Bank will also assist the authorities in promoting Croatia as an investment destination.

**To ease access to finance to credit-worthy local corporates**, the Bank will provide funding for local banks, structured to facilitate provision of restructuring loans to viable MSMEs and mid-sized corporates on sound banking principles.

**Policy Dialogue**
The Bank will continue its engagement in high level policy dialogue, jointly with the EU and the World Bank, on improving the business climate and will seek to identify one or two areas for a focused, TC-supported effort to lower regulatory barriers.

To ease the shortage of liquidity and working capital funds in the economy, the Bank will follow up on the grain warehouse receipt initiative, where, following the adoption of the relevant law, implementation decrees need to be prepared and adopted. The Bank will also continue to provide technical assistance on the drafting of a new law on factoring companies with a view to support this important subsector of financial institutions to broaden its product range to provide working capital to corporates.

3.1.2. Leveraging the benefits of EU accession to advance transition

Transition challenges

- The local MSMEs’ capacity for developing appropriate applications and business plans to access EU funding is fairly limited. Such enterprises would also require medium-term financing for their co-financing with EU grants.
- Municipalities face significant transition challenges in developing market mechanisms and attracting private sector participation into areas where EU grant funding can help, such as water and wastewater services, as well as solid waste management.
- The Government’s plans to stimulate investment into energy efficiency improvements for public buildings, as well as to encourage residential energy efficiency, would benefit both from strategic policy advice and EU grant co-financing to achieve critical mass.

Operational Response

To assist MSMEs, the Bank will seek commitments from its partner banks on-lending EBRD credit lines to provide advisory support to MSME clients to facilitate their access to EU funds. Using Small Business Support instruments, the Bank will continue to provide advisory services to MSMEs in the area of competitiveness and energy efficiency, in co-operation with and transferring knowledge to, HAMAG Invest, the Croatian agency for SME support.

To advance transition in the municipal sector, the Bank will aim to enhance the water/waste water utilities’ financial and operational performance through supporting a critical mass of investments, in particular co-financing with EU funds, and the consolidation of such utilities. The Bank will also seek to identify solid waste management and urban transport projects that it could help develop and subsequently support with financing without relying on sovereign or municipal guarantees, including through PPP structures and co-financing with EU funds.

To stimulate investments into energy efficiency improvements, the Bank will provide credit lines under the Western Balkan Sustainable Energy Financing Facility for on-lending for municipal and SME energy efficiency projects and provide corresponding consultancy services to help prepare such investments. As a follow-up to this initial effort, the Bank will work with the relevant Government agencies, in particular with the Fund for Environmental Protection and Energy Efficiency, to design further financing schemes with grant (whether EU or Government) and commercial financing appropriately blended, to stimulate energy efficiency investments in municipalities and in the SME sector.
Policy Dialogue

The Bank will seek to support the Government’s strategic planning and project preparation for the 2014-2020 Financial Framework period in the areas of its expertise: SME financing, energy efficiency and municipal infrastructure.

The Bank will make available technical advisory services under the Western Balkan Sustainable Development Facility to help prepare the legislative framework enabling budget-neutral financing of municipal energy efficiency investments and thus also a jump-start of such investments.

The Bank will explore the possibility to use EU structural funds for technical assistance mandates (as recently concluded in Romania).

3.1.3. Restructuring and commercialising public sector enterprises

Transition challenges

- The Government has launched a new initiative to restructure the state-owned transport companies, starting with the railways sector. Croatian Railways, now split into infrastructure, passenger and cargo operations, will still need to commercialise and increase efficiency to make the sector competitive and ease pressures on the state budget for subsidies.
- The Government has also recently embarked on corporate restructuring of the state-owned motorway companies, HAC and Autocesta Rijeka-Zagreb, including potentially restructuring debt with the involvement of private operators. Further efficiency is to be gained through contracting out maintenance services to the private sector.
- The power sector is still dominated by the state-owned national utility HEP, while it also owns the largest ESCO in the country and owns/operates the main district heating companies. Key challenges are to increase private sector involvement in the sector and to strengthen the allocation of cross-border transmission capacities.
- Croatia will need to diversify further the routes and sources of its gas/oil supplies through investments in relevant infrastructure with private sector involvement.
- Croatian Post will face the challenge of the liberalisation of the postal services market as of 2013. The Government is currently preparing a plan for restructuring Croatian Post and the company is devising plans to invest in projects enhancing its logistics’ efficiency.

Operational Response

To promote transition in the transport sector, the Bank will seek to identify ways to support the implementation of restructuring measures in the Croatian railways infrastructure and road sector, in conjunction with financing capital expenditure programme to enhance regional links. The Bank will support viable privatisations, including railways cargo or non-core businesses of the railways companies. The Bank will aim to support private sector port terminal operators or logistic/intermodal operators, including through PPP structures.

To support competition, efficiency and private sector involvement in the power sector, the Bank will seek opportunities to finance efficiency investments at the power utility (e.g. smart grid and smart metering) as well as investments in power generation with private sector companies, particularly in renewable energy.
To promote energy security, the Bank will consider supporting, using the Energy Community platforms for prioritisation, investments in the gas/oil sector aimed at enhancing security of supply.

The Bank will also further explore ways to encourage private sector involvement in the postal logistic services through, for example, PPP or EU/PPP structures for new investments.

Policy Dialogue

The Bank will continue its support for regulatory reform in the rail infrastructure sector, including improvement to the methodology of track access charges.

The Bank will support the outsourcing of maintenance services to private sector providers at the state-owned motorway companies, as well as the implementation of other agreed measures as a result of its on-going corporate governance improvement advisory services to HAC.

The Bank will seek to support, through mobilising appropriate grant resources, the preparation of PPP projects in the municipal sector, including EU/PPP financing structures.

3.2 Environmental and Social Implications of Bank Proposed Activities

Croatia has completed its transposition of EU environmental acquis in the national law as part of its preparation for accession to the EU. This sets out a sound framework for structuring all EBRD financed projects to comply with its Environmental and Social Policy (“ESP”) and Performance Requirements (“PRs”). However, the new laws are not applied retroactively to existing projects and there is a transition period during which some development consents, approvals and permits issued on the basis of the previous legislation still remain legally valid. Therefore, the Bank needs to remain diligent in ensuring that the Bank’s PRs and EU environmental standards are met over this transition period and while the capacity of the Croatian authorities to implement and enforce the new EU-compliant legislation is developing.

Implementation of EU Directives may also pose challenges, especially to the development of new large-scale infrastructure. Specifically, Croatia has proposed that about 40 per cent of its territory be designated as protected areas under the Natura 2000 ecological network. As a result, it will be necessary to balance the land use needs between infrastructure projects and protection of environmentally-sensitive areas and valuable biodiversity from encroachment and fragmentation. EBRD will continue to apply its policy requirements relating to the protection of biodiversity when considering financing infrastructure projects as these may have the potential to adversely impact biodiversity and/or proposed Natura 2000 sites. EBRD will pay specific attention to ensuring that due process is followed in undertaking Environmental and Social Impact Assessments of the projects and that a participatory public disclosure and consultation will be an integral part of development of such projects.

Proactive stakeholder engagement processes will also be an important instrument in mitigating social impacts and ensuring the ESP and PRs relating to social sustainability are met, especially where the projects could have adverse impacts on ethnic minorities, people at
risk of social exclusion or otherwise vulnerable people. When EBRD considers projects that involve privatisation of infrastructure companies (transport, municipal and energy sectors) and requires labour restructuring and rationalisation programmes, it will aim to ensure that redundancies are done in a transparent, consultative and non-discriminatory way.

Financing projects in the municipal environmental infrastructure sector will offer the Bank significant opportunities to achieve tangible environmental and social benefits and public health improvements. EU funding is expected to mitigate constraints arising from affordability and ensure that investment programmes will be adequate to bring water, wastewater and solid waste management facilities into compliance with the Bank’s PRs and EU standards.

Health and safety will be an important consideration in all EBRD projects. In transport infrastructure and urban transport projects the Bank will promote road safety initiatives and require road safety assessments. EBRD will work with clients in all sectors to mitigate the health and safety risks through good project design and best practices in safety management.

4. ACCESS TO CAPITAL: PRIVATE AND PUBLIC SOURCES OF FINANCE

4.1 Access to capital

Croatia’s public debt is financed by domestic and external sources in roughly the same proportion. Most of the domestic public debt is financed through debt securities issued on domestic capital markets, and about a quarter is financed through bank credit. Most of the government’s external debt has been funded through international financial markets. Croatia issued its first Eurobond for US$ 300 million in 1997 and has since regularly tapped international capital markets. In its latest issue in April 2012, the Government placed a 5-year US$ 1.5 billion 5-year Eurobond at an annual yield of 6.375 per cent. Only one of the three main rating agencies, Fitch, still has Croatia at investment grade sovereign rating. In early 2013, Moody’s and Standard & Poor’s downgraded Croatia to below investment grade following the publication of the 2013 budget and the associated uncertainty over Croatia’s commitment to fiscal adjustment.

The entry of foreign banking groups in Croatia led to a significant increase in access to credit for both households and corporates. At its peak in 2006/2007, total credit growth averaged over 20 per cent y/y. These trends have changed dramatically since the onset of the global financial crisis. Supply-side pressures from parent banks along with demand-side pressures (country risk and credit demand) led to significant cross border deleveraging and a dramatic deceleration in credit growth that has persisted over the past three years. Over this period, total credit growth has risen at rates between 2 and 7 per cent y/y with the exception of a few months at the end of 2009 and early 2010 when credit was contracting. Recent trends have been more worrying as private credit has been consistently contracting since mid-2012.

Households account for around 55 per cent of total loans to the private sector with corporates accounting for the remaining 45 per cent. The relative ratio has not changed significantly over the past ten years. Most of the loans are either denominated or indexed to a foreign currency (mainly the euro but also the Swiss franc). Access to finance for MSMEs has been particularly affected by the limited liquidity and increased risk aversion in the financial system due to the crisis.
Croatia has more a developed capital market relative to other regional peers, but it still lags behind advanced capital markets in the EU. Equities are traded on the Zagreb Stock Exchange (ZSE), which was established in 1991. ZSE has had an electronic trading platform since 1995. Market capitalisation has decreased during the crisis, standing at 35.2 per cent at the end of 2011 compared to 51 per cent in 2009, and liquidity is quite low (turnover ratio was 0.04 in 2011). Furthermore, about 85 per cent of recorded transactions in 2012 were over the counter.

Bond markets are dominated by Croatian government bonds and some corporate issues, and the major market participants are banks, pension funds, mutual funds and insurance companies. Most transactions are over the counter with exceptionally small volumes traded directly on the stock exchange. The corporate bond market remains underdeveloped, with extremely low and irregular trading volumes. There were eight bonds in the market in early 2011. Market makers were quoting executable prices for six of these.

4.2 Other IFIs and the European Union and co-operation with EBRD

International Monetary Fund

Croatia has been member of the International Monetary Fund (IMF) since December 1992. The last financial arrangement expired in 2006. The latest Article IV consultation took place in November 2012. The report from this consultation particularly highlighted the need to:

- Continue a gradual but steady expenditure-based consolidation in 2013 and well into the medium term, while protecting capital spending. Croatia was also encouraged the authorities to persevere with their efforts to rebalance the tax structure away from labour in a revenue-neutral way.
- Undertake further structural reform measures to restore competitiveness and spur growth as well as to strengthen EU funds absorption capacity that would allow Croatia to take full advantage of EU accession by supporting growth-enhancing investments. Croatian authorities were further encouraged to develop specific policies and prioritize measures, focused on raising labour force participation, enhancing labour market flexibility, reducing barriers to market entry, and fostering competition.

World Bank Group

Since 1993, the World Bank has provided financing in Croatia for 47 projects in the amount of US$ 3.3 billion. During the last years it has been focusing its assistance on helping Croatia prepare for successful EU integration and implement structural reforms that would boost competitiveness and mitigate the impact of the financial crisis. World Bank projects included, among others, sustained support to establish an integrated land administration system as well as continued support for the Rijeka port infrastructure modernisation and export finance intermediation through the Croatian Bank for Reconstruction and Development. The World Bank has committed US$ 806 million in 2010-2012 in Croatia.

The International Finance Corporation had a US$ 130 million portfolio in Croatia as of July 2012. IFC’s investments in Croatia have financed projects in the financial markets, general manufacturing, tourism, and agribusiness sectors. IFC’s latest investments in Croatia include a syndicated loan for a wind farm and participation in Atlantic Grupa refinancing with
EBRD. IFC advisory services have been extended to tax transparency and simplification as well as corporate governance under their Western Balkans initiatives.

The World Bank is currently working on its Country Engagement Strategy for Croatia where the strategic priorities include:

- **Public Finance** (lending: health, social protection; technical assistance: debt and contingent liability management, medium-term budget planning, means testing for social programmes, tax administration and reserves management).
- **Competitiveness** (lending: railways sector reform; technical assistance: SOE governance reform, public administration reform, business process simplification, R&D and Smart Specialisation Support; IFC lending – credit lines for energy efficiency, renewable energy and SMEs, long-term financing for infrastructure, municipal and trade finance and technical advisory to facilitate private sector participation in infrastructure)
- **Maximizing the benefits of EU membership** (preparing the national reform programme for effective use of EU funds, strengthening capacity of public sector for the absorption of EU Structural Funds and improving Croatia’s regional co-operation for EU convergence)

**European Investment Bank**

The EIB’s lending operations in Croatia support projects helping the country to meet EU accession criteria and to integrate rapidly into the European Union. EIB lending in Croatia since 2001 reached around EUR 3.3 billion at the end of 2012.

In 2010-2012 the EIB increased its activities in Croatia as a response to the economic crisis. It has provided the Croatian Bank for Reconstruction and Development with some EUR 500 million and local commercial banks with EUR 170 million. This support went mostly towards SMEs investments with new SME credit lines established with local financial institutions and public sector projects in line with the priorities of the Government. Mainland infrastructure has benefited from EUR 185 million of financial commitment from the EIB.

Over the coming years, as was the case in the other new EU member states, the EIB intends to step up its financing of infrastructure projects in Croatia, as well as to continue expanding its lending to municipalities and local authorities for infrastructure improvements in the environment, health and education sectors, in particular focusing on co-financing with the EU structural funds. The EIB will also continue providing support to SMEs.

**European Union**

The 2010-2012 period has been characterised by intensified efforts of Croatia to complete the EU accession negotiations and to enhance its readiness to meet the challenges and harvest the benefits of EU accession. The country successfully completed its accession negotiations and the accession agreement is under ratification by the EU member states with a view to Croatia joining the European Union on 1 July 2013.

During the period leading to the country’s accession, the European Commission regularly monitors the implementation of further measures to ensure Croatia’s compliance with the *acquis communautaire* and to evaluate its preparedness to join the European Union.
Since 2007 Croatia has benefited from the EU Instrument for Pre-accession (IPA). The financial allocation of the IPA programme for Croatia in the period 2007-2012 was EUR 910.2 million. For the year 2013 EUR 93.5 million is allocated. The IPA programme consists of the following components: assistance in transition and building of institutions, cross-border co-operation, regional development, human resources development and rural development (IPARD). As of December 2012 some 60 per cent of available EU financing has been contracted and some 33 per cent was disbursed.

In the period 2014-2020 some EUR 11 billion is planned to be made available as EU financial assistance for Croatia, including financing for infrastructure and private sector competitiveness enhancement projects. The Croatian authorities are planning to prepare the relevant draft strategies and operational programmes by end June 2013.

**EBRD co-operation with IFIs and the European Union in 2013-2015**

EBRD co-operation with the World Bank Group, EIB as well as with the European Union will focus on competitiveness enhancement and on strengthening the capacity of relevant Croatian public and private sector counterparts to leverage the benefits of EU accession. In particular:

- The Bank will continue to work closely with these institutions on the main policy dialogue issues related to further reforms aimed at increasing the competitiveness of Croatia’s transport, energy and municipal sector and will seek to structure financing that it is complementary to those offered by these institutions. In particular, the World Bank will continue be an important counterpart on policy reform issues in the railways sector and in the reforms leading to the regional consolidation of the municipal water utilities.
- Close co-ordination and co-operation will be pursued with the World Bank Group on investment climate issues, as well as with the European Commission on strategic planning and project preparation for the 2014-2020 EU financial perspective.
- In the financial sector, the Bank will continue co-leading the Vienna 2.0 related country level and regional dialogue and will co-operate closely with the IMF, the other co-leader of this initiative.
- In the private SME sector, the Bank will boost its actions through the new SME platform devised together with the EU and EIB for the Western Balkans and Croatia and approved under the WBIF, the Enterprise Development and Innovation Facility (EDIF), though which a set of financing mechanisms and TC for structural reforms in the areas of private equity and innovation will be made available to the region. Within EDIF, a new fund, the Enterprise Expansion Fund (ENEF), will be created as a vehicle to co-finance equity-driven projects with LEF, thus representing a key element to the co-operation with all other institutional players in the region.
ANNEX 1 – POLITICAL ASSESSMENT

Croatia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with the conditions specified in Article 1 of the Agreement Establishing the Bank.

The constitutional and legislative framework for a pluralistic parliamentary democracy is in place. The separation of powers and checks and balances in the political system, guarantees for fundamental rights and protection of minorities, and for a meaningful role of civil society are largely in line with international and European standards, as assessed by the Council of Europe and the European Union. Elections are conducted in a manner deemed by the OSCE and the Council of Europe to be free and in line with international standards.

In the period since the adoption of the previous Strategy Croatia has made further significant progress in democratic reform. To a great extent it was geared towards integration into the European Union (EU), which Croatia is due to join as a full member on 1 July 2013, subject to successful completion of ratifications of the Accession Treaty by the Member States. Progress has been achieved across the board in all four key areas: representative and accountable government, civil society, media and participation, the rule of law, and civil and political rights. Based on the comprehensive monitoring report on Croatia’s state of preparedness for EU membership released by the European Commission (EC), which reaffirmed, in particular, that Croatia meets the political criteria for membership in the EU, the Council of the EU concluded on 11 December 2012 that Croatia has achieved progress in adopting and implementing EU legislation and is completing its alignment with the acquis communautaire (acquis). Particular progress has been achieved in strengthening institutions underpinning democracy, the respect for human rights, including the protection of minorities, the fight against corruption, where persistent efforts started to yield concrete results, including tackling high-level corruption cases, and the overall strengthening of the rule of law.

At the same time, certain challenges remain in the areas of public administration reform and the judiciary. The EC’s monitoring report of 2012 called, in particular, for “increased efforts” in improving efficiency of the judiciary. The final monitoring report on Croatia’s accession preparations was issued on 26 March 2013. The EC concluded that Croatia completed the priority actions identified in previous monitoring reports and demonstrated its ability to fulfil other commitments in good time before accession, expressing confidence that Croatia would be ready for membership on 1 July 2013.

Representative and Accountable Government

Free, fair and competitive elections

The existing legal framework provides a sound basis for democratic elections. The legal framework benefited from a series of reforms over the years, although it is fragmented, comprising the Law on the elections to the Parliament, adopted in 1999 and amended in 2010, the Law on voter lists, the Law on the State Election Commission, the Law on Constituencies, among others. The OSCE Office for Democratic Institutions and Human Rights (ODIHR) has recommended reviewing and harmonizing various electoral laws with view of possible adoption of a single comprehensive electoral code that would regulate all types of elections. Among other possible areas for improvement, as assessed by ODIHR, is
revising the boundaries of constituencies, which were delimitated in 1999 and currently provide for up to 30 per cent variations in the number of registered voters (the relevant Law requests that the number of voters should not differ by more than 5 per cent), as well as enhancing the overall accuracy of the voter lists.

Previous elections in the country were assessed as “free and fair” by observers from the ODIHR, as well as by other competent international observers. Elections are generally highly competitive, starting with the inclusive candidate registration that offers a diverse choice to the electorate. The candidates are able to campaign freely. The Central Election Commission is an independent, permanent, and professional body, appointed for the term of eight years. It is headed by the President of the Supreme Court. Media provide voters with diverse and extensive coverage of electoral campaigns, which is appropriately regulated. The laws provide for domestic and international election observation at all levels of election administration.

Under the Constitution, the parliament is a unicameral body directly elected on the basis of universal and equal suffrage through secret ballot. The parliament is elected every four years. The latest general elections, which took place on 4 December 2011, were marked by a calm and peaceful environment and were genuinely pluralistic. Their conduct was assessed by the OSCE/ODIHR Limited Election Observation Mission as well administered, efficient, and transparent.

Separation of powers and effective checks and balances

The constitutional and legislative framework for a parliamentary democracy – underpinned by the separation of powers and checks and balances in the political system, independent legislature and well established procedures of legislative oversight in prescribed domains of decision-making – is in place in Croatia and largely in line with international and European standards, as assessed by the Council of Europe and EU. The scope of powers of the legislature to hold the government to account and to exercise parliamentary oversight is largely in line with international standards. Public bodies respect the recommendations by the general Ombudsman and specialised ombudspersons, whose activities are regulated by a special Law, which was adopted in 2012.

Overall the functioning of the Parliament is satisfactory and political dialogue between the government and opposition is maintained. Representatives of the opposition head a number of important parliamentary committees. Prime Minister and Government Ministers participate in four to six Q&A sessions with MPs annually. Each year, they respond in writing to hundreds of enquiries from MPs. Ministers regularly participate in the interpellations requested by the parliamentary opposition, as well as in hearings at the parliamentary committees. Exercising its right to initiate and amend legislation, the parliamentary committees regularly initiated bills and legislative amendments.

Effective power to govern of elected officials

Croatia has established institutional, legal, and financial arrangements for elected officials to exercise effective power to govern and they are not constrained by any non-democratic veto powers or other undue influences. As in many other transition countries, there has long been a close relationship between business and political elites. However, this does not compromise the powers of elected officials to govern the country.
Civil Society, Media and Participation

Scale and independence of civil society

There is a satisfactory legal framework for civil society organisations. There is a sophisticated and diverse network of institutions responsible for cooperation between the government and CSOs, including a specialised agency in the government, the Council for Cooperation (comprising both government and CSO representatives, and the national Endowment for the Development of Civil Society, providing funding to the CSOs). There is also – among the first in the region – a “Partnership for Open Government”. A new Strategy for the Development of Civil Society was adopted in 2012. Its preparation was broadly participatory. Each ministry and governmental agency has dedicated officers for the work with civil society. However, despite considerable efforts in training, the practical performance remains uneven.

Significant progress has been achieved in the inclusion of civil society representatives in the work on the EU-related agenda. The parliamentary committee on EU Affairs holds joint sessions on key EU issues, and NGOs specialised in this area provide expert advice and actively participate in public consultations. At the same time, the impact of future EU membership is also one of the main concerns of the CSOs: they fear that foreign funding could decrease once Croatia is formally recognised as an advanced democracy.

There are more than 50,000 registered CSOs in Croatia. However, not more than 200 of them are well established, mostly in the capital and other large cities. “Platform 112” brings together 67 various CSOs. Some CSOs are highly professional in their respective areas of expertise, particularly those specialised in EU integration related issues, good governance, anti-corruption, human rights, environment, and gender issues.

The right to form trade unions is enshrined in the law and respected in practice. The Economic and Social Council plays an active role in the social dialogue. In 2012, representativeness criteria for the participation of trade unions in collective bargaining were adopted, and two sectoral councils were established in addition to the two already existing.

Independent pluralistic media that operates without censorship

Croatia has a diverse media environment which includes some 170 radio stations, 31 TV channels, and 15 daily newspapers, offering citizens a wide range of political views. More than 60 per cent of households have access to the Internet. Pluralism in the media, which operate freely and without censorship, has increased overall in recent years. The legal framework is largely in place and in line with international standards. The new media law provides for greater transparency in media ownership.

Television remains the predominant source of information, with nine channels providing nationwide coverage, seven of which are privately owned. The Croatian public broadcaster, Hrvatska Radiotelevizija (HRT), includes four nationwide TV channels and three national radio stations. In 2011, the parliament adopted a new statute of HRT, designed to increase HRT’s editorial independence. A new law on the public broadcaster was adopted in July 2012. The 2009 Law on Electronic Media provides the Council for Electronic Media with the mandate to monitor the activities of broadcast media and with the power to impose sanctions.
Multiple channels of civic and political participation

Multiple channels of civic and political participation are in place. The system of public consultations is largely in place, although the rules are not always enforced. The Croatian parliament is one of few in the region which has an institutionalised system of external members of the parliamentary committees from among CSOs, experts, and academia. The provisions for public consultations are generally respected.

Freedom to form political parties and existence of organised opposition

The freedom to form political parties is both guaranteed by the Constitution and implemented in practical terms, highlighted by the existence of a significant opposition able to campaign freely and oppose government initiatives. The main opposition political party currently holds about 30 per cent of seats in the national parliament, its representatives head a number of parliamentary committees, and they are also in majority in a number of municipalities. 40 political parties participated in the last general elections in Croatia, and 15 parties are currently represented in the Parliament.

Rule of Law and Access to Justice

Supremacy of the law

Necessary legislative and institutional safeguards for the supremacy of the law are in place. Croatia continued to make progress in comprehensive reforms of the judiciary and in aligning it with European standards and legislation. The Council of the EU noted in December 2012 that Croatia is completing its alignment with the acquis ahead of the membership, expected in 2013. The EC’s 2012 comprehensive monitoring report concluded that Croatia is generally meeting the commitments and requirements arising from the accession negotiations in the field of the judiciary and should be in position to implement the acquis as of accession in July 2013.

Independence of the judiciary

The independence of the judiciary is guaranteed by the Constitution and key safeguards are in place to ensure its impartiality. Strengthening the independence, accountability and professionalism of the judiciary have been among the key objectives of the judicial reform strategy and the respective action plan adopted and implemented by the authorities. A number of amendments to the Constitution adopted in 2010 strengthened the independence of the judiciary. The reformed State Judicial Council (SJC) and State Prosecutorial Council (SPC) have continued to function independently. Both SJC and SPC appoint judicial officials based on uniform and transparent criteria. The merger of courts as part of the court rationalisation process continues, as is the rationalisation of the prosecutor’s office. These efforts were underpinned by the implementation of the wider State Administration Reform Strategy for 2008-2011 and Civil Service Human Resources Development Strategy for 2010-2013, designed to improve the professionalism, impartiality and merit-based character of the public service. While noting the overall increase in the efficiency of the judiciary, the 2012 EC comprehensive monitoring report noted at the same time the continuing trend of an increasing number of unresolved civil, commercial and enforcement cases, expressing concern regarding the backlog in the courts.
**Government and citizens equally subject to the law**

The authorities have stepped up measures to prevent the abuse of authority by public office holders. The Law on Free Access to Public Information is in place, and new rules on access to information are being applied. Improved and stricter conflict of interest legislation was adopted in early 2011. Some initial steps were taken in 2012 for setting up of the Conflict of Interest Commission. Efforts continued towards building a modern, professional, transparent, merit-based and citizen-oriented administration, as envisaged by the State Administration Reform Strategy and the Civil Service Human Resources Development Strategy. There has been progress in access to justice for citizens, including full implementation of the Administrative Dispute Act.

**Effective policies and institutions to prevent corruption**

An adequate institutional and legal framework for fighting corruption is in place, as assessed by the EU. The previous key elements of the legal framework have either been recently revised (Law on Access to Public Information) or replaced by new legislation (Law on Financing of Political Activities, Conflict of Interest Act). Croatia has improved its track record of strengthened prevention measures by means of a number of legal instruments, including such areas as financing of political parties and electoral campaigns, access to information, and public procurement. The new public procurement legislation in force since 2012 provides for increased transparency including publication of information on the actual execution of contracts.

According to the reports by the Council of Europe’s Group of States against Corruption (GRECO), Croatian criminal legislation provides an effective basis for the investigation and prosecution of corruption offences and the improvements of the last years in that area are commendable. GRECO’s latest Evaluation Report on Croatia provided a number of recommendations. According to the Compliance Report, adopted by GRECO at the end of 2011, Croatia implemented satisfactorily seven out of eleven recommendations and was commended for efficient and prompt implementation, while being urged to continue efforts to implement the pending (partly implemented) recommendations as well.

Law enforcement bodies, including the Office for the Fight Against Corruption and Organised Crime (USKOK) and the Police National Office for the Suppression of Corruption and organised Crime (PNUSOK), are very active, especially in higher-level cases. The new Police Act, adopted in 2011, led to further professionalization in the work of the police. The interagency cooperation in the fight against corruption and organised crime has improved over the years, and there is a well-functioning system in place with regular meetings of the governmental coordination committee. The overall progress in the area of anti-corruption activities has been assessed in the recent relevant EU reports as “substantial”. The latest efforts to intensify the fight against high-level corruption included cases against former members of the Government and senior political figures, heads of local administration. Importantly, the investigations have been conclusive, with a number of verdicts enforced. The efforts to fight high-level corruption led, inter alia, to the spectacular sentencing of the former Prime Minister Ivo Sanader to ten years in jail.

At the same time, local-level corruption remains a problem, particularly in such areas as public procurement, and is still perceived by Croatian citizens as a widespread phenomenon.
According to the 2012 Transparency International Corruption Perception Index, Croatia has a score of 4.6, which places it 62nd out of 176 countries, among the worst in the CEEB region, although still better placed than a few EU member states and far ahead of the neighbouring Western Balkans countries.

**Civil and Political Rights**

*Freedom of speech, information, religion, conscience, movement, association, assembly and private property*

Overall civil and political rights continue to be well respected in Croatia. According to the national report submitted by Croatia in the framework of the United Nations Universal Periodic Review of Human Rights (UPR 2010), the main challenges are related to efficient implementation of the existing legislation and strengthening administrative and financial capacity.

The Constitution guarantees the basic freedoms and rights of citizens recognized in international law, while international treaties are directly enforceable by domestic courts and their status is superior to the domestic law. Freedom of speech, information, religion and conscience, movement, association and assembly, and private property are therefore fully guaranteed. The Constitution and relevant laws prohibit discrimination on grounds of sex, race, language, religion, national or social origin, property or social status.

Croatia has developed a track record of implementing the 2009 Anti-Discrimination Law and legislation on hate crimes. In 2012, a number of further amendments to the Anti-Discrimination Law were adopted. A new Criminal Code, due to enter into force in 2013, contains a modified definition of hate crimes and new provisions on violation of equality. Measures have been taken to strengthen the position of the Ombudsman Office as the central body in charge of implementation of the above-mentioned law.

Croatia is a signatory to all major international human rights instruments. The high level of ratifications of the conventions of the United Nations, Council of Europe (Croatia is party to 88 instruments of the Council of Europe), and regional human rights instruments represents a significant achievement.

As part of its preparations for the forthcoming membership in the EU, Croatia adopted legislation on the right to vote for EU citizens, as well as amendments to the Aliens Act in order to align its provisions with relevant EC directives on the right of citizens to move and reside freely within EU.

Property rights are generally respected and protected. Progress has been made in compensation for the use of private property confiscated under the war legislation from the 1990s, although there remain some cases of delayed repossessions.

*Political inclusiveness for women, ethnic and other minorities*

The legislative framework for the protection of ethnic minorities is broadly in place. According to the 2012 Report on Croatia by the European Commission against Racism and Intolerance of the Council of Europe (ECRI), Croatia has achieved further progress in a number of areas pertaining to the rights of minorities.
The Constitution has been amended to recognise the existence of 22 ethnic minorities. The latter are guaranteed eight seats in the 151-strong parliament, including three seats reserved specifically for ethnic Serb minority. There is a special legislation in place designed to protect the interests of ethnic minority communities, Constitutional Act on the Rights of National Minorities (CARNM). The practical cooperation between the authorities and political representatives of ethnic minorities, some of which are part of the governing coalition, has been satisfactory. At the local level, the authorities increased support to the local Councils for National Minorities.

Under CARNM, the authorities adopted in 2011 a special plan for minority employment for 2011-2014. Progress in its implementation has been uneven, largely due to the general constraints in recruitment in the civil service because of the general economic crisis.

There has been visible progress in refugee returns. Roughly half of Serbian refugees who fled Croatia in 1990s have returned. As of 2012, there were approximately 1,900 missing persons related to the 1990s conflict in Croatia. Croatia continues to engage with regional neighbours in the Sarajevo Declaration Process, launched in order to find solutions for refugees displaced as a result of the armed conflicts in the former Yugoslavia between 1991 and 1995. A housing care programme for returnees has been implemented, and substantial efforts and investment were made by the authorities, although challenges remain related to houses reconstruction.

More remains to be done to protect smaller ethnic minorities, particularly the most vulnerable Roma community, which faces challenges in the areas of education, social protection, health care, employment and access to personal documents. Regarding Roma, several measures have been taken. According to the 2012 ECRI Report on Croatia, significant resources were invested in addressing inequalities faced by Roma. Pre-school facilities were made available for Roma children and their enrolment at primary school level has increased. Measures have been taken to put an end to separate Roma-only classes. Several Roma settlements have been legalised and infrastructure improvements carried out. However, many Roma still do not have personal identity documents. Stereotyping against Roma persists, and there is certain reluctance to take cases of racially motivated prejudice, hostility and violence seriously.

The key legislative elements for gender equality are in place in Croatia. The Ombudsperson for Gender Equality is supervising the implementation of the 2008 Gender Equality Law. Other institutional mechanisms for gender equality are being developed, both at the central and local levels. There is special legislative framework against domestic violence, where some challenges remain. As with the rest of the Croatian legislation, the work has been ongoing for the alignment with EU legislation of various provisions related to equal opportunities, including maternity and parental benefits, safety and health of pregnant workers and workers who have recently given birth or are breastfeeding. Further measures are envisaged by the National Policy for the Promotion of Gender Equality for 2011-2015.

In the previous Parliament, the share of female MPs was 25 per cent. It is 23.8 per cent in the current Parliament. There are currently four female members of the Government, including two deputy prime ministers. During the latest general elections 35 per cent of candidates were women, and women represented 15.6 per cent of the candidates in the first positions on the lists. ODIHR recommended further clarification of the requirements for gender representation on the candidate lists in the existing legislation on gender equality.
Lesbians, gays, bisexual and trans-gender (LGBT) people still face prejudice.

*Freedom from harassment, intimidation and torture*

Constitutional guarantees against harassment, intimidation, and torture are in place and are largely upheld in practice. The latest (2007) report of the Council of Europe’s European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) contained recommendations to improve the treatment of persons in police custody, prison conditions, and the situation of patients in psychiatric institutions and residents in social care homes. A CPT delegation carried out a nine day visit to Croatia in September 2012 in order to assess the country’s progress. Their conclusions will be submitted in a report to the Croatian authorities in March 2013, and should be made public, alongside the responses of the Croatian Government, by the end of 2013.
ANNEX 2 – ASSESSMENT OF TRANSITION CHALLENGES

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<td>Capital Markets</td>
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INDUSTRY, COMMERCE AND AGRIBUSINESS

Agribusiness
Market structure: Small
Market institutions: Medium

The present level of support to agricultural producers is in line with EU and OECD averages (although support to the sector is still mainly linked to production and thus differs from the reformed CAP). Significant reductions in import protection are being implemented under the WTO and EU agreements. Over the last four years, most of the majority state-owned companies have been privatised. The remaining companies that could be privatised include operationally and financially weak corporates unlikely to attract strong interest from strategic investors. The privatisation of state-owned land with cadastre/land registry issues is progressing well. The Croatian government with the support of the World Bank is developing the Integrated Land Administration System Project (ILAS Project) with completion expected in 2015. Restrictions on acquiring agricultural land by foreign physical persons still remain, while it is possible for foreign owned companies to own land. The three largest private agribusiness producers cultivate about 52,000 ha (less than 6%) out of estimated 870,00 ha of arable land, while the remainder is dominated by small family owned farms resulting in a very small average farm size of 2.4 ha. Thus, yields in the agricultural sector remain below the EU averages for many crops despite improvements in recent years. There is an important food and retail industry which the Bank has supported through various projects. Investments in technology and energy efficiency are needed to increase the
agribusiness sector competitiveness, particularly in view of Croatia’s EU accession. Private sector banks still show limited interest in servicing the sector mostly due to high sector fragmentation and the lack of bankable collateral. A warehouse receipts law is approved, but there is limited usage of the registered warehouses due to perceived high cost of storing goods in the licensed warehouses as well as underdeveloped confidence in the new system. From a lenders’ perspective, the institutional framework requires further improvement, in particular related to foreclosure procedures as well as building of a warehouse capacity and registering property.

**Manufacturing and Services**
Market structure: *Small*
Market institutions: *Small*

Reforms in Manufacturing and Services in Croatia have progressed in recent years, mainly under the umbrella of the on-going EU accession negotiations, and the country is now scheduled to accede in July 2013. However, the degree of privatisation, restructuring and competition is less advanced than in the other central European and Baltic countries, due primarily to the continued high level of state involvement in major companies, either through indirect or direct significant shareholdings or state-aid. The large scale restructuring of enterprises in ship-building industry either as a going-concern or through bankruptcy procedures have been protracted but is now progressing in order to comply with EU accession terms. Moreover, most of the locally owned private enterprises still require operational and financial restructuring and corporate governance improvements, and the limited foreign direct investment in the sector needs strong encouragement especially given the need for innovation and technology improvements in Croatia as well as increasingly tight credit conditions due to the post-crisis deleveraging by commercial banks.

According to cross-country surveys the quality of the business environment remains a concern and reflects the need to tackle obstacles to doing business, such as improving permitting procedures, closing restitution issues, harmonising the land registry and cadastre, and increasing the efficiency of court procedures and strengthening minority rights protection. Inflexibility of the labour market due to legislative restrictions also hinders the smooth setting-up and running of businesses. Competition law has been reformed in 2009 and legislation is now in line with EU competition *acquis*; however, the enforcement track record is still poor, with few cartel cases opened and relatively small fines.

**Real estate**
Market structure: *Medium*
Market institutions: *Small*

The real estate sector has developed significantly over the past decade, including the introduction of new types of property as well as financing instruments. However, the majority of commercial development has been focused on Zagreb and the coastal cities. Despite the negative impact of the global financial crisis, the long-term growth potential in the commercial property sector remains strong due to the lack of modern warehousing stock and high quality office space in regional cities. The tourism sector has further developed especially in the coastal region, including the emergence of international class assets, but lack of transparency in the sector and bureaucratic interference remain unsolved issues. Also, over a dozen hotels and many other tourism assets have remained state-owned. Developers still suffer from relatively lengthy procedures to register a property or obtain a construction
permit (according to the World Bank Doing Business 2012 survey, obtaining a permit takes over 300 days and registering property over 100 days, significantly more than the OECD average of about 150 and 30 days, respectively).

**Telecommunication**
Market structure: *Small*
Market institutions: *Small*

The telecommunications sector is regulated by the Croatian Post and Electronic Communications Agency (HAKOM), an independent regulator with adequate capacity to regulate. The regulatory framework is aligned with that of the EU (the EU 2009 regulatory framework). Fixed and mobile number portability have been introduced. Analogue broadcasting switch-off has already been completed, freeing up spectrum for mobile broadband services.

Although the market has been fully liberalised, the fixed-line incumbent Hrvatski Telekom (T-HT, controlled by Deutsche Telekom) still retains a major share of the market. However, there are a number of alternative fixed line operators and competition is likely to further intensify. In the mobile segment, there are three network operators, T-Mobile Croatia (controlled by the fixed line incumbent), VIPnet and Tele2. Broadband penetration, including mobile broadband penetration, is increasing steadily. Cable TV segment, potentially a platform to increase competition in the broadband and telephony segments, is still fragmented, especially in the regions.

**Private equity**
Market structure: *Medium*
Market institutions: *Medium*

There have been few meaningful private equity transactions historically. Nevertheless, active capital and capital available for investment both increased somewhat over the last year, estimated at just over 0.4 and 0.5 per cent of GDP, respectively (up from 0.3 per cent for both in 2010). In February 2010 the Government launched in initiative allocating HRK 1 billion to create ‘Economic Cooperation Funds’ in which the Government would invest alongside private investors in private equity funds. This has resulted in the launch of 5 funds with approximately EUR 130 million in committed capital, of which 50% of the equity is from pension funds and local corporates. These funds have yet to establish a track record of investment. Less than ten regional fund managers have been identified for which Croatia is in scope. The bulk of net committed capital is focused on buyouts and growth funds. Mezzanine is not yet [there is hardly any available] well-represented, whilst infrastructure is very minor, and distressed, small cap and venture capital non-existent. Conformity with OECD Principles of Corporate Governance is reasonable.

**ENERGY**

**Natural Resources**
Market structure: *Small*
Market institutions: *Small*

Croatia is a significant oil import and refining capacity. Croatia has some domestic on- and off-shore oil and gas reserves, but these are small and do not meet the current levels of
demand. Investment in the Croatian upstream sector has been historically limited, partly as a consequence of the country’s old mining legislation, which prescribed separate tenders for exploration and production licences. The country could see its import capacity expanded in the long term if a liquefied natural gas (LNG) terminal on the Adriatic coast is commissioned.

The Croatian state still owns a 45 per cent stake in the national oil and gas company, INA, which has been privatised to MOL (Hungary). MOL currently has a 47 per cent stake and management rights according to its agreement with the Government. The gas storage business has been de-vested from INA to Plinacro, a state-owned company that is in charge of the transmission and storage of gas. Jadranski Naftovod (Janaf) manages the oil transport and storage system and remains state-controlled. In addition to its exploration and production activities, INA operates two large refineries, in Sisak and Rijeka, as well as a network of around 400 petrol stations and other distribution assets abroad. INA dominates the downstream segment and IOC presence is limited at present: OMV is currently divesting its Croatian assets while Lukoil is increasing its presence; Serbia’s NIS, a Gazprom subsidiary, has expressed interest in the Croatian market in the past.

The liberalisation of the gas market is proceeding and network rules for the transport and distribution of gas have been enacted. However, the gas market remains dominated by single suppliers, undermining effective competition. Plinacro (in charge of transmission and supply) remains in hands of the State and Prirodni Plin (in charge of imports and trading) is an INA subsidiary. In addition, there are about 37 licensed gas distribution companies in Croatia that operate at local level. The country is a signatory of the Energy Community Treaty, which aims at establishing an Integrated Energy Market Organisation in South-East Europe. In April 2007, the Croatian Parliament passed the Gas Market Act (GMA) which is harmonised with the EU Gas Directive 2003/55/EC. An independent regulator, the Croatian Energy Regulatory Agency (HERA) was established in 2001. The key remaining challenges are to encourage competition in the retail oil products sector, ensure transparent and non-discriminatory third party access to the gas system, including upstream pipelines, transmission and distribution system and gas storage..

**Power**

**Market structure:** *Large *

**Market institutions:** *Medium*

The Croatian power sector is still dominated by the state-owned national utility, Hrvatska Elektroprivreda (HEP). However, progress has been made with legal unbundling of HEP, which is currently organised as a holding company with generation, transmission and distribution activities operated by separate subsidiaries. In 2009, legislation was introduced in order to improve energy trading, customer rights and the allocation of cross-border transmission capacities. In addition, the electricity sector was opened in July 2008 and consumers are able to choose their supplier. However, the sector still has only limited private sector participation and competition given that electricity prices are not fully cost reflective. In practice, HEP is the only distribution company and has over 90% share in electricity generation. The quality of Croatian institutions has been strengthened. An independent regulator (HERA) is in charge of the tariff system and of the issuance of licenses. However, the government defines the amounts of tariff items. Despite further recent increases (by 20 per cent for households and by 9.5-12 per cent for companies in July 2008, followed by another 20 per cent for households in May 2012), tariffs are still not cost-reflective and cross-subsidisation persists. Losses also remain at a high level but energy intensity is within 30% of
the EU level. Legislation supporting renewable energy was implemented in 2007 based on a feed-in tariff, and further enhanced in June 2012 with the introduction of a new tariff system and extension of the validity of support mechanisms from 12 to 14 years.

**Sustainable Energy**
Market structure: *Medium*
Market institutions: *Medium*

The Energy Development Strategy (October 2009) and a National Renewable Energy Action Plan (June 2010) include objectives to increase energy efficiency, security of energy supply, diversification of energy and sources, utilisation of renewable energy sources and environmental protection. Despite recent electricity price increases, tariffs are still not costs reflective and do not include environmental costs. Therefore price signals do not provide adequate incentives to use energy efficiently and to invest in RES projects. Cross-subsidies persist. Implementing legislation related to energy labelling of household appliances has been enacted. The RES law adopted in 2007 and amended in 2012 sets targets for the share of RES in energy generation and introduced and later adjusted feed-in tariffs, which support the development of a few wind power plants on the Adriatic coast. However, tangible progress in installed capacity of RES has been very limited, mainly due to the long administrative process and market dominance of the vertically integrated state-owned utility, HEP. RES legislation was further enhanced in June 2012 to bring it more in line with the EU practices. In addition to attractive feed-in tariffs, the market supporting system now includes a power purchase obligation for a period of 14 years and priority dispatching by the network operator.

Croatia ratified the UNFCC and Kyoto Protocol (in 2007) where it holds the status of the Annex 1 Party (with emission target), but supporting infrastructure to participate in the Kyoto flexible mechanisms are not yet developed. Remaining challenges include further improvements in incentives for EE (e.g. increases in tariffs) and the development of carbon credit related institutional and project delivery capacity. Croatia still needs to ensure compliance related to energy end-use efficiency and energy services, and transpose the EU *acquis* related to the energy performance of buildings.

**INFRASTRUCTURE**

**Urban Transport**
Market structure: *Medium*
Market institutions: *Small*

Most urban transport companies are under municipal control and they enjoy a fair degree of autonomy. The larger operators have a solid financial and operational performance, while some of the smaller ones need to improve operational efficiency and collection rates. Competition and private sector involvement is limited in the urban transport sector. Formal contractual arrangements between municipalities and transport companies are common.

**Water and wastewater**
Market structure: *Medium*
Market institutions: *Small*

Water companies are under municipal control, and they enjoy a fair degree of autonomy. The larger operators have a solid financial and operational performance with adequate metering
and bill collection, while some of the smaller ones need to improve operational efficiency and collection rates. Competition and private sector participation are limited with only one private concession for a wastewater treatment plant in Zagreb. In larger municipalities the tariffs allow for cost recovery, but there is a lack of transparency in the tariff formula and there is a lack of clarity about calculation and allocation of investment grants provided by Croatian Water. A few municipalities have introduced service contracts.

Some of the major outstanding transition challenges are to increase the transparency of the tariff methodology and remove cross-subsidies between consumer groups. Remove the centralised and non-transparent allocation of investment grants channelled through Croatian Water. They also include improving contractual arrangements for a wider number of regionalised utilities that would clarify service levels and expected performance, strengthening arms-length relationships between municipalities and their operators, as well as open up for increasing competitive pressures from sound private sector participation.

**Roads**
Market structure: Small
Market institutions: Medium

Separate state-owned companies have been established for the development and operation of state roads (Hrvatske Ceste) and motorways (HAC). In August 2012 the government decided to merge, by January 2013, HAC with the Rijeka-Zagreb motorway company, the latter originally set up in 1997 as a state-owned project company to be privatised after the motorway’s construction completion. There have been two road concession projects, dating back to 1995-1996 but not fully in line with international best practice. All contracts for road construction, rehabilitation and periodic maintenance are tendered on a competitive basis to the private sector. Routine maintenance of state roads is contracted out to road maintenance companies, most of which have been privatised. Motorways are tolled and priced similarly to neighbouring European countries. An automatic tolling system was partly introduced since 2011.

**Railways**
Market structure: Medium
Market institutions: Medium

In 2003 the key railway act was passed, defining the types of services, status and management of railways infrastructure, access charges, financing of new infrastructure and concessions for the construction of new and maintenance of existing infrastructure network. In 2005 a railway restructuring bill was adopted and which called for Croatian Railways (HZ) to be divided into separate freight, passenger, maintenance and infrastructure companies. The bill also called for the creation of an independent regulator. Freight tariffs have been on a cost recovery basis, and PSO reform has started. Nevertheless, there is limited private sector participation and effective competition in the market. The regulator is not fully independent. In July 2012 the Government decided that HZ would be restructured in the coming months: HZ holding is to be dismantled; HZ Traction to be dissolved with its assets’ allocation between Passenger and Cargo companies, both becoming under direct state ownership; Cargo to establish strategic commercial partnership, including through privatisation; non-core HZ businesses are to be divested; and further major labour restructuring is scheduled to be implemented in all three companies.
FINANCIAL INSTITUTIONS

Banking

Market structure: Small
Market institutions: Small

The Croatian banking sector is relatively well developed, with bank operations and skill levels reflecting the 90 per cent foreign ownership (15 foreign out of 31 banks). A full range of products and services is available to corporate, SME, micro and retail segments. However, the regulatory framework and infrastructure for some products, particularly working capital products such as factoring and warehouse receipts, are lacking, and the inefficiency of the legal system has further impact on the ability of banks to extend credit to borrowers. The sector is rather concentrated, with the top five banks holding 76 per cent of assets. The Government has announced plans to privatize Hrvatska Postanska Banka (HPB). The assets/GDP ratio was 120 per cent at end 2011 (slightly up from 117 per cent in 2010) and the deposits/GDP ratio remains unchanged at 71 per cent. Availability of medium to long-term funding is limited on the local markets. Substantial external liabilities imply vulnerabilities to the banking sector. Restrictions imposed by the Croatian National Bank (CNB) in recent years have resulted in an increased focus on attracting domestic deposits to reduce dependence on foreign funding. Deposits grew by around 2 per cent in 2011, but decreased by 0.4 per cent in the first half of 2012 vs. 2011. Nevertheless, loans/deposits ratio was 119 per cent in 2011, up from 114 per cent in 2010. As in the previous year, the deposit growth slow-down was attributable to a decline in corporate deposits (by 2.6 per cent), whilst household sector deposits grew by 4.8 per cent. Total deposit growth was heavily supported by an increase in non-resident deposits – HRK 7.8bn out of the total increase of HRK 12.8bn in 2011. 66 per cent of deposits are denominated in foreign currency. Credit to the private sector at the end of 2011 stood at 72.5 per cent of GDP. Private credit granted rose by 5 per cent between December 2010 and December 2011 – a slight decline from the 6.3 per cent growth seen during the same period of the previous year. However, Q1 2012 credit growth (3.4 per cent in nominal terms) was mainly spurred by increased lending to the government and public enterprises.

Banks have tightened credit standards in the crisis, and while many of the smaller banks have had zero lending activity, some of the larger banks have also slowed down lending. The slowdown in credit growth appeared in 2012 to be affecting working capital, with an increasing number of corporate accounts blocked due to failure to meet official payments. The inefficiency and ineffectiveness of the legal system is a contributor to trade creditors’ inability to enforce payment. While factoring products are offered by some banks, there is no legal framework in place for this activity. FINA and another company provide electronic invoicing; however, there is no electronic signature system in place. There is no infrastructure for warehouse receipts, and in particular there is no registration system. The credit bureau, HROK, on the other hand, is well established, with systems provided by Transunion. HROK has close to 100 per cent coverage of individuals, and since beginning coverage of corporate (including SME) entities in August 2010, it now has data on 100,000 business entities, including large, SME, micro, crafts/professionals, and farms.

HAMAG, the state SME agency that also provides credit guarantees, has not been much used because its guarantee was conditional. The new management are introducing an
unconditional guarantee, which may spur additional lending but, depending on pricing and structure, may carry some of the same pitfalls as HBOR interventions.

Taking into account FX indexed loans, 74.5 per cent of loans to the private sector were in foreign currency, a high degree of euroisation. The largest such exposures are to the government and public enterprises, which also borrow FX or FX-linked. With the majority of loans at variable interest rates and linked to foreign currency, and banks dependent on foreign funding, the system continues to be exposed to interest- and exchange-rate induced credit risks from borrowers who may not be fully hedged as well as cross-border contagion risk. So far, the CNB has been successful in maintaining the tight peg of the currency vis-à-vis the euro for the last 14 years. In an effort to further reinforce systemic stability, CNB has increased capital requirements further from 10 to 12 per cent in April 2010. At the end of Q2 2012, the capital adequacy ratio of the banking system was just above 20 per cent.

**Micro, Small and Medium-sized enterprises**
Market structure: *Medium*
Market institutions: *Medium*

MSMEs play an important role in the economy as they account for 99.8 per cent of the number of enterprises and 67 per cent of total employment. They also contribute 57 per cent to the overall economy as measured by the value added. However, access to bank finance by MSMEs has suffered from the limited liquidity and increased risk aversion in the financial system due to the crisis. Aside from the general slowdown in credit, the biggest issue cited with respect to lending specifically to SMEs is their current levels of indebtedness and undercapitalisation. Several public financial support programmes for SMEs are in place. The Croatian SME agency, HAMAG runs 9 credit guarantee programmes, one of them targeting start-ups. These credit guarantee schemes target different areas from agriculture to new technologies and the credit amount and guarantee coverage differ for each type. However, these programmes have further restricted sustainable commercial lending to MSMEs. Training programmes and assistance from banks remain limited, although some banks provide training to SMEs on preparing their business plans and the loan application. Product tailoring, training and borrower information services are necessary to support lending to specific sectors (e.g. medicine) and SMEs international competitiveness (EU desks) by banks. Furthermore, supply chain finance initiatives could be an opportunity to develop the SME sector. There have been some improvements in the effectiveness of cadastre registration and private credit bureau. Indeed, an online cadastre is in place and fully functioning (e-Katastar). The financial agency handles the registration of movable assets which is available online. In general terms, collateral requirement is 150 per cent of loan amount however guarantee schemes benefit from a more flexible definition. A private credit bureau is also in place since 2007, founded by 20 Croatian banks. It covers 100 per cent of adults and started collecting information on firms but access is limited to financial institutions. Challenges remain in terms of ensuring creditors’ rights efficiency such as guaranteeing that secured creditors are paid first when a debtor defaults outside an insolvency procedure.
Insurance and other financial services

Market structure: Small
Market institutions: Small

Standard NBFI products are well established in Croatia, including a three-pillar pension system. Penetration in mortgages is low, and the infrastructure for working capital finance, such as factoring and warehouse receipts is lacking.

The premia/GDP ratio has continued to decrease to 2.6 per cent (from 2.96 per cent and 2.83 per cent in the last two reviews), with non-life insurance premia at 1.91 per cent of GDP and life insurance premia at 0.69 per cent of GDP. As of late 2011, there were 28 insurance companies operating in the Croatian insurance market, including seven life insurance companies, ten non-life insurance companies, while 10 operated both life and non-life business and one was a reinsurance company. The top three players account for 56 per cent of premia, of which more than half are accounted for by the largest player, majority state-owned Croatia Osiguranje. .

Insurance legislation and regulation almost meet the IAIS standards, and Croatia is yet to become a member of IAIS. Most shortfalls in implementation and staffing of the supervisory body were addressed through the establishment of a single supervisor for non-bank financial institutions; although some issues related to the imposition of fines and risk-oriented supervision remain to be fully addressed. Only one pension insurance company has been established and is operating in Croatia, Raiffeisen mirovinsko osiguravajuće društvo d.o.o., which is authorised to pay out pensions due from mandatory and voluntary pension funds in the country. There are 25 leasing companies in Croatia, of which the majority is foreign-owned. Total leasing assets amount to 5.3 per cent of GDP with the top five leasing companies accounting for just over 60 per cent of total lease assets.

Mortgage penetration remains modest at a little over 17.5 per cent. Croatia’s pension system is operating in all three Pillars, with pension to GDP ratio at just over 10 per cent.

Factoring is available in Croatia, with somewhere on the order of EUR 1.2 bln outstanding and turnover growing, despite there being no regulation in place for factoring. The market is concentrated and bank-dominated. Products include discounting bills of exchange, and purchase of receivables; there is little non-recourse factoring. Electronic invoicing is available, but there is no electronic signature system in place. There is also no registration system infrastructure for warehouse receipts.

Capital markets

Market structure: Medium
Market institutions: Small

The Zagreb Stock Exchange (ZSE) market was established in 1991 and its electronic trading platform was introduced in 1995 and NASDAQ OMX's X-Stream, was launched in autumn 2007. Capitalisation has decreased during the crisis, standing at 35.2 per cent at the end of 2011 (USD 22,452 million), versus 42 per cent of GDP and 51 per cent of GDP in 2010 and 2009, respectively. The market continues to lack liquidity; the turnover ratio in 2011 remained at 0.04. Roughly 85 per cent of recorded transactions for 2012 were OTC, with only 15 per cent regular. The market is regulated by the Croatian Financial Services Supervisory Agency, which also regulated the 130 investment funds active in Croatia. Investment funds
AUM was EUR 1.8 bln at end-2011, down 13 per cent from end-2010. Croatia showed high compliance with the IOSCO principles, and relatively high effectiveness in applying the laws and regulations. The securities market regulator is considered highly effective in pursuing complex cases. In 2011 the regulator issued new guidelines for investment management firms on liquidity management.

The bond market is mainly represented by Croatian government bonds and several corporate issues. The entire market functions mainly as OTC dealer market, with exceptionally small volume traded directly on the ZSE. The amounts traded OTC need only to be reported to the ZSE at the end of the trading day for valuation and statistics purposes. The major market participants are banks, mandatory and voluntary pension funds, mutual funds and insurance companies.

The corporate bond market in Croatia remains underdeveloped, with extremely low and irregular trading volumes. There were 8 bonds in the market in early 2011. Market makers were quoting executable prices for 6 of these.
ANNEX 3 – LEGAL TRANSITION

Since the commencement of the EU accession process, Croatia has made significant improvements in numerous areas of commercial legislation. Although Croatia’s legislative framework is greatly compliant with the EU standards, some key challenges still remain – notably, the need to revamp the secured transactions regime (and possibly introduce the factoring legislation), to ensure training of judges in commercial law matters, to create a sector-specific energy efficiency framework and to strengthen the corporate governance regime. This annex covers areas of commercial legislation relevant to the Bank’s proposed strategy in Croatia. It is based on assessments produced by the Bank’s Legal Transition Programme.4

Improving the business climate and encouraging SME development

Access to finance

Provisions on taking non-possessory pledge over movable assets and rights are currently part of the Croatian Enforcement Act, as the Property Act provides for possessory pledge only. Regulating secured transactions through the Enforcement Act, apart from being conceptually suboptimal, has created legal uncertainty and made transaction costs much higher than necessary. For example, since a security agreement is, in essence, part of a voluntary enforcement proceeding, it has to be notarised, which increases costs.

Registration of non-possessory pledges created in accordance with the Enforcement Act is effected at the Registry of Court and Notary Public Created Security (the “Pledge Registry”) operated by the state-owned Financial Agency. The Pledge Registry is a comprehensive document-filing system against the name of the pledger (as opposed to a modern approach based on a simple notice filing], it is operated electronically, and is publicly accessible online. In addition to the Pledge Registry, there also exist a number of specialised registries (e.g., the Trademark Registry (for trademark pledges), the Patent Registry (for patent pledges), the Central Depositary and Clearing Company (for share pledges), etc.). Apart from introducing the Pledge Registry, the Law on the Registry of Court and Notary Public Created Security also contains substantive law provisions introducing the concept of floating charge over tangible assets, thus adding to the already rather fragmented regulation of security rights.

Financial and operative leasing is regulated by the Leasing Act, which provides a modern legislative framework for undertaking leasing transactions. Leasing companies are substantially regulated, require a license and are supervised by the Croatian Financial Markets Supervisory Agency (HANFA). The Croatian leasing market is relatively developed with real estate and cars representing the most commonly leased objects.

There is no special legislation on factoring apart from the general “assignment of claim by contract” provisions of the Obligations Law which provide the basis for assigning accounts receivable. Consequently, there is no definition of factoring services or types of factoring transactions, which could help increase legal certainty of factoring transactions and hence reduce associated costs and risks of re-characterisation of transactions. The Croatian

4 www.ebrd.com/law
government decided to introduce a new law that would provide legislation of factoring transactions and regulation of factoring business. EBRD is providing technical assistance to the Croatian Ministry of Finance in drafting the necessary legal framework.

**Corporate Governance**

The primary source of corporate governance legislation in Croatia is the Companies Act, which entered into force in 1995 and has been extensively amended since then, especially for the purpose of harmonising national legislation with the *acquis communautaire*. The Companies Act is mainly deriving from the German model. The Act details the requirements for setting up and running commercial companies in Croatia.

In 2007, a voluntary Code of Corporate Governance for companies listed on the Zagreb Stock Exchange was developed by the Croatian Financial Services Supervisory Agency (HANFA) and the Zagreb Stock Exchange. The Code was revised in 2010\(^5\) and came into effect on 1 January 2011. The revised Code is based on “comply or explain” mechanism: listed companies are required to state in their annual reports (which are also published on their websites) whether they comply with the Code and state the reasons for non-compliance.

Croatia has undertaken substantial legal and regulatory change that has led to a number of improvements in the framework for corporate governance. This includes the introduction of a Takeovers Act and a Capital Market Act, substantial amendments to the Companies Act, and the creation of a single supervisory authority for capital markets, insurance, and private pensions (HANFA). The issuance of the Code of Corporate Governance is also a positive improvement. However, some substantial challenges still remain. The legal framework contains some critical gaps, especially with regard to conflicts of interest, disclosure of financial and non-financial information, including related party transactions and ultimate (beneficial) ownership (rather than merely a custodian, in case there is one). The composition of the audit committee should be better detailed so as to ensure the necessary qualification, independence (without any executives allowed to serve on the audit committee) and expertise for the effective performance of its functions. Finally, the Code should clarify the reasoning behind having independent directors on the supervisory board and its committees.

**Insolvency**

The sector is governed by the Bankruptcy Act of 1996 (as last amended in 2012) (the “Bankruptcy Act”). The Bankruptcy Act applies to legal entities and to individual debtors who are sole proprietors or tradesmen, subject to certain exclusions or qualifications for state or state-related entities.

The EBRD Insolvency Sector Assessment completed in late 2009 concluded that the Croatian insolvency law provisions were of a very high quality in all aspects, other than reorganisation, which is only permitted following the commencement of bankruptcy proceedings.

On 1 October 2012, the Act on Financing and Pre-Bankruptcy Settlement came into force in an effort to promote reorganisation. The Act requires the debtor to initiate ‘pre-bankruptcy’

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settlement proceedings within certain legally prescribed deadlines following the occurrence of illiquidity or insolvency (as defined in the Bankruptcy Act). Creditors cannot initiate ‘pre-bankruptcy proceedings’. Furthermore, pre-bankruptcy proceedings cannot be opened if bankruptcy proceedings have already been initiated against the debtor. Upon commencement of the pre-bankruptcy settlement proceedings and for the duration of such proceedings, no bankruptcy petition can be filed against the debtor.

Pre-bankruptcy settlement proceedings are aimed primarily at operational and financial restructuring of the debtor with a view to ensuring the survival of its operations post-insolvency (with a restructuring plan having to be approved by the majority of creditors). Pre-bankruptcy settlement proceedings are considered ‘urgent’ proceedings, thereby ensuring greater speed and cost effectiveness. The first stage of the proceedings, involving approval of a reorganisation plan, takes place before the Financial Agency. Assuming approval by the requisite majority, the second phase of the proceedings involves the confirmation of the re-organisation plan by the Commercial Court.

It remains to be seen how Croatia will benefit from the new insolvency regime, as well as whether the measures envisaged under the Act on Financing and Pre-Bankruptcy Settlement will be effective in ensuring the survival of viable businesses in financial difficulties.

Contract enforcement / Judicial capacity

Croatia’s judiciary comprises courts of general jurisdiction dealing with civil and criminal matters, as well as specialised commercial and administrative courts.

As in other pre-EU accession countries, the harmonisation process has served as a catalyst for the upgrading and modernising of the country’s legislation. However, it also generated a degree of legal instability as new laws were introduced to reflect the acquis communautaire, which in turn affected the predictability and quality of judgments. Nevertheless, the EBRD Judicial Decisions Assessment found court judgments in commercial law matters in Croatia to be generally predictable and of reasonably good quality. The Assessment found the major concern to be the slow pace of justice. Commercial courts continue to suffer from substantial backlogs. In 2011 there was a 10 per cent rise in the number of commercial cases, accompanied by an increase in the complexity of cases. Insolvency cases rose by 225 per cent against 2010, as a consequence of the recession. Judges have at their disposal certain statutory tools for tightening procedural discipline, such as awarding penalties and costs in respect against litigants whose conduct is aimed at frustrating proceedings (such as unreasonable and repeated applications for adjournments, or failure to submit documents on time). However, these powers are almost never used. Alternative dispute resolution mechanisms are available, including in relation to commercial mediation. Nevertheless, tangible results have not yet been seen; in the last three years less than 4 per cent of commercial litigation ended in settlement.

Another major concern identified in the Assessment relates to difficulties with the enforcement of judgments in commercial matters. This is consistent with data from the EBRD / World Bank Business Environment and Enterprise Performance Survey, where only 30 per cent of Croatian respondents considered that judgments were regularly or always enforced. Recent reforms have been directed at this problem. For example, in 2011, a new system was introduced for enforcement of judgment debt against bank accounts. Previously, a judgment creditor had to identify the debtor’s bank account number in order to collect funds; and each
bank developed its own practice. Since 2011, the Croatian Financial Agency has been entrusted with power in relation to the enforcement of judgment debt against bank accounts under a new uniform procedure, which has shown signs of speeding up the enforcement process. Another measure aimed at increasing the efficiency of the enforcement system has been transferring routine enforcement powers to specialised enforcement departments of municipal courts. However, the system has not yet become fully operational and it is too early to judge its effect.

Croatia has made significant changes to its judicial system since the start of the EU accession process. Further measures to strengthen contract enforcement and judicial capacity would include: providing further systematic and specialised training to judges in commercial law matters, including on the use of tools designed to promote timeliness among litigants; establishing comprehensive and up-to-date court judgment databases; further strengthening the enforcement system, including through provision of greater public information on enforcement procedures and strengthening enforcement institutions’ capacity and measures to promote the use of commercial mediation.

**Promoting energy efficiency**

Croatia has been undertaking considerable efforts to create a sound policy and regulatory framework for promoting energy efficiency ("EE") across various sectors of the economy. However, the existing framework requires further efforts, in particular as it concerns adoption of sector-specific EE law and relevant implementing regulations.

The current policy framework for the EE sector of Croatia is envisaged in the Strategy for Energy Development (the “Strategy”) adopted in 2009 as part of the country’s preparation for EU accession. Improving energy efficiency is one of the government’s priorities under the Strategy, with a goal of 9 per cent decrease of final energy consumption by application of EE measures by 2016.

The legal framework for the broader energy sector and EE in particular, has recently been upgraded, with the adoption of a new Energy Act of 2011 (last amended in November 2012). As a major step toward energy sector liberalisation, for the first time energy companies were allowed to set the electricity and gas prices they would charge the users. The tariffs remain subject to approval by the country’s newly independent energy sector regulator (“HERA”) but they have started growing to reflect real cost.

In the area of EE regulation, the Energy Act introduced a system of guarantees of origin of electricity as well as a requirement to set out a minimum EE share of the country’s energy balance. Further regulation of energy efficiency is carried out by special laws (such as the Act on Energy End-Use Efficiency), some of which remain to be harmonised with the EU energy efficiency acquis.

Envisaged in the Energy Act, a state Fund for Energy Efficiency and Renewable Energy was established under a special act of December 2012 tasked with preparing, developing and implementing projects in connection with sustainable development, renewable sources and environment protection. A few months earlier in October 2012, the government created another institution,
With updated energy policy and legislation and supporting institutions, Croatia has set the grounds for sustainable development of its energy sector. Nonetheless, the country still lacks a sector-specific energy efficiency framework compliant with the EU *acquis*. In particular, implementing regulations have to be adopted regarding (i) EE requirements for various stages of exploitation of energy facilities, (ii) improving energy performance of buildings, and (iii) labelling.

**Restructuring public utilities through public-private partnerships (PPPs)**

With a well contemplated and comprehensive government approach to PPP development and implementation, PPPs in Croatia have high potential in the near future subject to improving their financing prospects through legislative changes as detailed below.

A set of modern legislation was introduced in the past few years, first in 2008 and then reworked further recently, consisting of the 2008 Concessions Act as amended as of 12 December 2012 (the “Concessions Act”), the Public Private Partnerships Act enacted in 2008 and largely reworked in its new edition of 10 July 2012 (the” PPP Act”), a number of Government endorsed documents including notably the Strategic Framework for the Development of Public-Private Partnerships in the Republic of Croatia and a Framework Programme for the construction, reconstruction and Modernisation of Public Building using contractual PPP Model.

The legislative framework seems fair and comprehensive. It includes many necessary rules and contains clear procedures. Furthermore, the establishment of the PPP Agency has been a clearly positive step in cementing the authorities’ recent efforts in promoting PPP. During the 2012 EBRD Assessment of the PPP/Concessions Laws throughout its countries of operations (undertaken before the new laws were enacted) the Croatian laws were viewed in high compliance with the best international standards.

In general, the latest amendments to the Concessions Act aim at providing better control over the implementation of concession contracts and establishing a clear distinction between concession contracts and public procurement contracts.

However, some important elements that are generally necessary for the financing of PPP projects are still missing, which might raise potential concerns on bankability of PPP projects. Neither the Concessions Act nor the PPP Act provide for possible government support or guarantee, or offer comfort to lenders with respect to financial security. In addition, although arbitration is provided for PPP dispute resolution, an explicit possibility to apply international arbitration would be welcome.

The new regime’s practical implementation is somewhat difficult to assess because the arguably most visible project (Zagreb airport development), recently initiated under the new regime, is still at an early stage with the construction completion envisaged in 2015 with a 30-year service ahead.
ANNEX 4 – SMALL BUSINESS SUPPORT

The EBRD supports economic transition by achieving enterprise change in promising micro-, small- and medium-sized enterprises (MSMEs) and contributing to the development of a sustainable market of local business advisory services. This is achieved through two complementary instruments, the Enterprise Growth Programme (EGP) and Business Advisory Services (BAS), which are implemented by the EBRD Small Business Support (SBS) team.

Previous SBS experience in Croatia

EGP has been active in Croatia since 1999 with almost €2 million of donor funding mobilised from the EU, the ESSF, Luxembourg and other bilateral donors. Until today, 37 enterprises in Croatia have received EGP assistance, with manufacturing, food processing as well as tourism being the most common sectors of intervention. To date, 25 projects have been evaluated of which almost 30 per cent were rated as highly successful. Furthermore, 20 per cent of beneficiaries reported an increase in their workforce, and almost 50 per cent an increase in turnover. In addition, EGP has carried out various sector development activities and assisted in organising business matching trips to industrially advanced countries.

Since inception in 2004, BAS Croatia has received a total of almost €4.6 million in donor funding from the EU, the ESSF, Taipei China, Luxembourg, Austria and other bilateral donors, which has been supplemented by €4.5 million in client contributions. To date, BAS has implemented 555 projects, mainly related to quality management, technology and environmental management across a wide range of industries, including agribusiness and tourism. 423 projects have been evaluated one year after completion, of which 66 per cent were rated successful or highly successful. 52 per cent of enterprises reported an increase in turnover, and 35 per cent an increase in the number of employees. In addition, 36 per cent have received financing of more than €900,000 on average. BAS has also undertaken 17 market development activities to help develop an adequate MSME support infrastructure.

SBS has addressed important cross-cutting objectives that are vital for the development of a competitive private sector in Croatia. Since 2010, SBS has increasingly focused on energy efficiency and environmental management and it is currently implementing a regional “Woman in Business” programme.

The MSME and consultancy sector in Croatia

The MSME sector

MSMEs form the backbone of the private sector economy in Croatia, representing more than 99 per cent of all businesses. Most enterprises are micro-enterprises, with only a few mid-sized corporates. Businesses predominately operate in wholesale and retail trade, manufacturing, construction and the ICT sector. The MSME sector accounts for almost 56 per cent of value added, 50 per cent of total employment and 40 per cent of Croatian exports.

Amid the ongoing economic crisis, the Croatian MSME sector is in decline, with only modest start-up activities and increasing insolvencies. In light of the country’s accession to the European Union, the MSME sector is further faced with increasing competitive pressures from the single market. Areas of concern include the need to upgrade operational capacities to increase production volumes, meeting higher standards by enhancing product quality, but
also improving strategy and marketing to take advantage of new market opportunities.

**The consultancy market**
The Croatian consultancy market faces ‘small’ transition challenges with regard to MSMEs, reflecting the high market penetration and consolidation of the sector. The quality and supply of services has been continually improving and in turn businesses have increasingly recognised the potential of accessing external advice to overcome challenges and continue their growth. The spectrum of advisory services available is comprehensive with many consultants offering services related to market analysis and planning in particular. Due to the efforts of BAS, the percentage of those specialising in environmental management and energy efficiency has also increased substantially in recent years. Nonetheless, further efforts are needed to consolidate expertise in this segment. An area of concern is the shortage of consultants providing services to enable businesses to apply for EU funding, which will become available for Croatia in the coming years. The level of female participation in the consultancy industry is adequate but significant discrepancies remain in less developed areas. Lastly, the industry is formally represented by the Association of Management Consultants (AMC) however this body has significantly decreased its activity in recent years.

**Infrastructure of MSME support**
Institutional support is well developed and comprehensive. The Ministry for Entrepreneurship and Crafts is formally in charge of MSME policy, with priorities including improving MSME competitiveness, access to finance, entrepreneurial education, institutional capacity and infrastructure to support private sector development. The strategy for women’s entrepreneurship further supports gender equality in the private sector. The Ministry’s policies are implemented by the Croatian SME and Investment Promotion Agency, HAMAG Invest. To date, HAMAG Invest’s role included the management of state guarantees and grants as well as co-financing of advisory services, but after accession the agency will also become a focal point for the management of structural and cohesion funds. In addition, the Business and Innovation Centre of Croatia (BICRO) plays a vital role in the execution of MSME policy and the development of an innovative private sector. The state agency provides co-financing for innovative investments, collaborates closely with research institutes and supports the development of technology parks and incubators. SME access to finance is further supported through the Croatian Development Bank HBOR, which offers financing to MSMEs at favourable subsidised loans. Lastly, a number of private stakeholders actively support the development of the Croatian MSME sector, including the Croatian Chamber of Commerce and the Agency for Entrepreneurship.

**Continuation of the Bank’s small business support in Croatia**
While transition gaps in the MSME sector in Croatia are small relative to other markets, the Bank will continue to support the sector on its path to full integration in the European single market. SBS will support MSMEs, particularly in agribusiness, ICT, tourism and wood processing. Subject to funding, EGP will assist Croatian mid-sized enterprises to fully exploit and benefit from the opportunities of EU accession through a transfer of management skills and specific industry knowledge. Assistance will focus on increasing management performance and productivity, upgrading production techniques and increasing product quality through exposure to international best practises and linkages with other companies in the EU market. Areas of support will also include strategic marketing and branding as well as meeting technical and environmental standards. BAS will support smaller businesses with a focus on women in business, energy efficiency and environmental management.
Facilitating access to finance through the Bank and its partner financial institutions will be a priority. In this regard, BAS will assist LEF clients with financial management and reporting to improve their transparency. As the final phase of support, BAS plans to transfer knowledge and experience acquired in Croatia to the SME Agency HAMAG Invest to build its capacity and ensure the sustained development of a competitive MSME sector upon completion of SBS activities in the country.
ANNEX 5 – TECHNICAL COOPERATION

TC COMMITMENTS BY DONOR THROUGH EBRD, 2010-2012

<table>
<thead>
<tr>
<th>Donor</th>
<th>TC Commitments (€)</th>
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<tbody>
<tr>
<td>Austria</td>
<td>287,000</td>
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<td>Czech Republic</td>
<td>245,000</td>
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<tr>
<td>EBRD Shareholder Special Fund</td>
<td>3,181,205</td>
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<td>EU</td>
<td>2,063,930</td>
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<tr>
<td>France</td>
<td>398,000</td>
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<tr>
<td>Italy</td>
<td>273,575</td>
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<tr>
<td>Netherlands</td>
<td>345,000</td>
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<tr>
<td>Portugal</td>
<td>57,500</td>
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<tr>
<td>Taipei China</td>
<td>288,500</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>7,139,710</strong></td>
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TC COMMITMENTS BY SECTOR THROUGH EBRD, 2010-2012

<table>
<thead>
<tr>
<th>Sector/Team</th>
<th>TC Commitments (€)</th>
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<td>SME Development *</td>
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<td></td>
<td>EGP/BAS</td>
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<tr>
<td>E2C2</td>
<td>E2C2</td>
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<tr>
<td>Environment</td>
<td>Environment</td>
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<tr>
<td>Financial Institutions</td>
<td>Financial Institutions</td>
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<td>LTT</td>
<td>LTT</td>
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<tr>
<td>Infrastructure</td>
<td>MEI</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td></td>
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</tbody>
</table>

Note: Commitment values based on year end or period end data for each year.

* This sector category encompasses direct assistance to SMEs and indirect assistance through policy dialogue between the EBRD, the authorities and commercial/business associations (e.g. Investment Councils)
## ANNEX 6 – SELECTED ECONOMIC INDICATORS

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
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<tbody>
<tr>
<td><strong>Output and expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>GDP</td>
<td>5.1</td>
<td>2.1</td>
<td>-6.9</td>
<td>-14</td>
<td>0.0</td>
<td>-19</td>
<td>12</td>
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<tr>
<td>Private consumption</td>
<td>6.3</td>
<td>13</td>
<td>-7.6</td>
<td>-0.9</td>
<td>0.2</td>
<td>-10</td>
<td>n.a.</td>
</tr>
<tr>
<td>Public consumption</td>
<td>5.0</td>
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<td>0.4</td>
<td>-16</td>
<td>-0.3</td>
<td>-3.7</td>
<td>n.a.</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>7.1</td>
<td>8.7</td>
<td>-14.2</td>
<td>-6.0</td>
<td>7.2</td>
<td>-3.7</td>
<td>n.a.</td>
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<tr>
<td>Exports of goods and services</td>
<td>3.7</td>
<td>17</td>
<td>-18.2</td>
<td>5.2</td>
<td>2.0</td>
<td>0.3</td>
<td>n.a.</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>6.1</td>
<td>4.0</td>
<td>-214</td>
<td>-14</td>
<td>12</td>
<td>-2.0</td>
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<td><strong>Labour Market</strong></td>
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<td>Gross average monthly earnings in economy (annual average)</td>
<td>6.2</td>
<td>7.1</td>
<td>2.2</td>
<td>-0.4</td>
<td>15</td>
<td>10</td>
<td>n.a.</td>
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<td>Real LCU wage growth</td>
<td>3.3</td>
<td>0.9</td>
<td>-0.1</td>
<td>-14</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
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<tr>
<td>Unemployment rate (end-year)</td>
<td>9.4</td>
<td>8.3</td>
<td>9.1</td>
<td>12.2</td>
<td>13.7</td>
<td>14.2</td>
<td>n.a.</td>
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<tr>
<td>Consumer prices (annual average)</td>
<td>2.9</td>
<td>6.1</td>
<td>2.4</td>
<td>10</td>
<td>2.3</td>
<td>3.4</td>
<td>3.0</td>
</tr>
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<td>Consumer prices (end-year)</td>
<td>5.8</td>
<td>2.8</td>
<td>19</td>
<td>19</td>
<td>2.0</td>
<td>4.7</td>
<td>3.0</td>
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<td><strong>Fiscal Indicators</strong></td>
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</tr>
<tr>
<td>General government balance</td>
<td>-2.1</td>
<td>-1.3</td>
<td>-4.2</td>
<td>-5.1</td>
<td>-5.2</td>
<td>-4.4</td>
<td>n.a.</td>
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<td>General government revenues</td>
<td>39.6</td>
<td>39.2</td>
<td>39.0</td>
<td>37.8</td>
<td>36.8</td>
<td>37.0</td>
<td>n.a.</td>
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<td>General government expenditure</td>
<td>38.5</td>
<td>38.4</td>
<td>41.2</td>
<td>41.4</td>
<td>40.5</td>
<td>39.8</td>
<td>n.a.</td>
</tr>
<tr>
<td>General government debt</td>
<td>32.9</td>
<td>29.3</td>
<td>35.8</td>
<td>42.2</td>
<td>46.7</td>
<td>54.3</td>
<td>n.a.</td>
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<td><strong>Monetary and financial sectors</strong></td>
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<td></td>
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<tr>
<td>Broad money (M2, end-year)</td>
<td>3.3</td>
<td>4.3</td>
<td>-0.9</td>
<td>4.4</td>
<td>3.5</td>
<td>3.9</td>
<td>n.a.</td>
</tr>
<tr>
<td>Credit to the private sector (end-year)</td>
<td>5.1</td>
<td>9.1</td>
<td>-0.6</td>
<td>6.2</td>
<td>6.0</td>
<td>5.1</td>
<td>n.a.</td>
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<td>Non-performing loans ratio</td>
<td>4.8</td>
<td>4.9</td>
<td>7.7</td>
<td>11.1</td>
<td>12.3</td>
<td>13.2</td>
<td>n.a.</td>
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<td><strong>Interest and exchange rates</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Local currency deposit rate</td>
<td>2.7</td>
<td>2.9</td>
<td>2.2</td>
<td>16</td>
<td>19</td>
<td>18</td>
<td>n.a.</td>
</tr>
<tr>
<td>Foreign currency deposit rate</td>
<td>3.7</td>
<td>4.0</td>
<td>3.8</td>
<td>3.0</td>
<td>2.9</td>
<td>3.0</td>
<td>n.a.</td>
</tr>
<tr>
<td>Local currency lending rate</td>
<td>9.1</td>
<td>8.7</td>
<td>11.1</td>
<td>9.9</td>
<td>11.1</td>
<td>11.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Foreign currency lending rate</td>
<td>6.7</td>
<td>7.7</td>
<td>8.1</td>
<td>7.6</td>
<td>7.1</td>
<td>6.9</td>
<td>n.a.</td>
</tr>
<tr>
<td>Exchange rate (end-year)</td>
<td>5.0</td>
<td>5.4</td>
<td>5.0</td>
<td>5.6</td>
<td>5.8</td>
<td>5.7</td>
<td>n.a.</td>
</tr>
<tr>
<td>Exchange rate (annual average)</td>
<td>5.4</td>
<td>4.9</td>
<td>5.3</td>
<td>5.5</td>
<td>5.3</td>
<td>5.9</td>
<td>n.a.</td>
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<td><strong>External sector</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account</td>
<td>-7.3</td>
<td>-9.0</td>
<td>-5.1</td>
<td>-11</td>
<td>-10</td>
<td>-12</td>
<td>n.a.</td>
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<tr>
<td>Trade balance</td>
<td>-2.18</td>
<td>-2.28</td>
<td>-11.6</td>
<td>-19.4</td>
<td>-14.2</td>
<td>-13.8</td>
<td>n.a.</td>
</tr>
<tr>
<td>Merchandise exports</td>
<td>21.1</td>
<td>20.5</td>
<td>17.1</td>
<td>20.2</td>
<td>21.8</td>
<td>22.2</td>
<td>n.a.</td>
</tr>
<tr>
<td>Merchandise imports</td>
<td>42.9</td>
<td>43.4</td>
<td>33.7</td>
<td>33.6</td>
<td>36.0</td>
<td>36.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Foreign direct investment</td>
<td>7.9</td>
<td>6.8</td>
<td>3.4</td>
<td>0.9</td>
<td>2.3</td>
<td>2.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Gross reserves, excluding gold (end-year)</td>
<td>23.0</td>
<td>19.1</td>
<td>23.2</td>
<td>24.9</td>
<td>24.9</td>
<td>24.9</td>
<td>n.a.</td>
</tr>
<tr>
<td>External debt stock</td>
<td>77.7</td>
<td>85.0</td>
<td>100.1</td>
<td>101.1</td>
<td>101.9</td>
<td>106.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Public external debt</td>
<td>15.0</td>
<td>9.7</td>
<td>14.0</td>
<td>14.4</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Private external debt</td>
<td>68.5</td>
<td>72.8</td>
<td>89.4</td>
<td>80.9</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Gross reserves, excluding gold (end-year)</td>
<td>4.7</td>
<td>6.1</td>
<td>7.0</td>
<td>6.8</td>
<td>7.0</td>
<td>6.7</td>
<td>n.a.</td>
</tr>
<tr>
<td><strong>Memorandum items</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP (in billions of Kuna)</td>
<td>38.3</td>
<td>343.4</td>
<td>328.7</td>
<td>327.0</td>
<td>334.0</td>
<td>337.8</td>
<td>n.a.</td>
</tr>
<tr>
<td>GDP per capita (in US dollars)</td>
<td>13,385.6</td>
<td>16,694.1</td>
<td>14,050.1</td>
<td>13,449.2</td>
<td>13,177</td>
<td>13,050.8</td>
<td>n.a.</td>
</tr>
<tr>
<td>Share of industry in GDP (in per cent)</td>
<td>23.4</td>
<td>23.9</td>
<td>22.8</td>
<td>22.1</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Share of agriculture in GDP (in per cent)</td>
<td>4.2</td>
<td>4.4</td>
<td>4.7</td>
<td>4.8</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>FDI (in million of US dollars)</td>
<td>4,702.2</td>
<td>4,755.3</td>
<td>2,019</td>
<td>540.8</td>
<td>1,450.3</td>
<td>1,209.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>External debt/exports of goods and services (in per cent)</td>
<td>14.0</td>
<td>18.9</td>
<td>28.6</td>
<td>26.3</td>
<td>22.7</td>
<td>23.1</td>
<td>n.a.</td>
</tr>
<tr>
<td>Broad money (M2, end-year in per cent of GDP)</td>
<td>67.8</td>
<td>65.5</td>
<td>67.9</td>
<td>71.2</td>
<td>72.2</td>
<td>74.1</td>
<td>n.a.</td>
</tr>
</tbody>
</table>
ANNEX 7 – GENDER EQUALITY

Gender Inequality and Human Development

According to the 2011 UNDP Human Development Index (HDI), Croatia has a very high human development index\(^5\). It is ranked 46\(^{th}\) out of 187 countries, which is around the regional average for Europe. The HDI is comprised of three dimensions: health, education and decent standard of living. The country ranks significantly better in terms of the UNDP Gender Inequality Index (GII), at 27\(^{th}\) globally. The GII is a composite measure, which captures the loss of achievement, within a country, due to gender inequality and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.

Labour force participation and gender pay gap

Labour force participation rates are lower for women than men in Croatia. According to the Croatian Bureau of Statistics, 40.4 per cent of women participated in the labour force as compared to 53.2 per cent of men in 2012. There are no significant gender differences in unemployment rates in Croatia but they are high for both women and men (14.7 per cent for males and 14.3 per cent for females). According to the 2012 publication ‘Women and Men in Croatia’ of the Croatian Bureau of Statistics, in 2010 women earned on average 10.2 per cent less than men, when monthly gross income was taken into account.

According to the Croatian Bureau of Statistics, in 2010 the proportion of female graduates in postgraduate studies was higher as compared to that of men (57.3 per cent and 42.7 per cent). Of note, however, is that most of the students enrolled in the field of humanities and social sciences are women, while men outnumber women in the fields of computing, engineering, transport and security services. This gender segregation in education may result in occupational segregation in the labour market, as the table below shows.

![Croatia: total employment by economic activity for 2010](source)

<table>
<thead>
<tr>
<th>Croatia: total employment by economic activity for 2010</th>
<th>Female</th>
<th>Male</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>12%</td>
<td>88%</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>16%</td>
<td>84%</td>
</tr>
<tr>
<td>Water supply</td>
<td>19%</td>
<td>81%</td>
</tr>
<tr>
<td>Electricity, gas, steam and air conditioning supply</td>
<td>22%</td>
<td>78%</td>
</tr>
<tr>
<td>Transport and storage</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>36%</td>
<td>64%</td>
</tr>
<tr>
<td>Information and communication</td>
<td>39%</td>
<td>61%</td>
</tr>
<tr>
<td>Admin and support services</td>
<td>42%</td>
<td>58%</td>
</tr>
<tr>
<td>Real estate activities</td>
<td>43%</td>
<td>57%</td>
</tr>
<tr>
<td>Public administration and defence</td>
<td>45%</td>
<td>55%</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>53%</td>
<td>47%</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>56%</td>
<td>44%</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>57%</td>
<td>43%</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>70%</td>
<td>30%</td>
</tr>
<tr>
<td>Education</td>
<td>77%</td>
<td>23%</td>
</tr>
<tr>
<td>Human health and social work</td>
<td>79%</td>
<td>21%</td>
</tr>
</tbody>
</table>


\(^5\) Countries fall into four broad human development categories: Very High Human Development, High Human Development, Medium Human Development and Low Human Development
According to the World Bank’s Women, Business and the Law database, the mandatory minimum length of paid maternity leave in Croatia is 182.5 calendar days. The law mandates the employer to give an employee the same position when she returns from maternity leave. No applicable provisions can be identified with regards to the law on paternity leave. There are laws or constitutional provisions mandating equal pay for equal work. Women are also, by law, protected from non-discrimination practices in hiring on the basis of gender and from sexual harassment in the workplace.

_Entrepreneurship, access to finance_

According to the World Bank’s Global Financial Inclusion database that surveys approximately 1,000 people using a randomly selected nationally representative sample, in 2011 over 89.7 per cent of male and 87.2 per cent of female adults held an account at a formal financial institution in Croatia. According to the 2007-2008 Business Environment and Enterprise Performance Survey (BEEPs), of the 36.1 per cent of the 633 surveyed firms that applied for a loan and had a woman among the owners, 33.3 per cent were rejected. In comparison, 15.4 per cent of the 62.7 per cent of the firms within the same BEEPs sample that applied for a loan and had no women owners were rejected.