COUNCIL RECOMMENDATION

of 13 July 2018

on the 2018 National Reform Programme of Croatia and delivering a Council opinion on the 2018 Convergence Programme of Croatia

(2018/C 320/10)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances ([2]), and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Croatia as one of the Member States for which an in-depth review would be carried out.

(2) The 2018 country report for Croatia was published on 7 March 2018. It assessed Croatia's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017 ([3]), the follow-up given to the recommendations adopted in previous years and Croatia's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018. The Commission's analysis led it to conclude that Croatia is still experiencing excessive macroeconomic imbalances, although they are being reduced. Vulnerabilities are linked to still high levels of public, private and external debt, all largely denominated in foreign currency. The level of non-performing loans remains high, in particular for non-financial corporations. Croatia's potential growth remains insufficient to enable a durable adjustment and overall there has been little progress in implementing policy measures to address the chronically low labour utilisation and slow productivity growth. Competitiveness and investment remain hindered by a restrictive business environment and the fragmentation of the public administration weighs on efficiency in public services.

(3) On 26 April 2018, Croatia submitted its 2018 National Reform Programme and its 2018 Convergence Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

([1]) OJ L 209, 2.8.1997, p. 1.
([2]) OJ L 306, 23.11.2011, p. 25.
([3]) OJ C 261, 9.8.2017, p.41.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council [1], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance.

(5) Croatia is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. Starting from a general government surplus of 0,8 % of GDP in 2017, the 2018 Convergence Programme plans the headline balance to fall into a deficit of 0,5 % of GDP in 2018 and then to gradually improve to a surplus of 0,5 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 1,75 % of GDP — is planned to continue to be overachieved throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to fall from 78,0 % of GDP in 2017 to 75,1 % in 2018 and to continue declining to 65,9 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. However, the planned budgetary targets appear cautious. The Commission 2018 spring forecast projects the general government balance at 0,7 % and 0,8 % of GDP in 2018 and 2019, respectively.

(6) On 11 July 2017, the Council recommended Croatia to remain at its medium-term budgetary objective in 2018. Based on the Commission 2018 spring forecast the structural balance is forecast to stand at – 0,3 % of GDP in 2018 and at – 0,6 % of GDP in 2019, remaining above the medium-term budgetary objective. Croatia is forecast to comply with the debt rule in 2018 and 2019. Overall, the Council is of the opinion that Croatia is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

(7) The planned adoption of key legislation to improve Croatia's fiscal framework is long overdue. Flaws in the design of the numerical fiscal rule make it ineffective for fiscal policy planning and the role of the Fiscal Policy Commission as an independent body is still weak. Croatia's still high level of public debt and its exposure to currency risks mean that sound debt management practices remain essential. In 2017, the debt management function was strengthened and a debt managemet strategy was produced, which requires regular updates. The introduction of a property tax already legislated was postponed with no indication of whether and when it would be implemented. This leaves Croatia with a low proportion of revenue from recurrent taxation of immovable property. A recurrent property tax would create scope for improving the overall growth-friendliness of revenue collection, while ensuring a stable and predictable source of revenue for local government units.

(8) The Croatian labour market continued to recover in 2017. Still, employment and activity rates remain substantially below the Union average, hampering potential growth. To date, the statutory pensionable age is 62 years for women and 65 years for men. The convergence and increase of the statutory retirement age is slow, with both sexes stipulated to reach a pensionable age of 67 only in 2038. In addition, older workers can benefit from many pathways to early retirement and the pension system includes a number of special pension schemes providing more favourable conditions for retirement. The care responsibilities of women contribute further to their low labour market participation. The resulting low average duration of working lives implies low current and future pension adequacy and risks of old-age poverty. The announced measures to encourage longer working lives have not yet been implemented.

(9) Even though the social dialogue structure in Croatia is in place, the actual interaction between the authorities and stakeholders in the policy preparation process is limited and has been mostly confined to the provision of written feedback on the Government-proposed measures. In addition, the fragmentation of trade unions limits their overall capacity to engage in social dialogue.

(10) Despite recent improvements, the share of the population at risk of poverty or social exclusion remains high, with marked territorial disparities across counties. The elderly, the low-skilled and people with disabilities are

[1] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

particularly affected. The social protection system displays shortcomings in effectiveness and fairness. Social benefits have a limited poverty reduction capacity. Lack of coordination across institutions and lower fiscal capacity of poorer local government units leads to an uneven provision of social benefits.

(11) Croatia performs below Union average in education investment, early childhood education and care, basic skills, tertiary educational attainment and labour market relevance of vocational education and training in education. Croatia has launched the implementation of several reforms outlined in the strategy on education, science and technology. The reform of school curricula is likely to have a positive impact on the quality of Croatia's education, if it is implemented in full and consistently with the other actions in the strategy. The labour market relevance of vocational education and training programmes appears limited, as suggested by the fact that more than half of registered unemployed are vocational education and training graduates. Better coordination between public authorities and employers is needed to improve the identification of skills needs. The adult education system aiming to help inclusion in the labour market is characterised by a large and unevenly distributed number of providers across the country, and learning programmes that are not properly assessed. Participation in adult education and educational programmes offered as part of active labour market policy measures are critically low.

(12) The territorial fragmentation of Croatia's public administration and the wide distribution of competences across levels of government weigh on the effeciency of public service provision and public expenditure. Many small local units lack adequate financial and administrative capacity to carry out decentralised functions. Indicators of public administration efficiency show performance below the Union average, which hinders the design and implementation of public policies and a more efficient use of European Structural and Investment Funds. The planned reduction of the number of local branch offices of the central administration and the streamlining of the system of state agencies have been further postponed. Lack of coherence in the wage-setting frameworks in the public administration and public services impede equality of treatment and government control over the public wage bill. The planned legislation for their harmonisation has been further postponed to mid-2018. The authorities have taken the first steps to integrate some functions among hospitals in order to improve efficiency in service provision and access to healthcare. However, an ineffective model of the health system's financing results in accumulation of debts, especially related to inpatient care.

(13) State-owned enterprises maintain their large presence in the economy. Measures to improve their governance have advanced slowly, and they continue to operate at low levels of productivity and profitability. New legislation governing the management and disposal of state assets has been adopted.

(14) November 2017 saw the finalisation of an independent asset quality review of the Croatian Bank for Reconstruction and Development. Given the bank's importance for implementing the Union financial instruments and the Investment Plan for Europe as well as its increasing engagement in direct lending, the review's findings should be used to strengthen the bank's supervisory and regulatory framework and governance.

(15) Administrative burden and parafiscal charges continue to weigh on the business environment. Reduction of the administrative burden has been progressing steadily, but at a modest pace. Cuts in parafiscal charges have been limited and transparency is low, as neither regular updates of the registry nor impact assessments of the planned cuts have been conducted.

(16) The anti-corruption action plan 2017-2018 needs to be fully implemented in order to deliver on the objectives of the anti-corruption strategy 2015-2020. Several key elements still require improvement, particularly asset and conflict-of-interest disclosures, raising awareness of whistle-blowing reporting channels, and an effective control of risks in public procurement, which remains vulnerable to corruption due to a large share of in-house contracting by state-owned entities.

(17) Restrictive regulation in goods and services markets, in particular a high number of exceedingly regulated professions hampers competition. Easing regulation has been slow against the background of strong resistance from interest groups.

(18) Lengthy court proceedings and sizeable backlogs continue to weigh on the quality and efficiency of the justice system and consequently the business environment. The observed decrease in backlogs was mainly driven by a lower inflow of new cases rather than faster resolution of cases. Despite improvements, electronic communication in litigation and insolvency proceedings remains underused.

(19) Some targeted efforts to reform the national science and innovation system are in the making via Croatia's smart specialisation strategy. Policy responsibilities in support of science and innovation appear uncoordinated, which weakens the implementation of the policy strategy. Similarly, major universities have highly fragmented governance structures and rigid administrative rules. Cooperation between research institutions and the business sector is weak. There is no systematic monitoring and evaluation of the impact of research and innovation policies in place, preventing proper priority setting. The tertiary education system could benefit from incentives to encourage quality and labour market relevance.

(20) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Croatia's economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme, the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Croatia in previous years. It has taken into account not only their relevance for a sustainable fiscal and socioeconomic policy in Croatia, but also the extent to which they comply with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(21) In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion ([1]) that Croatia is expected to comply with the Stability and Growth Pact.

(22) In the light of the Commission's in-depth review and this assessment, the Council has examined the 2018 National Reform Programme and the 2018 Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (4) below,

HEREBY RECOMMENDS that Croatia take action in 2018 and 2019 to:

1. Strengthen the fiscal framework, including by strengthening the mandate and independence of the Fiscal Policy Commission. Introduce a recurrent property tax.

2. Discourage early retirement, accelerate the transition to a higher statutory retirement age and align pension provisions for specific categories with the rules of the general scheme. Deliver on the reform of the education and training system to improve its quality and labour market relevance for both young people and adults. Consolidate social benefits and improve their poverty reduction capacity.

3. Reduce the territorial fragmentation of the public administration, streamline the functional distribution of competencies and enhance the capacity to design and implement public policies. In consultation with social partners, introduce harmonised wage-setting frameworks across the public administration and public services.

4. Improve corporate governance in state-owned enterprises and intensify the sale of state-owned enterprises and non-productive assets. Significantly reduce the burden on businesses arising from parafiscal charges and from cumbersome administrative and legislative requirements. Enhance competition in business services and regulated professions. Reduce the duration of court proceedings and improve electronic communication in courts.

Done at Brussels, 13 July 2018.

For the Council

The President

H. LÖGER

([1]) Under Article 9(2) of Regulation (EC) No 1466/97.