



Croatia: structural reforms are crucial

In recession since 2009, Croatia is responding to pressure from Brussels and has promised to implement major structural reforms to reduce its public expenditure. It has announced savings of EUR 130 million in the first year of an ambitious programme that includes privatisation, streamlining of public agencies, and the removal of pay-related benefits.

Despite GDP at 39% below the European average¹, albeit higher than that of Bulgaria and Romania (members of the European Union since 2007), the country fully met the Copenhagen criteria, including all obligations of the community acquis (split into 35 chapters² since the seventh enlargement). The negotiations with Croatia took place at a sustained pace over five years, and the country officially joined the European Union on 1 July 2013.

Zoran Milanović's government subsequently formulated big aspirations for the country's European integration, involving in particular a revival of foreign investment to reverse the effects of the economic crisis that hit the country heavily and plunged it into recession. Less than two years after joining the EU, Croatia must now oversee reform of its government administration.

Despite initial measures, the budget deficit persists

On 25 February 2015, Valdis Dombrovskis, Vice President of the European Commission, and Pierre Moscovici, European Commissioner for Economic and Financial Affairs, presented the College decisions from the European Semester 2015³. Along with four other countries, including France, Croatia features in the group of countries identified with "excessive imbalances which require specific monitoring and decisive policy action", which is the last warning level before triggering of the excessive deficit procedure. The Commission's case for this decision was the following: "In a context of subdued growth, delayed restructuring of firms and dismal performance of employment, risks related to weak competitiveness, large external liabilities and rising public debt coupled with weak public sector governance, have significantly increased".

In Brussels, Branko Grčić, Deputy Prime Minister Responsible for European Funds and Regional Development, promised that Croatia's National Reform Programme (NRP) would be submitted within the European Union deadline of 30 April⁴. He also undertook to immediately reassure his fellow citizens, who had already been impacted directly by the first measures introduced after the arrival in power in 2011 of the government coalition led by the social democrats (SDP): a VAT increase to 25%, a 3% reduction in public sector wages, which account for nearly 22% of the active population. The conservative party's (HDZ) victory in the 2014 European elections, and more recently that of Kolinda Grabar-Kitarović as president of the Republic, were seen as a consequence of the austerity measures.

Public sector companies at the centre of reform

Within a relatively short time, therefore, Zagreb had to build a solid reform plan to significantly and durably reduce its public expenditure. With the European Union having set Croatia a deficit target of 2.7% for 2016, finance minister,

¹ <http://ec.europa.eu/eurostat/documents/2995521/5164758/1-25062013-AP-FR.PDF/de26ff17-2fcb-4a46-9e77-46405c1fbff2?version=1.0>

² http://ec.europa.eu/enlargement/policy/conditions-membership/chapters-of-the-acquis/index_fr.htm

³ http://europa.eu/rapid/press-release_IP-15-4504_fr.htm

⁴ <https://vlada.gov.hr/news/croatia-prepares-national-reform-programme/16839>

Boris Lalovac, acknowledged that some of the public companies were a great burden on the budget, and that they would be subject to significant cuts⁵. The restructuring and wage cuts will give savings of EUR65 million, which is half of the target from the **three categories** of measures that must be achieved:

- **privatisations**, as set out in the 2013 law governing the management of national assets. After two recent failures (no buyers were found for Hrvatska Postanska Banka, Croatia's postal bank, and Petrokemija, a national fertiliser company, in 2014), the state is looking to actively relaunch the process. In a 2015 national management plan, it listed 611 companies of which it owns at least 50% of the capital⁶. Among these, 27 are of "strategic importance for the government" and 26 are of "specific strategic importance", and therefore a sale (subject to a government decision) in these cases is not yet envisaged, with the exception of the national airline, Croatia Airlines⁷, of which it owns 90%. The government recently withdrew its plan to lease out its motorway network to a private company following strong popular opposition;
- **merge public bodies**, a large number of which were qualified by the European Union as inefficient. Arsen Bauk, Croatia's minister of public administration, is responsible for steering this part of the reform programme. On 23 April, he announced that they would be reduced in number from 57 to 48 by 2016⁸. Operational budgets are also to be reduced as part of this streamlining work (a maximum threshold of EUR11 per square metre for office rental, a reduction of 10% in travel expenses, the removal of certain outsourced services such as translation and consultancy);
- **harmonised remuneration**. The first measure here involves aligning the wages of all public agency employees with public sector guidelines⁹. The government will also remove certain bonuses (end-of-year, summer holidays) that are still in place in several public agencies, as well as financial compensation for overtime, night work and working on public holidays.

A programme that will have to meet the European Union's requirements

Next May, the Commission will give an opinion on this national reform programme and will decide on the measures¹⁰ it will take concerning Croatia's second year with an excessive deficit. Since the country is not in the euro zone, the applicable sanction – provided for under the stability and growth pact¹¹ – would be the suspension of commitments to pay structural funds and of investment by the European Union. This measure has not yet been taken against a member state.

On 30 March, the European Investment Bank (EIB) renewed its commitment to Croatia by lending it EUR300 million¹², on top of structural funds, to finance its competitiveness and cohesion operational programme for 2014-2020, which combines infrastructure projects in the transport, energy, environment, education and healthcare sectors.

A timely coincidence: a few days before the announcement by Brussels, the Croatian government made a gesture in favour of the most disadvantaged sector of the population¹³: everyone with excessive debt (a maximum of HRK35,000, or EUR4,550) and who earns a monthly revenue below HRK2,500 (EUR325) would have their debt cancelled before May. According to the government, which struck agreements with the main creditors (financial and credit institutions, local authorities and public agencies, energy providers and telephone operators), this measure concerns 60,000 people and will cost it EUR273 million. In a country in which unemployment is at 20% (third-highest in the European Union, behind Greece and Spain), social policies remain a government priority.

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⁵ <https://vlada.gov.hr/news/grcic-and-lalovac-to-meet-moscovici-on-tuesday-to-discuss-national-reform-programme/16735>

⁶ <http://ceelegalmatters.com/index.php/legal-analysis-corporate-m-a/item/2355-ongoing-privatisation-in-croatia>

⁷ <http://www.ch-aviation.com/portal/news/29946-zagreb-to-resume-croatia-airlines-privatization-this-autumn>

⁸ <http://dalje.com/en-economy/govt-to-save-on-agencies-by-merging-them-cutting-salaries-and-costs/542402>

⁹ <https://vlada.gov.hr/news/govt-salaries-in-agencies-to-be-in-line-with-rest-of-public-sector/16822>

¹⁰ <http://www.euinside.eu/en/news/sanctions-for-croatia-and-france-if-no-credible-reforms-plans>

¹¹ http://ec.europa.eu/economy_finance/economic_governance/sqp/index_fr.htm

¹² <https://vlada.gov.hr/news/finance-minister-boris-lalovac-and-eib-sign-eur-300-million-loan-agreement/16644>

¹³ <http://www.faz.net/aktuell/wirtschaft/schuldenerlass-in-kroatien-fuer-die-aermsten-der-armen-13404468.html>