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Dear President,

The Republic of Croatia expressed its firm intention to enter the Exchange Rate Mechanism II (ERM II) in a letter of intent dated 4 July 2019. In this letter, the Croatian authorities committed to implement measures in six policy areas that are of high relevance for a smooth transition to, and participation in, the ERM II.

In their statement of 8 July 2019, ERM II parties welcomed Croatia's intention to simultaneously join the ERM II and the Banking Union, and asked the European Central Bank (ECB) and the Commission to monitor the effective implementation of the prior commitments acting within their respective areas of competence as provided for by the Treaties and secondary legislation.

On 8 June 2020, the Croatian authorities informed ERM II parties of the full implementation of the prior commitments, which do not relate to establishing close cooperation with the ECB, and asked ERM II parties to invite the Commission and the ECB to assess their effective implementation.

On 12 June 2020, the President of the Eurogroup Working Group invited, on behalf of the ERM II parties, the Commission and the ECB to assess the implementation of the five prior commitments, in accordance with the division of competence between both institutions provided for in the statement of 9 July 2019.

Regular technical exchanges with the Croatian authorities have allowed our services to monitor continuously the progress made as regards the four prior commitments falling within the Commission's area of competence. These relate to the following policy areas: i) the anti-money laundering framework, ii) the collection, production and dissemination of statistics, iii) public sector governance, and iv) the financial and administrative burden on enterprises.

We hereby confirm that, in view of the detailed evidence provided by the Croatian authorities, the Commission's assessment is that these four prior commitments have been fulfilled. We welcome the efforts that Croatian authorities have put into fulfilling their commitments to better prepare Croatia's economy for a smooth participation in ERM II. An accompanying technical report provides the details of the Commission services' assessment of the implementation of the prior commitments.

Yours sincerely,



Valdis Dombrovskis


Paolo Gentiloni

Cc: Finance Ministers of the euro area Member States, President of the European Central Bank, Finance Minister and Central Bank Governor of Denmark, President of the Economic and Financial Committee and Eurogroup Working Group, Members of the Eurogroup Working Group, Members of the Economic and Financial Committee of Denmark

Commission Staff Working Document

Technical assessment of the implementation of the prior-commitments 3 to 6 taken by the Republic of Croatia in view of its participation in ERM II

In July 2019, Croatia announced its intention to put in place the necessary elements for a successful entry into ERM II. For that purpose, it committed to implement before joining ERM II policy measures in the following six areas: i) banking supervision (close cooperation with the ECB) , ii) the macro-prudential framework, iii) the anti-money laundering framework, iv) statistics, v) public sector governance and vi) business environment.

The ERM II parties have asked the ECB and the Commission to monitor the implementation of Croatia's commitments in their respective areas of competence, i.e. banking supervision (close cooperation with the ECB) and the macro-prudential framework for the ECB and the other four commitments for the Commission.

Regular technical exchanges with the Croatian authorities have allowed Commission services and the ECB to closely monitor the progress made with the implementation of the measures and to inform regularly ERM II parties on the state of play.

On 8 June, the Croatian authorities notified ERM II parties of the fulfilment of their prior commitments and invited them to ask the ECB and the Commission to prepare their assessment. On 12 June, the President of the EWG asked the two institutions to prepare the assessment of the effective implementation of Croatia's prior commitments in their respective areas of competence.

This report presents the assessment of the Commission services on the fulfilment of the prior commitments 3 to 6 the Republic of Croatia committed to in its letter of intent of 4 July 2019.¹ The first section of the assessment describes the "overall objective and rational" of each prior commitment. The "implementation" section details the actions taken by the Croatian authorities in relation with each prior commitment. The assessment of the Commission services is presented in the third section for each prior commitment.

Prior commitment 3: Anti-money laundering framework

Strengthening of the anti-money laundering framework through early adoption of legislation transposing and fully implementing the 5th Anti-Money Laundering Directive (AML5-Directive).

¹ <https://www.consilium.europa.eu/media/40282/letter-of-intent.pdf>

1. Overall objective and rationale

The Union legal framework for preventing money laundering and terrorist financing has been substantially enhanced over the past years, with the adoption of the 4th and 5th Anti-Money Laundering Directives and by granting new coordinating tasks to the European Banking Authority.

The 4th anti-money laundering directive (AML4-Directive) strengthens the existing AML rules with the aim of making the fight against money laundering and terrorism financing more effective and of improving transparency.

The fifth anti-money laundering directive (AML5-Directive - (EU) 2018/843 of the European Parliament and of the Council) substantially amends the 4th anti-money laundering directive to better equip the EU to prevent the financial system from being used for money laundering and for funding terrorist activities. The AML5-Directive: (i) enhances transparency on the real owners of companies, trusts and other legal arrangements; (ii) enhances the powers of EU Financial Intelligence Units and provides them with access to broad information for the carrying out of their tasks; (iii) limits the anonymity related to virtual currencies and wallet providers, but also for pre-paid cards; (iv) broadens the criteria for the assessment of high-risk third countries and improves the safeguards for financial transactions to and from such countries; (v) sets up central bank account registries or retrieval systems in all Member States; (vi) improves the cooperation and enhances the information flows between anti-money laundering supervisors, prudential supervisors and the European Central Bank.

The 5th anti-money laundering directive (AML5-Directive) was published in the Official Journal of the European Union on 19 June 2018. Member States had 18 months to transpose the new rules into their national order; the exact transposition deadline was 10 January 2020.

2. Deliverables and implementation by the authorities

The Act on Amendments to the Anti-Money Laundering and Terrorist Financing Act was published on 17 April 2019 in the Official Gazette (39/2019). The Act strengthens the anti-money laundering and terrorist financing system in the Republic of Croatia, and transposes the AML5 Directive.

Between 25 April 2019 to 4 May 2020, Croatia notified the adoption of 69 transposition measures and declared a complete transposition of the AML5 Directive.

In particular, the Ordinance on the Register of Beneficial Owners (Official Gazette 53/2019) entered into force on 25 May 2019. Data entry into the Register started on 3 June 2019 and was made available to competent authorities, reporting entities (banks and other entities), and the public as of January 2020.

Furthermore, Croatia adopted its Ordinance on the Unified Register of Accounts on 30 April 2020 and notified it officially to the Commission on 4 May 2020.

3. Commission services' assessment

The Commission services' assessment is that prior commitment 3 has been fulfilled. In particular, the amended Croatian legal framework ensures the complete transposition of the 5th Anti-Money Laundering Directive. Additionally, upon assessment and without prejudice to its powers under

Article 258 TFEU, the Commission services consider this transposition to be in principle in line with the terms of the 5th Anti-Money Laundering Directive.

Prior commitment 4: Statistics

Improvement of collection, production and dissemination of statistics, by strengthening the institutional and methodological capacity in relation to the quality of National Accounts and GFS/EDP reporting.

1. Overall objective and rationale

Member States whose currency is the euro have to meet extensive statistical reporting requirements under Regulation (EU) 549/2013. Following a number of improvements realised in recent years, this prior commitment aimed at further strengthening the institutional and methodological capacity of the Croatian Bureau of Statistics (CBS) to enhance the reporting of National Accounts and Government Finance Statistics / Excessive Deficit Procedure (GFS/EDP) Statistics, notably in terms of completeness, accuracy and coherence of data. Improvement needs have been identified in personnel resources (persisting low staff numbers coupled with significant staff turnover), coordination within and between the Croatian statistical authorities, organisation of the source data and data compilation arrangements. While the CBS is in charge of statistical methodology and production, some of the identified improvement measures were the remit of other Croatian public authorities and required changes to the institutional framework in which the CBS operates.

2. Deliverables and implementation by the authorities

The deliverables for this commitment were the following:

- Reinforcing capacities of statistical authorities, including personnel resources;
- Improving procedures for the production and dissemination of statistics and their documentation;
- Updating procedures and obligations for timely data exchange between statistical and other relevant authorities
- Enhancing relevant data sources.

The new Regulation on the Internal Organization of the CBS is in force as of 2 August 2019 (published in Official Gazette 74/2019 on 2 August 2019) and aims at **reinforcing the capacity of the statistical authorities, including personnel resources**. In accordance with the new Regulation, the CBS adopted a new Ordinance on its internal organisation structure on 23 September 2019, to strengthen the overall efficiency of the organisation and reinforce the capacity of units in charge of the production of macroeconomic statistics. Since the adoption of the new Ordinance, the CBS recruited 43 new employees. The new organization and scope of the Macroeconomic Statistics Directorate aims at ensuring more efficient and more functional work methods for the production of macroeconomic statistics. Compared to the previous organisation structure, 11 additional posts are envisaged in the Macroeconomic Statistics Directorate. This gives opportunity to the CBS to hire new and qualified young professionals. To reduce staff turnover and improve the level of methodological expertise in

crucial production units, higher job complexity ratios have been requested for Macroeconomic Statistics Directorate and Information Technologies Directorate, to enable higher staff remuneration.

Furthermore, the new Official Statistics Act (adopted on 28 February 2020) ensures transparency in the appointment, mandate and dismissal of the Director General, in turn ensuring professional independence of the national statistical institute.

For the first time ***the Revision Policy of National Accounts and GFS / EDP statistics was prepared, finalized (on 30 April 2020) and published on the CBS website.*** Achieving full consistency between all domains is a complex task and long-term process that requires the cooperation of all departments in the Macroeconomic Statistics Directorate of the CBS, other statistics producers as well as the Ministry of Finance and the Croatian National Bank. The new Revision Policy for National Accounts and GFS / EDP statistics aims to improve the documentation of procedures for the production and dissemination of National Accounts and GFS/EDP statistics, with the ultimate goal of a timely publication of time series in an accessible format on the CBS website.

A new Memorandum of Understanding, aiming to ***enhance cooperation and communication between institutions involved in the compilation of GFS / EDP statistics and specifying their obligations for timely data exchange,*** was signed on 31 January 2020. Strengthened cooperation between CBS, the Ministry of Finance and the Croatian National Bank, through clear procedures and obligations, will lead to improved and timely data exchange between the three institutions. The role of the Working Group for Sector Classification is clarified, clearly stating that its decisions have to be reached by consensus and, in case consensus cannot be reached, the CBS in cooperation with Eurostat has the final say. Moreover, the internal deadlines of data delivery in March each year have been advanced, to provide sufficient time to the CBS to compile and deliver high quality data within the deadlines provided for in the EU Regulations.

The adoption of the new Official Statistics Act stipulates free access to all administrative sources by the CBS thus contributing ***to enhance relevant data sources.*** In relation to improving access to administrative data, the new Official Statistics Act strengthens the implementation of the provisions set in Regulation (EC) 223/2009. The holders of administrative data are now required to notify the CBS in writing and in a timely manner, before introducing the collection of new administrative data or before amending or eliminating existing administrative data sources. In particular, if the administrative data are used to perform statistical activities determined by the CBS' Annual Implementing Plan, the data sources could only be eliminated or their coverage reduced subject to prior consent by the CBS.

Finally, the new Official Statistics Act also aims at strengthening the coordination role of the CBS and at simplifying the organisation and functioning of the official statistical system of the Republic of Croatia.

3. Commission services' assessment

The Commission services' assessment is that prior commitment 4 has been fulfilled. The implementation of this prior commitment takes forward the improvements already undertaken by the CBS in recent years for the production of National Accounts and GFS/EDP statistics. In particular,

the new Official Statistics Act and the Ordinance on internal organisation structure are important steps towards further reinforcing the capacity of the statistical authorities, as envisaged in the prior commitment. While the previous Memorandum of Understanding already stipulated the procedures and obligations for timely data exchange between statistical and other relevant authorities, the updated Memorandum of Understanding further strengthens the cooperation between the institutions involved (CBS, Croatian National Bank and Ministry of Finance), but its strict implementation by all three institutions remains crucial. Finally, the new Official Statistics Act also creates scope for enhancing data sources.

Prior commitment 5: Public sector governance

Enhancement of public sector governance through improved governance of state-owned property and disposal of non-essential assets, as well as rationalization and further legal harmonisation and de-politicization across the Croatian civil service.

1. Overall objective and rationale

Public administration efficiency in Croatia underperforms the EU average. A number of indicators highlight weak public-sector performance in service delivery, which in turn affects the level of trust in the government². Long-standing weaknesses include excessive fragmentation at sub-national level and of the wage setting framework, as well as inefficient coordination within the public administration, politicisation of expert functions and heavy influence of the state on the economy. These issues weigh on the quality and consistency of services provided to citizens, hamper policy effectiveness and impede the functioning of the market by reducing allocative efficiency. Recently, Croatia made some progress with the harmonisation of state agencies and the modernisation of public service provision through increased offer and uptake of e-government services.

This prior commitment was designed to improve governance in the broad public sector. By divesting some of its minority shares with no strategic value for the state and no economic rationale for government ownership, the government can focus its efforts on more effectively managing the rest of its portfolio. Adopting the Law on unvalued property should help resolve property rights conflicts that originated with the conversion and privatisation of land in the 1990s. The law would enable more efficient use of state owned land and increase legal certainty for businesses operating on it, most notably in the tourism sector. The adoption of a set of laws regulating the recruitment of officials aims to de-politicise and professionalise the state administration. This in turn should strengthen the professional competence and independence of the public administration, and ensure business continuity. Amendments to the Institutions act should harmonize the rules for establishing,

² European Commission (2019), Standard Eurobarometer 92, Autumn 2019 (<https://ec.europa.eu/commfrontoffice/publicopinionmobile/index.cfm/Survey/getSurveyDetail/surveyKy/2255>)

Koprić, I. (2019), Public administration characteristics in Croatia, part of the report The Public Administration in the EU 27: An insight in the characteristics, capacity and performance of EU Public Administrations, European Commission, Luxembourg

managing and supervising all institutions vested with public powers (colloquially known as “agency-type legal persons”).

2. Deliverables and implementation by the authorities

Sale of minority shares or stakes in companies that are not listed as companies of strategic interest were structured in three rounds (30 companies in each) between August 2019 and March 2020. Interested investors were first invited to submit letters of intent to purchase state shares or stakes in companies in each round. Based on the received letters of intent, the government’s Restructuring and sale center determined the starting price for the auction for each company. In the three rounds altogether, shares and business interests in 26 companies were sold, worth around HRK 4.5 million (around 600 thousand EUR), with two more sales being in the final stages. Most of those companies belong to the manufacturing sector (7+1 to be completed) and tourism (6+1 to be completed).

A call for an additional fourth round of sale of minority shares or stakes has been prepared but the tender publication had to be postponed until the end of the COVID-19 state of emergency. It comprises 20 companies, some unsold ones from the first three rounds and some newly prepared for sale.

The Law on Unvalued Construction Land was adopted by parliament on 17 April 2020, following consultation with the Croatian tourist board and the employers’ association.

The State Administration System Act and the amendments to the Act on the Obligations and Rights of State Officials were adopted in June and July 2019, respectively. These legislative changes modify the way heads of administrative organisations within ministries are appointed. Instead of assistant ministers, who were politically appointed officials, the government will now appoint directors for a period of four years, based on criteria on educational qualification and professional experience set in the State Civil Service Job Classification Decree and ordinances on the internal order of individual state administration bodies.

The Institutions Act was amended in December 2019 and the amendments entered into force on 1 January 2020. The Act on Amendments to the Institutions Act applies to all existing institutions vested with public powers (colloquially known as “agency-type legal persons”) and the institutions that will be established after its entry into force. Therefore, all institutions vested with public powers must perform their activities in accordance with the provisions of the new Act, regardless of whether the legal acts of such institutions have been aligned with the Institutions Act or not.

3. Commission services’ assessment

The Commission services’ assessment is that prior commitment 5 has been fulfilled. Efforts undertaken include the launch of procedures for the disposal of state minority shares and stakes in companies, some of which were eventually sold, and legislative changes in the areas of managing state owned assets and public administration. The initiated sale of minority shares and business interest in companies that are not listed as companies of strategic interest, although modest in scope and revenue generated, shows a commitment towards narrowing the focus of state presence in the economy. The new law on unvalued construction land helps better define the framework for the use of state owned land and provides legal certainty for companies operating on it. The two measures in

the area of public administration aim to increase transparency and professionalism at the top of the public administration hierarchy, and harmonize the institutional framework across the broader public sector.

Prior commitment 6: Business environment

Reduction of administrative and financial burden through a decrease in the number and overall burden of para-fiscal charges, in administrative obligations for entrepreneurs, and liberalisation of selected professional services

1. Overall objective and rationale

A cumbersome business environment hinders competitiveness and productivity growth. Steps to improve it in recent years include the identification and subsequent removal of excessive administrative burden in many key sectors and the liberalisation of services in a few sectors. Furthermore, Croatia reduced the restrictiveness of its product and services market regulation. The 2018 version of the Product Market Regulation indicators (OECD, 2020) shows that the restrictiveness of Croatia's regulations was close to the EU average, which is a big improvement compared to 2013, when Croatia was found to have substantially more restrictive regulation. However, Croatia still scores relatively low on 'simplification and evaluation of regulations' and 'barriers in services sector'. Over-regulation of several professional services hampers competition. According to the Commission's restrictiveness indicator (EC, 2016), Croatia's regulatory restrictiveness is higher than the EU average for six out of seven analysed professions. Furthermore, excessive administrative and legislative requirements and parafiscal (non-tax) charges (totalling approximately 2.3% of GDP) burden businesses, particularly smaller ones.

This prior commitment was designed to provide additional momentum towards improving the business environment, with a focus on relaxation and simplification of administrative requirements (inter alia through electronic solutions), reduction and abolition of parafiscal (non-tax) charges and further liberalisation of professional services.

2. Deliverables and implementation by the authorities

The deliverables for the **removal or simplification of administrative requirements** for the corporate sector were the following:

- Setting up and making available to users the platform for online registration of business
- Implementing 101 administrative reduction measures
- Preparing of the 4th Action Plan for Administrative Burden Reduction

The online platform for the registration of companies was set up and is now available to users. By 24 April 2020, 243 companies and 40 crafts had been established using it. 101 measures of administrative burden reduction have been implemented since early July 2019. An additional 17 measures are expected to be implemented by the end of the 2nd quarter 2020. The 4th Action Plan for Administrative Burden reduction, adopted by the government on 30 April 2020, contains 10 sets of measures through which administrative procedures should be optimised and digitalised, with the

expected reduction in cost for businesses amounting to HRK 686.6 million (cost measured using the Standard Cost Methodology model). The most burdensome procedures were identified in close cooperation with the business representative organisations.

The work stream on **parafiscal charges** had two deliverables: 1) completing a systematic analysis of para-fiscal charges and 2) adopt a decision on the reduction of para-fiscal charges.

A thorough analysis of all para-fiscal charges was completed and the Registry of parafiscal charges was updated in November 2019. The new Action Plan for the reduction of parafiscal charges, adopted by the government on 7 May 2020, contains measures to reduce 33 parafiscal charges, abolish administrative fees that are paid into the central state budget, and reduce fees charged for 17 sector-specific exams by 25%, with the estimated total relief for businesses amounting to HRK 531.9 million. In addition, specific relief measures in the form of temporary reduction of parafiscal charges have been adopted over the past months in response to the COVID-19 crisis.

Finally, there were three deliverables towards **liberalisation of services**: 1) adoption by the Croatian Parliament of the amended Act on Physical Planning and Building Tasks and Activities; 2) adoption of bylaws within the field of competences of the Ministry of Health and the chambers of Pharmacists and Physical Therapists, as well as 3) tendering the provision of physical therapy services.

The entry into force of the Act on Physical Planning and Building Tasks and Activities has led to the relaxation of legal requirements and abolition of both compulsory chamber membership and compulsory professional insurance for site engineers and/or performance managers.

The Ordinance on Standards and Norms regarding Premises, Medical and Technical Equipment and Health Care Workers relaxed the restrictive minimum requirements for pharmacies. With the adoption of bylaws within the field of competences of the Ministry of Health and the chambers of Pharmacists and Physical therapists, working hours of pharmacies were liberalized, and restrictions on advertising of pharmacy services, physical therapy and public health facilities were relaxed. Finally, the Croatian Health Insurance Fund concluded contracts with two new providers of in-home physical therapy, following a tendering procedure that was completed on February 24 2020.

3. Commission services' assessment

The Commission services' assessment is that prior commitment 6 has been fulfilled. Efforts undertaken in the context of this prior commitment include the online registration of businesses, continued reduction of the administrative burden and parafiscal charges, and relaxation of regulation of selected services professions.