OECD Reviews of Regulatory Reform

Regulatory Policy in Croatia

IMPLEMENTATION IS KEY



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Foreword

Croatia has made great strides in strengthening its regulatory policy framework and implemented a broad set of regulatory reforms to support more effective law-making and reduce administrative burdens for businesses. The recently introduced RIA law and the law on access to information set out requirements to conduct impact assessments and public consultations and accompanying guidance documents have been provided to regulators to help them implement practices as set out in the *OECD 2012 Recommendation on Regulatory Policy and Governance*.

The *OECD Review of Regulatory Policy in Croatia* assesses the development of these reforms, and takes a detailed look at how the reforms are put into practice. It reviews the policies, institutions, and tools employed by the Croatian government to design, implement and enforce regulations. This includes policies on administrative simplification, *ex ante* and *ex post* evaluation of regulations, public consultation practices, as well as regulatory enforcement and inspections. The review also contains a special chapter on the taxation of small and medium-sized enterprises. The review then provides policy recommendations based on best international practices and peer assessment to strengthen the government's capacity to manage regulatory policy.

The review finds that Croatia has successfully put in place some of the essential tools of better regulation. For example, stakeholder engagement via the e-consultation platform *e-Savjetovanja* is common practice and RIA starts relatively early in the process and looks at a wide variety of impacts. Challenges remain, however, to ensure that the tools are used effectively and both primary and secondary legislation are targeted. The review makes recommendations to address these particular challenges. For example, Croatia would benefit from strengthened analytical capacities in line ministries, as well as renewed political commitment to better regulation.

The review methodology draws on decades of experience in better regulation reflected in the *OECD 2012 Recommendation on Regulatory Policy and Governance*. The Recommendation identifies the measures that governments can and should take to support better regulation. These measures are used as a baseline for assessing regulatory management capacity in Croatia. The review also uses the *2014 OECD Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections* and the *OECD Enforcement and Inspections Toolkit*, which address the design of effective compliance policies and institutions and the process of reforming inspection regimes to achieve policy objectives.

The OECD Regulatory Policy Committee leads the programme on regulatory governance with the support of the Regulatory Policy Division of the OECD Public Governance Directorate. Regulatory policy country reviews are a key part of the Committee's programme. The Directorate's mission is to help government at all levels design and implement strategic, evidence-based and innovative policies to strengthen public governance; respond effectively to diverse and disruptive economic, social and environmental challenges and deliver on government's commitments to citizens. The goal of the programme is to support sustainable economic and social development through sound government frameworks that enable evidenced-based policy making.

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Abbreviations and acronyms

CEE	Central and Eastern Europe
DTF	Distance-to-frontier
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GLO	Government Legislation Office
ICT	Information and Communications Technology
iREG	Indicators of Regulatory Policy and Governance
MFEA	Ministry of Foreign and European Affairs
MoE	Ministry of the Economy, Entrepreneurship and Crafts
NGO	Non-governmental Organisation
PPP	Purchasing Power Parity
RIA	Regulatory Impact Assessment
RPC	Regulatory Policy Committee
SCM	Standard Cost Model
SMEs	Small and medium-sized enterprises
SOEs	State-owned Enterprises
UK	United Kingdom

Executive summary

The *OECD Regulatory Policy Review of Croatia* assesses the country's regulatory management capacity by taking stock of regulatory policies, institutions and tools, describing trends and recent developments, and identifying gaps in relation to good practices. Improving the entire regulatory policy cycle will ensure that regulations are built on a foundation of solid evidence and public participation and are designed to improve the security, health and well-being of citizens at a reasonable cost.

The Government of Croatia has made great strides in improving its regulatory policy. Line ministries are required to use tools such as RIA and stakeholder engagement when developing laws and regulations. However, challenges remain in ensuring that they implement these tools effectively. Croatia should support good law making by strengthening analytical capacities and oversight of the regulatory process.

Key findings

- The Government of Croatia has introduced a set of useful and important reforms to strengthen regulatory policy, including a legislative framework for RIA and stakeholder engagement, and made a great effort bundling the fragmented legislative framework. A whole-of-government policy bringing together these provisions is still missing.
- A number of line ministries, centre-of-government offices and other institutions are involved in regulatory policy oversight. The Government Legislation Office is well-situated at the centre of government. However, the GLO's mandate allows for scrutiny of RIA for primary legislation only. As a result, high burdens stemming from subordinate regulations go unchecked.
- Implementation of regulatory policy remains a challenge. A lack of analytical capacities for regulatory quality in GLO and line ministries compromises the quality of regulatory management tools.
- The Croatian legal and policy framework has created conditions for efficient stakeholder engagement in regulatory policy and Croatia is comparing well even with many OECD countries. However, most institutions rely exclusively on online consultations rather than combining several consultation methodologies, including early-stage consultations.
- All the necessary elements of RIA exist for primary laws in Croatia. RIA starts relatively early in the process and looks at a wide variety of impacts. However, policy makers have not used RIA to its full potential in part due to a lack of expertise and the actual information provided in RIAs seems to be relatively underdeveloped. RIAs for burdensome subordinate legislation are not conducted.
- *Ex post* reviews of regulations have almost exclusively focused on reducing administrative burdens to business, government and citizens. Generally, these reviews have brought improvements to the procedures internal to government, but this focus neglects whether laws and regulations are really meeting their objectives in an efficacious way.

- The inspection framework in Croatia is going through a substantive reform in 2019 relating to the creation of the State Inspectorate. The new framework should enable better planning of inspections and therefore reducing burdens stemming from inspections for the inspected subjects.
- Croatia's regional governments have significant authorities to develop their own regulations in key economic areas. Many of the smaller local governments lack the capacities to effectively implement regulatory policy.
- Croatia has successfully put in place a structure for co-ordinating between the EU- and national level but focuses its efforts on the later stage of the EU legislative process and rarely uses regulatory management tools to inform the national position during the negotiation phase.
- Recent efforts have been made to enhance small business taxation. However, the tax system remains complex and tax compliance costs continue to weigh heavily on small businesses. Overall, the Croatian tax system generates compliance costs and distortions that may hinder the development of SMEs.

Key recommendations

- Overall, the government should relaunch Better Regulation to bring evidence-based policy back into focus. At the core of this effort should be the introduction of an explicit and binding whole-of-government regulatory policy with clearly identified objectives and a clear communication strategy.
- The scope of better regulation efforts should be extended by moving beyond the current focus on administrative burden measurement and reduction to the effective implementation of regulatory management tools.
- The Government of Croatia should promote oversight and quality control of regulatory management tools. The Ministry of the Economy could consider extending the scope of its scrutiny to regulatory costs other than administrative burdens to address the substantial burdens stemming from secondary legislation.
- A central part of the effort to improve implementation of regulatory management tools is the promotion of analytical capacities in line ministries. Croatia should further invest in targeted staff trainings and hire additional staff, in particular economists.
- Croatia could consider improving the co-ordination during the law-making process, for example by setting up an inter-ministerial conference.
- Consultations should take place more systematically earlier in the process, prior to a preferred solution being identified. This could be encouraged by providing guidance and training on how to establish working groups.
- Croatia could improve the quality of RIA by targeting RIA and analytical resources to those major legislative initiatives that will have a major impact on Croatian citizens. RIA should also be applied to subordinate regulations with significant impacts.
- The Croatian government should also strengthen stakeholder's engagement in reviewing existing regulation. To strengthen dialogue and address the high regulatory burdens for businesses, it could be considered to establish a permanent discussion forum between the administration and businesses.
- Croatia should conduct targeted *ex post* reviews focusing on the performance of regulations or particular sectors to improve the quality of regulations. Priority areas or sectors for those reviews must be identified in co-operation with stakeholders.
- Croatia should focus on successfully implementing the inspection reform in the following years and the use of risk-based approaches to enforcement should be bolstered.

- The national government should promote quality regulatory policy on the sub-national level by sharing best practices and encouraging the use of regulatory policy tools.
- Croatia should ensure that a proportionate analysis of impacts is carried out and relevant stakeholders are involved in the process of preparing national positions to draft EU legislation.
- Taxpayer services targeted at small businesses could be improved, for example by setting up an SME portal. Reforms of the taxation system of SMEs should focus on strengthening the exchange of information between public administrations.

Country profile: Croatia

Geography, population and living standards	
Area (sq. km)	56 594
Population	4 144 559
Population density (sq. km)	73
Urban population	57%
Population growth rate	-1.2 (2017 est.)
Total fertility rate	1.4 (2016 est.)
Life expectancy	78.3 (2018)
Ethnic groups	Croats 90.4%, Serbs (4.36%), and 21 other ethnicities (less than 1% each).
Government	
State structure	Parliamentary Republic
Executive	President elected by popular vote every 5 years
	The prime minister of Croatia is appointed by the National Assembly
Legislative	Unicameral
	Sabor representatives (MPs): 100 to 160; elected by popular vote to 4 year terms
Elections	Last parliamentary elections: September 2016 (next to be held: December 2020)
	Last presidential elections: January 2015 (next to be held: January 2020)
Political situation	The current government led by prime minister Andrej Plenković is a centre-right/liberal coalition of the Croatian Democratic Union (HDZ) and the Croatian People's Party (HNS)
Legal system	Civil law system; legal appeals are made to the Supreme Court
Administrative-territorial structure	Croatia is a unitary state with three levels of governance: 21 regional government units; 428 municipalities and 127 towns on local level

Source: Eurostat database; the World Bank database; Economist Intelligence Unit; the CIA World Factbook (2019).

1 Macroeconomic and political context

This chapter describes the main governance reforms of Croatia since its independence in 1991 up until it joined the EU in 2013. It also describes the current economic context of regulatory reform efforts and points to the specific economic challenges that the country faces that hinder investment, economic growth, and well-being.

Political context: Croatia's path from independence to EU membership

Croatia declared independence and became a democratic republic on 25 June 1991, after being part of Yugoslavia for most of the 20th century. In 1989, the first free multi-party elections were held in the country and the Croatian Parliament adopted the Constitution of the Republic of Croatia on 22 December 1990 (The Miroslav Krleža Institute of Lexicography, 2013[1]).

The declaration of independence was met with resistance from many ethnic Serbs in Croatia and led to the Croatian war of independence, fought from 1991 – 1995 between Croat and Serb forces. The following years 1996 and 1997 were a period of post-war recovery and structural economic reforms.

After gaining independence, Croatia made great strides in joining the international community. In 1996, Croatia became a member of the Council of Europe, which laid down the political and economic preconditions for developing bilateral relations with Croatia soon after. In 2000, Croatia joined the World Trade Organization and became a member of NATO in 2009.

With the loss of its key export markets in Yugoslavia, Croatia looked to strengthen ties as quickly as possible with the rest of Europe to take advantage of the key political and economic benefits of integration. By 2003, Croatia had made enough progress in fulfilling the Copenhagen criteria to apply for EU membership, becoming the second former Yugoslav republic after Slovenia to do so. The treaty of Croatia's accession to the EU was ratified in 2011 and entered into force after a successful membership referendum held in 2012. On 1 July 2013, Croatia joined the European Union as its to date latest member.

Government structure

The constitution adopted in 1990 radically changed the governance system in Croatia, abandoning the primacy of the communist party over the state. After independence, Croatia emerged as a unitary state[1] with a semi-presidential system and a bicameral legislature. It later transformed to a parliamentary system with the Croatian Parliament (*Hrvatski Sabor*) being unicameral since the abolishment of the former Chamber of Counties in 2001 (European Committee of the Regions, 2012[2]).

Executive power is exercised by the Government and the President of Croatia. The prime minister is the head of government in a multi-party system. Together with four deputies, the PM forms the inner cabinet, tasked with proposing Government policies and co-ordinating and overseeing the Government's work programme. There are 16 other ministers in charge of different sectors of activity. They are appointed by the PM and approved by the Parliament. The president is elected for a five-year term and can serve maximum two terms according to the Croatian constitution. Among other duties, he or she has the power to perform functions related to the operation of the government such as calling elections to the Croatian Parliament, appointing the prime minister and call referenda.

The Government of Croatia adopts regulations and other acts such as decisions and conclusions and passes laws to the Croatian Parliament (*Hrvatski Sabor*) for adoption. The Sabor is composed of 151 members elected by direct election for a four-year term. Seats are allocated to represent the electoral districts: 140 members of the parliament are elected in multi-seat constituencies, 8 from the minorities and 3 from the Croatian diaspora.

The judiciary of Croatia is a three-tiered system of courts, led by the Supreme Court (*Vrhovni sud*) as the highest court. The lower two levels consist of 15 county courts and 32 municipal courts. With the latest judicial reform in 2018, municipal and misdemeanour courts have been merged to reduce the overall number of courts, thus increasing efficiency. The Constitutional Court (*Ustavni sud*) ensures compliance of legislation with the Constitution of the Republic of Croatia and rules on matters regarding jurisdictional disputes between the legislative, executive and judicial branches as it is not part of the judicial branch of government.

Local government structure

Croatia is a unitary state (Constitution, art. 1) with three levels of governance: central, regional/county and local level.

The basic units of regional self-government are the counties (*županija*). Croatia is divided into 21 regional government units: 20 counties and the city of Zagreb. Each county (apart from the city of Zagreb) consists of towns and municipalities. The municipal level counts 428 municipalities (*općina*) and 127 towns (*grad*) with an average municipal size of 7 625 inhabitants. The town status is given to municipalities that are seats of counties with more than 10 000 inhabitants. There are also 6 762 settlements which have their own councils and can be established by the municipalities and cities. (The Miroslav Krleža Institute of Lexicography, 2013[1]) (European Committee of the Regions, 2012[2])

The city of Zagreb has a special status, having competences of both a town and a county, and a significant role in performing state administrative tasks in its territory. (European Committee of the Regions, 2012[2]) The role of local governments is weaker, as more than half of local governments have less than 3000 inhabitants and lack financial resources (European Commission, 2018[3]).

The sub-national government system was established through the 1992 and 1993 laws on local self-government and administration. A major new phase of decentralisation took place in 2002 with the transfer of new responsibilities and financial means to counties and 32 towns with the strongest fiscal capacity. Decentralisation of tasks has been gradually extended over the last decade to counties, towns and some other units on an individual basis. In 2010, the Government adopted the *Guidelines and Principles for a Functional Decentralisation and Territorial Reorganisation*, however the breakdown of responsibilities is still quite complex and in some cases unclear (OECD, 2016[4]). A reform of local and regional government, which would result in larger regions and municipalities, is currently being discussed as part of a wider public administration reform. For information on the regulatory implications of this administrative fragmentation, see chapter 8.

Economic context

The economy of Croatia is a service-based economy with the tertiary sector accounting for 70% of the total GDP. With the declaration of independence, Croatia successfully transitioned to a stable market-based economy, after the 1990's conflict over its independence had severely affected Croatia's economy. The process leading to Croatia's gradual integration and accession to the EU shaped the country's economic development, leaving a profound impact on the institutional framework and policy-making. As of 2000, the country's economic situation began to improve with moderate but steady GDP growth, led by a surge of tourism and credit-driven consumer spending.

However, the 2008 global economic downturn revealed underlying structural weaknesses and the lack of serious structural reforms since the 2002 Pension reform and led to six years of contraction, where the economy entered into a sharp downturn. (OECD, 2017[5])

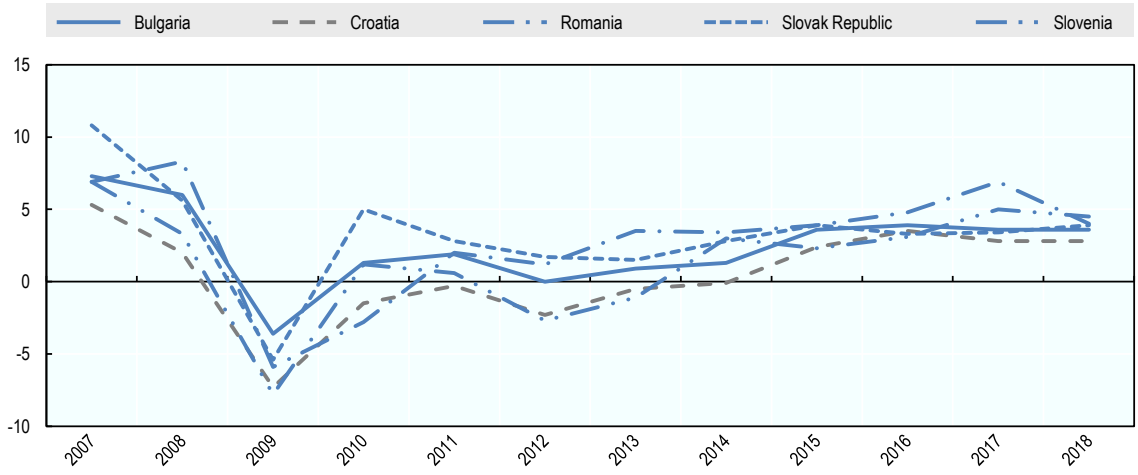
Current economic situation: Croatia's path of recovery from one of the EU's most severe recessions

When Croatia became a member of the EU in 2013, it gained access to the EU single market, which helped connect part of the economy to global value chains. After six years of recession and a modest recovery in 2015 (+2.4%), real GDP growth accelerated in 2016 with a 3.5% rate, mostly due to a sharp increase in trade, transportation and tourism. At the time of its accession to the EU, Croatia was wealthier than other EU-members from the Balkan, Bulgaria and Romania. The recovery began in 2015 and Croatia's economy since then has been growing at 3% annual in the three years to 2017 – a pace well above the EU annual

average at 2.3% (OECD, forthcoming[6]). By 2017, Croatia's GDP per capita had reached almost USD 22 000 in purchasing power parity (PPP) terms, which equates to 63% of EU average. (The World Bank, 2018[7]).

Nevertheless, this positive development is not enough to match pre-crisis growth rates and Croatia's purchasing power and growth over time is still lagging behind its EU peers (Figure 1.1). At an average of 1.8 annual percent change (2103-2017) the real GDP growth has been slower than in countries such as Romania (4.4%) and Bulgaria (2.8%).

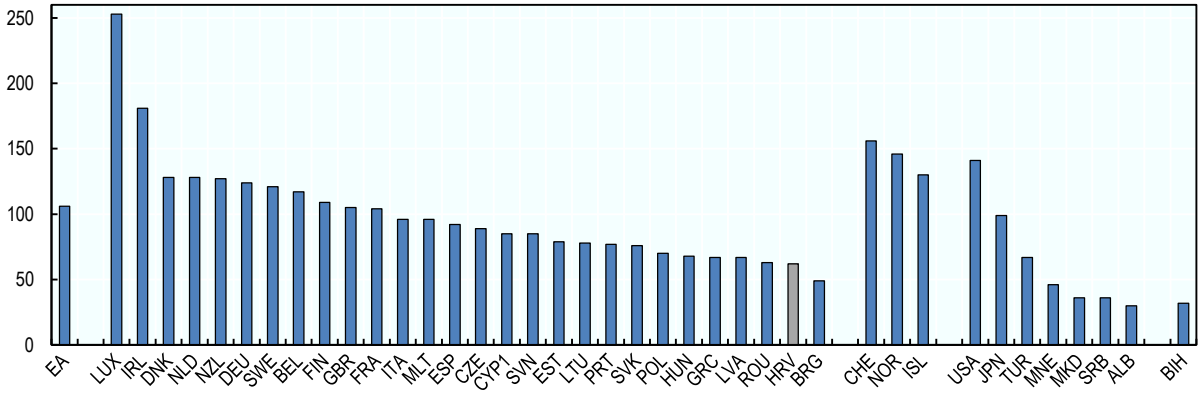
Figure 1.1. Real GDP growth in selected CEE countries, annual percent change



Source: IMF.

Croatia's GDP per capita (current USD 13.383 in 2017 according to the World Bank) is significantly lower than in other EU countries (Figure 1.2), with the GDP per capita expressed in Purchasing Power Standards (PPS) amounting to 61 % of the EU average in 2017 according to Eurostat.

Figure 1.2. GDP per capita, 2017 (EU-28=100)



Notes: The volume index of GDP per capita in Purchasing Power Standards (PPS) is expressed in relation to the European Union (EU28) average set to equal 100. If the index of a country is higher than 100, this country's level of GDP per head is higher than the EU average and vice versa.

1. Note by Turkey:
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".
Note by all the European Union Member States of the OECD and the European Union:
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Source: Eurostat.

The recession took its toll on the labour market, with unemployment rates going up to 16.2% in 2015, the 3rd highest in the European Union. Youth unemployment stood even higher at 31.8% in 2016 and the disproportionately low employment rates in rural areas reflect regional disparities in terms of economic performance. Furthermore, fiscal challenges need to be addressed as government debt increased rapidly during the recession and, while currently in decline, fiscal discipline needs to be sustained and underpinned by more structural measures. (EBRD, 2017[8]) The recession also negatively affected the dispersion of the regional development index, regional GDP per capita and regional productivity (GDP per employee) (Đokić, Fröhlich and Rašić Bakarić, 2016[9]) and benefits of economic growth have been unevenly distributed, to a disadvantage of small towns and rural areas.

Overall, Croatia's economy is expected to continue to grow and unemployment to contract, albeit at a slower pace (European Commission, 2018[10]). Growth remained solid in 2018 at 2.6% with private consumption being the main driver of growth, mainly due to an increase in disposable income as favourable labour market developments continued. Continued strong tax revenue growth is expected to keep the government balance in surplus and the debt ratio declining (The World Bank, 2018[11]). Despite the slow recovery, the short-term economic future looks positive for Croatia (Table 1.1), with the Central Bank and international organisations projecting GDP growth around 2.5% for 2019.

Table 1.1. Main economic indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Inflation	1.1	2.3	3.4	2.2	-0.2	-0.5	-1.1	1.1	1.5
Gross domestic product (GDP) growth	-1.5	-0.3	-2.3	-0.5	-0.1	2.4	3.5	2.9	2.6
Household consumption (growth contribution)	-0.9	0.2	-1.8	-1.1	-1.0	0.7	2.0	2.0	1.9[a]
Government consumption (growth contribution)	-0.1	-0.1	-0.2	0.1	0.2	-0.2	0.4	0.4	0.4[a]
Gross fixed capital formation (growth contribution)	-3.8	-0.6	-0.7	0.3	-0.5	0.7	1.0	0.7	1.4[a]
Change in inventories	0.3	0.2	-0.8	0.0	0.0	0.8	-0.2	0.4	-0.2[a]
Exports (growth contribution)	2.1	0.8	-0.1	1.3	2.6	4.3	2.7	3.0	2.9[a]
Imports (growth contribution)	0.9	-0.9	1.2	-1.3	-1.3	-4.0	-2.8	-3.7	-3.6[a]

[a]. Forecast.
Source: National Bank of Croatia.

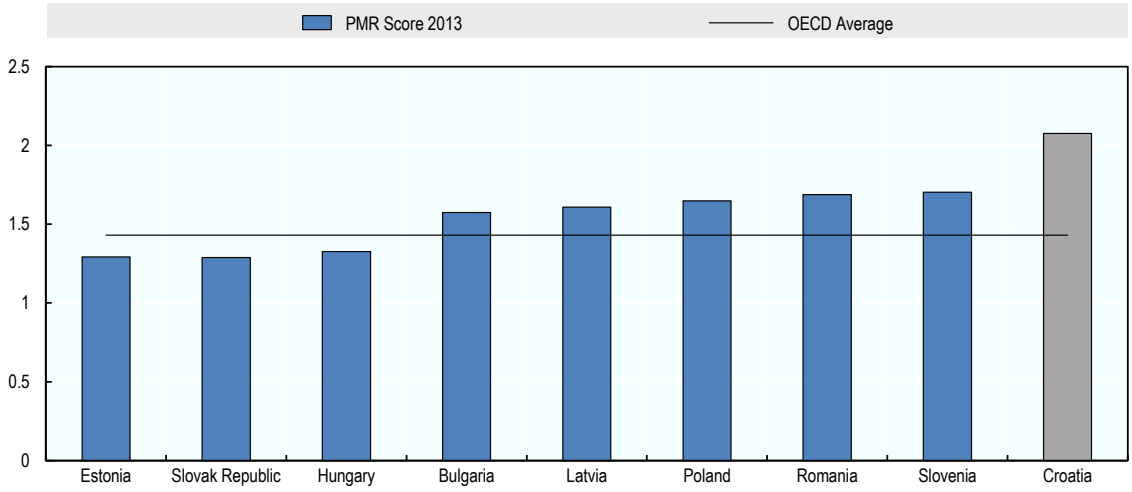
This positive development depends on a number of factors, including Croatia's capacity to attract investment and carry out structural reforms to its regulatory framework to address high public and private debt levels, improve the business climate, and boost productivity and competitiveness. Croatia would also greatly benefit from sustaining reforms to upgrade public services, key institutions and the governance of state-owned enterprises (SOEs) within the next few years. (OECD, 2017[5]) If these longstanding structural constraints are not addressed, Croatia risks a growth deceleration in the medium term.

Market regulation and competition

Croatia's economy remains highly regulated and businesses face a disproportionate level of administrative burden from regulation. Croatia has one of the strictest regulated product markets and scores higher than any of its peers in Central and Eastern Europe (CEE) in the *OECD Product Market Indicators* (Figure 1.3).

Too strict or badly designed product market regulation makes it harder for entrepreneurs to create firms and expand them and discourages the entry of foreign products and firms (Koske et al., 2015[12]).

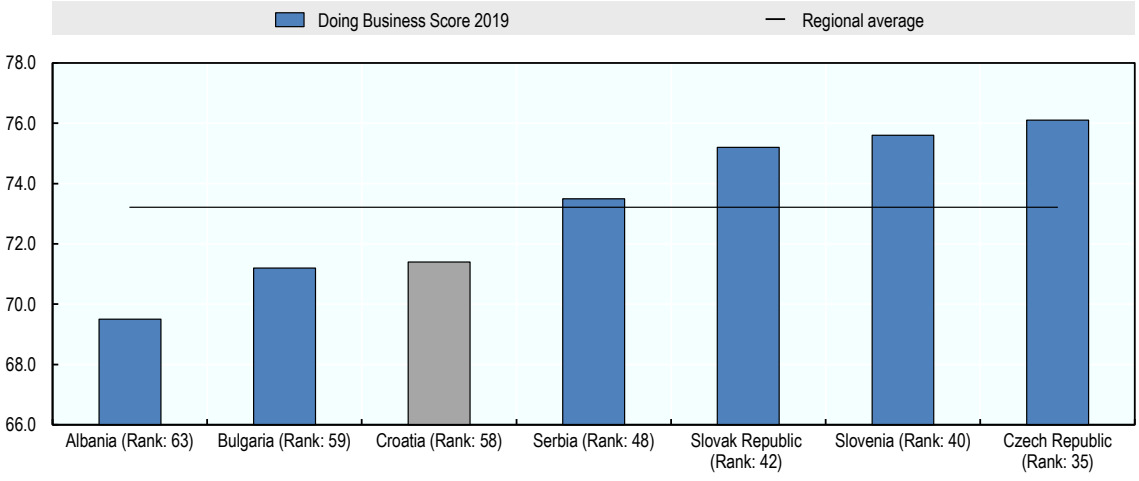
Figure 1.3. 2013 OECD Product Market Indicators score for CEE countries



Note: Scores are from 0 to 6 (least restrictive to most restrictive).
Source: (Koske et al., 2015[12]), "The 2013 update of the OECD product market regulation indicators: policy insights for OECD and non-OECD countries", *OECD Economics Department Working Papers*, No. 1200, https://dx.doi.org/10.1787/5js3f5d3n2vl-en.

Businesses in Croatia face comparatively high administrative and regulatory burdens. The World Bank Ease of Doing Business Indicator (Figure 1.4) shows Croatia scoring below the regional average, with CEE peers like Slovenia (Rank: 40) and the Czech Republic (Rank: 35) ranking higher. The regulatory environment is challenging for businesses in particular due to lengthy and costly procedures to obtain construction permits and to start a business. These procedures can vary highly between different municipalities.

Figure 1.4. World Bank 2019 Ease of Doing Business scores



Notes: The ease of doing business score captures the gap of each economy from the best regulatory performance observed on each of the indicators across all economies in the Doing Business sample since 2005. An economy's ease of doing business score is reflected on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance. The ease of doing business ranking ranges from 1 to 190.
Source: Worldbank (2019).

Croatia has started to address these issues by introducing the SME-Test as part of RIA (further described in Chapter 5) and the Action Plan on Administrative Burden Reduction with the purpose of creating investment incentives and providing easier market access. The substantial benefits of these measures are not yet reflected in Croatia's scores, with its Doing Business rank deteriorating to 58 in 2019 from 51 in 2018.

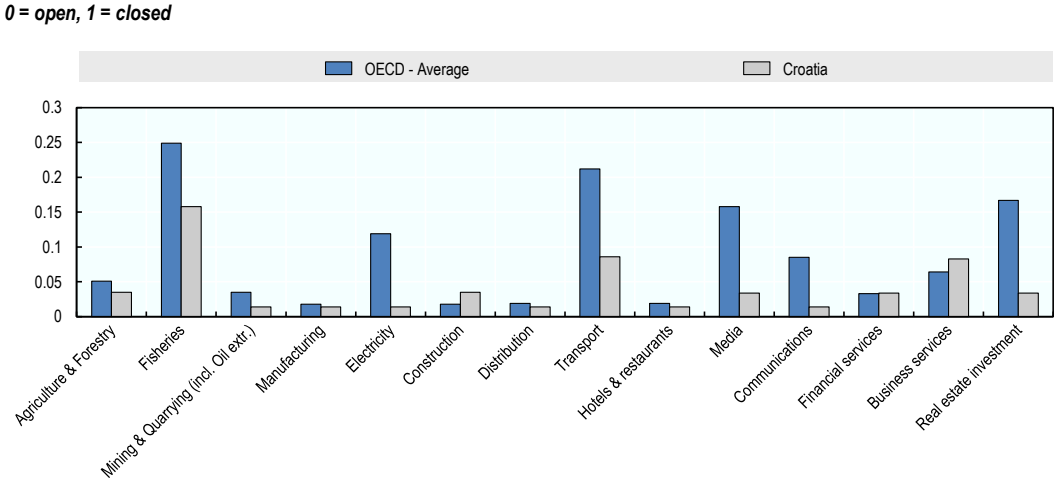
Investment in Croatia

Public investment experienced a sharp decline during the crisis from around 6% of GDP in 2002 – 2008 to below 3% in 2017 (one of the lowest among peers), while private investment dropped from around 28% in 2008 to 20% in 2017. This investment gap hinders long-term growth and while private investments have started to recover, there are still some investment constraints in the form of high administrative barriers to business activity, complex and often changing regulation, and weaknesses in public administration (EBRD, 2017[8]).

As explained in the Investment Policy Review of Croatia (OECD, forthcoming), foreign direct investment (FDI) plays a significant role in Croatia's economy with FDI accounting for nearly one fifth of all financial assets and nearly half of all financial liabilities in 2017. Overall, direct investments by foreign-owned firms in Croatia far outweigh investments by Croatian firms abroad. As such, Croatia sustains a negative net FDI position, of USD -22.9 billion in the first quarter of 2018. Relative to the size of the Croatian economy, the share of inward FDI stock to GDP stands at 61%, above the OECD and EU averages (of 39% and 53%, respectively); and the share of outward FDI stock to GDP at 11%, below the OECD and EU averages (of 48% and 62% each). These levels are similar to those found in comparable economies (e.g. the Czech Republic, Slovakia and Slovenia) (OECD, forthcoming[6]).

Croatia is largely open to foreign direct investment. National treatment of foreign investors in the post-establishment phase is guaranteed, which means that foreign investors, when incorporated and headquartered in Croatia, are considered domestic legal entities, with all the rights and obligations that are applied to domestic investors. The existing exceptions to national treatment are limited to foreign ownership restrictions in a handful of sectors, namely in legal services, freshwater fisheries and air transport (Figure 1.5). Other barriers to foreign direct investment mainly concern conditions imposed at establishment (e.g. local incorporation requirement and reciprocity condition for establishment of a branch). Such barriers are few, mostly sector-specific, and typically limited in their scope, applying almost exclusively to investors from outside the EU or the European Economic Area (EEA) or to investors from countries that are not WTO members.

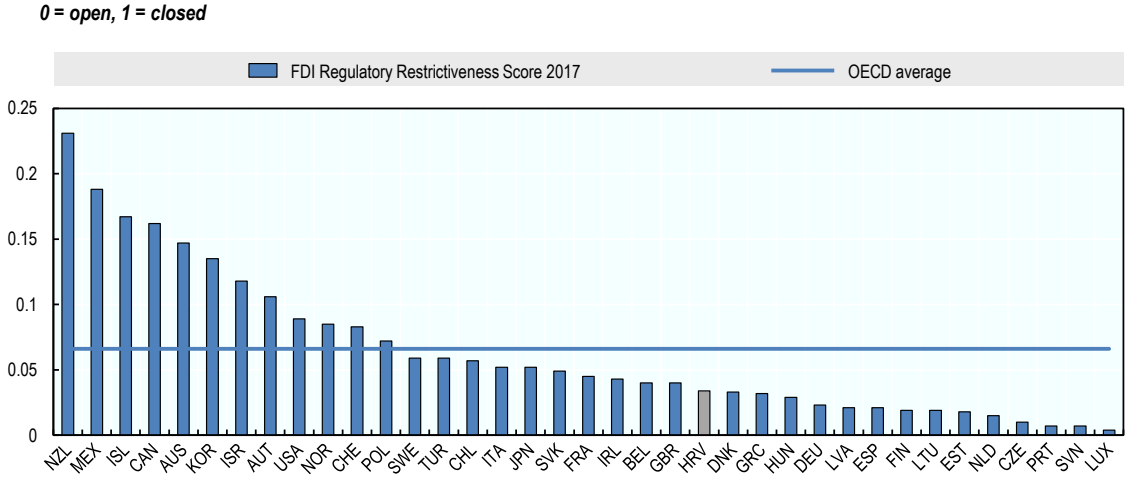
Figure 1.5. OECD FDI Regulatory Restrictiveness Index, 2017, by sectors



Source: OECD FDI Regulatory Restrictiveness Index, www.oecd.org/investment/fdiindex.htm in OECD (forthcoming), Draft Investment Policy Review Report.

As a result, Croatia's degree of restrictiveness is low in comparison to the OECD average, as well as against the average of non-OECD economies that have adhered to the Declaration, according to the OECD *FDI Regulatory Restrictiveness Index* (a measure of statutory restrictions on FDI, see Figure 1.6). However, the regulatory environment for foreign investment is not the only incentive that foreign investors respond to, as they are equally affected by deficiencies in the overall business environment (OECD, forthcoming[6]).

Figure 1.6. OECD FDI Regulatory Restrictiveness Index, 2017

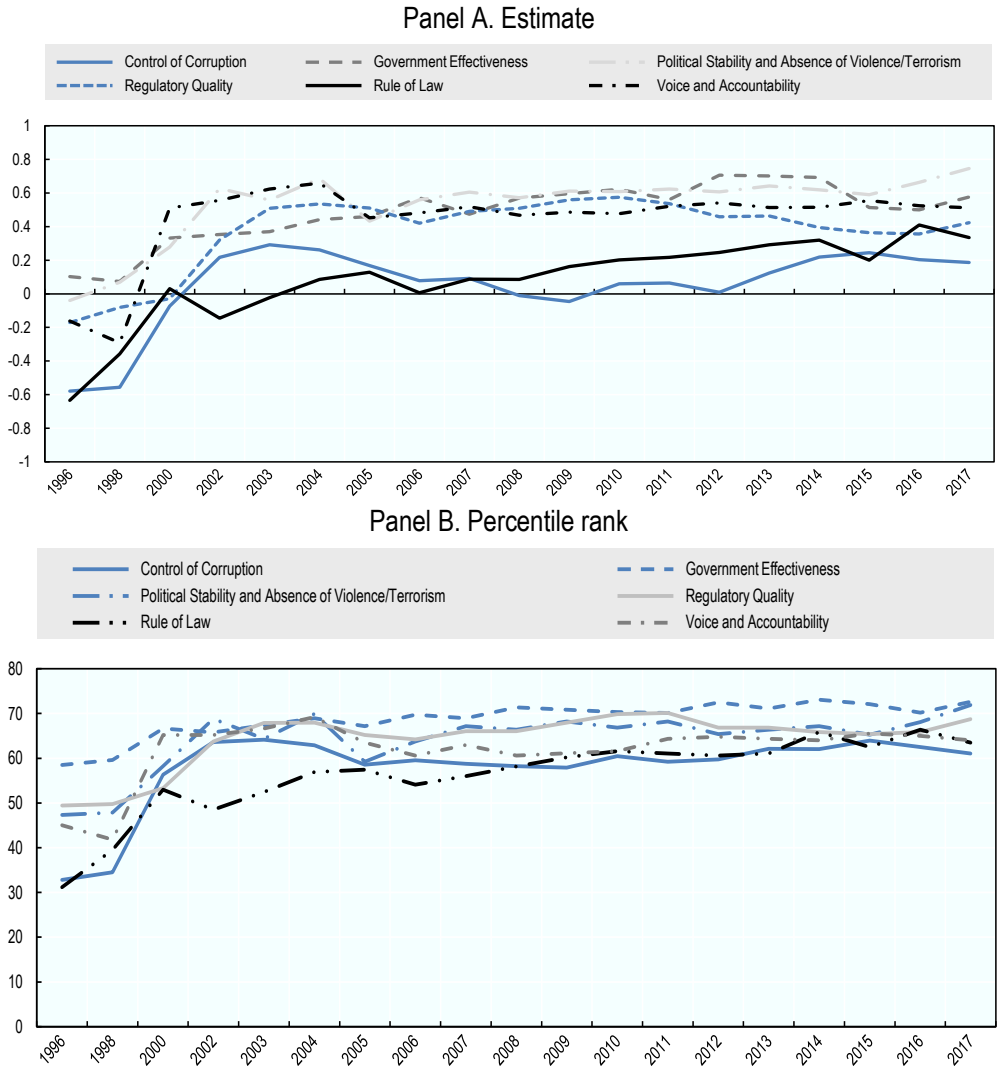


Notes: The OECD FDI Regulatory Restrictiveness Index covers only statutory measures discriminating against foreign investors (e.g. foreign equity limits, screening & approval procedures, restriction on key foreign personnel, and other operational measures). Other important aspects of an investment climate (e.g. the implementation of regulations and state monopolies, preferential treatment for export-oriented investors and SEZ regimes among other) are not considered. Data reflect regulatory restrictions as of December 2017. For Croatia, information reflects the regulatory environment as of September 2018. Please refer to Kalinova et al. (2010) for further information on the methodology.
Source: OECD FDI Regulatory Restrictiveness Index, www.oecd.org/investment/fdiindex.htm in OECD (forthcoming), Draft Investment Policy Review Report.

Public sector integrity and trust in government

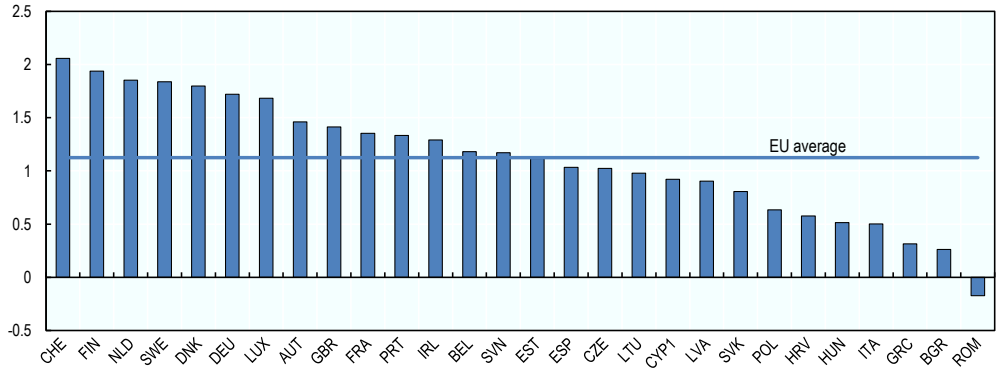
As captured by the World Bank's *World Governance Indicators* (Figure 1.7), Croatia has made progress in improving the rule of law, control of corruption, regulatory quality and other related aspects since the mid-1990s. Still, it has been scoring below the EU average on the same indicators (Figure 1.7). Furthermore, the EU polls suggest that the level of trust in government was among the lowest in the EU (only 15% reported to tend to trust the government in 2018). (OECD, forthcoming[6])

Figure 1.7. Overview of World Governance Indicators scores for Croatia, 1996-2017



Notes: Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance). The percentile rank is calculated based on the country's score and that of 154 other ranked countries.
Source: World Bank's World Governance Indicators database (2018) in OECD (forthcoming), *Draft Investment Policy Review Report*.

Figure 1.8. Government effectiveness in Croatia and EU 28 according to the World Bank World Governance Indicators



Notes: Estimate of governance (ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance). Results for EU 28 member states are shown.
1. Note by Turkey:
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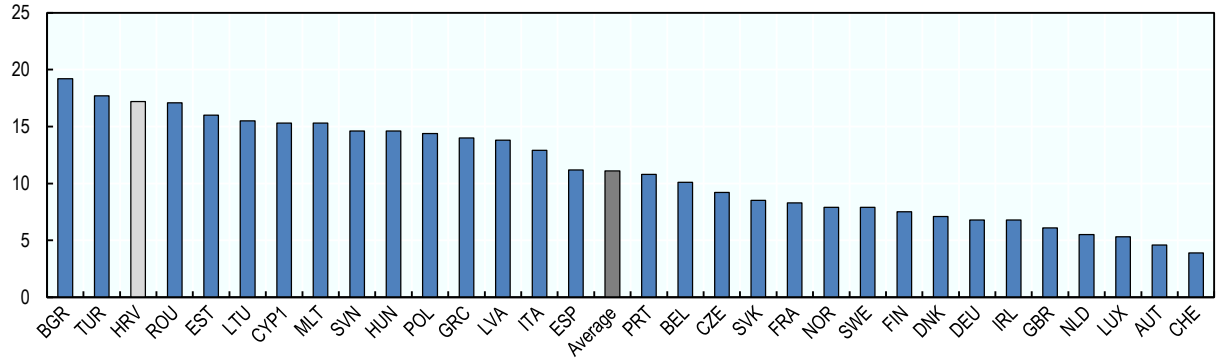
Source: World Bank's World Governance Indicators database (2018) in OECD (forthcoming), Draft Investment Policy Review Report.

Grey economy

A recent IMF report (IMF, 2018[13]) estimates the size of the grey economy in Croatia – which refers to economic activities hidden from official authorities for monetary, regulatory or institutional reasons – at 26.5% of GDP, the 3rd largest among European countries (Figure 1.9).[2]

Figure 1.9. Size of the shadow economy of 31 European countries in 2017: Adjusted MIMIC estimates



Notes: Multiple Indicators, Multiple Causes (MIMIC) approach: This method explicitly considers several causes, as well as the multiple effects, of the shadow economy. The numbers have been adjusted for do-it-yourself activities, neighbours' help, legally bought material and smuggling.
1. Note by Turkey:
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

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Source: (IMF, 2018[13]), "Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?", https://www.imf.org/en/Publications/WP/Issues/2018/01/25/Shadow-Economies-Around-the-World-What-Did-We-Learn-Over-the-Last-20-Years-45583 (accessed on 31 January 2019).

The extent of the shadow economy might be a consequence of the heavy regulatory burdens businesses in Croatia are facing: The main factors for undeclared work in Croatia include a low employment rate and lack of work opportunities, as well as relatively high taxes and obligatory contributions on wages.

The large share of the grey economy in total GDP could have a long-term negative impact on economic growth and job creation. However, the situation seems to slowly improve as reports on conducted labour inspections indicate a gradual decrease of cases of undeclared work in Croatia. This positive trend can primarily be attributed to the wide scope of different measures designed and implemented to address undeclared work and the shadow economy in general (European Commission, 2015[14]).

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The World Bank (2018), *The World Bank in Croatia*, http://www.worldbank.org/croatia (accessed on 31 January 2019). [11]

Notes

[1] As laid out in the Croatian constitution, art. 1.

[2] Grey (also known as shadow) economy is, by nature, difficult to measure (as its agents try to remain undetected) and there are various approaches to estimate its size. The IMF data has been chosen here as the approach considers several causes, as well as the multiple effects, of the shadow economy.

2 The context for Better Regulation in Croatia

This chapter describes the administrative and legal environment for regulatory reform in Croatia and assesses the communication with stakeholders on strategy and policies. It also looks at the policies, processes and institutions for evaluating the efficiency and effectiveness of programmes aimed at improving the regulatory environment. The role of e-government in support of regulatory policy and governance is briefly reviewed. Finally, it provides recommendations for Croatia to develop a formal and explicit regulatory policy.

Regulatory policy and core principles

Laws and regulations are essential tools governments have at hand to promote societal wellbeing and economic growth. A well-developed regulatory policy – the process governments use to create policies and if necessary regulation – is therefore crucial for a country to achieve its policy objectives. Poorly designed or insufficiently implemented legislation can be ineffective in achieving their objectives while imposing unnecessary costs on citizens and businesses (OECD, 2018[1]).

The objective of regulatory policy is to ensure that regulations are made in the public interest. It addresses the permanent need to ensure that regulations and regulatory frameworks are justified, of good quality and "fit-for-purpose" (OECD, 2010[2]).

Building on this idea, the OECD developed the 2012 *Recommendation of the Council of the OECD on Regulatory Policy and Governance* (OECD, 2012[3]) (see Box 2.1) to advise governments on how to develop explicit, dynamic, and consistent "whole-of-government" policy to pursue high-quality regulation. The Recommendation suggests countries should "commit at the highest political level to an explicit whole-of-government policy for regulatory quality".

Box 2.1. The 2012 Recommendation of the OECD Council on Regulatory Policy and Governance

The *2012 Recommendation of the OECD Council on Regulatory Policy and Governance* provides governments with clear and timely guidance on the principles, mechanisms and institutions required to improve the design, enforcement and review of their regulatory framework to the highest standards; it advises governments on the effective use of regulation to achieve better social, environmental and economic outcomes; and it calls for a "whole-of-government" approach to regulatory reform, with emphasis on the importance of consultation, co-ordination, communication, and co-operation to address the challenges posed by the inter-connectedness of sectors and economies. The Recommendation advises governments to:

1. Commit at the **highest political level to an explicit whole-of-government policy** for regulatory quality. The policy should have clear objectives and frameworks for implementation to ensure that, if regulation is used, the economic, social and environmental benefits justify the costs, the distributional effects are considered and the net benefits are maximised.
2. Adhere to principles of **open government, including transparency and participation** in the regulatory process to ensure that regulation serves the public interest and is informed by the legitimate needs of those interested in and affected by regulation. This includes providing meaningful opportunities (including online) for the public to contribute to the process of preparing draft regulatory proposals and to the quality of the supporting analysis. Governments should ensure that regulations are comprehensible and clear and that parties can easily understand their rights and obligations.
3. Establish mechanisms and institutions to actively **provide oversight of regulatory policy**, procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality.
4. Integrate **Regulatory Impact Assessment (RIA) into the early stages** of the policy process for the formulation of new regulatory proposals. Clearly identify policy goals, and evaluate if regulation is necessary and how it can be most effective and efficient in achieving those goals. Consider means other than regulation and identify the trade-offs of the different approaches analysed to identify the best approach.
5. Conduct **systematic programme reviews of the stock of significant regulation** against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost justified, cost effective and consistent, and deliver the intended policy objectives.

6. Regularly **publish reports on the performance of regulatory policy** and reform programmes and the public authorities applying the regulations. Such reports should also include information on how regulatory tools such as RIA, public consultation practices and reviews of existing regulations are functioning in practice.
7. Develop a **consistent policy covering the role and functions of regulatory agencies** in order to provide greater confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence.
8. Ensure the **effectiveness of systems for the review of the legality and procedural fairness of** regulations and of decisions made by bodies empowered to issue regulatory sanctions. Ensure that citizens and businesses have access to these systems of review at reasonable cost and receive decisions in a timely manner.
9. As appropriate **apply risk assessment, risk management, and risk communication** strategies to the design and implementation of regulations to ensure that regulation is targeted and effective. Regulators should assess how regulations will be given effect and should design responsive implementation and enforcement strategies.
10. Where appropriate promote regulatory coherence through **co-ordination mechanisms between the supranational, the national and sub-national levels** of government. Identify cross-cutting regulatory issues at all levels of government, to promote coherence between regulatory approaches and avoid duplication or conflict of regulations.
11. Foster the development of regulatory management capacity and performance at sub-national levels of government.
12. In developing regulatory measures, give consideration to all relevant **international standards and frameworks** for co-operation in the same field and, where appropriate, their likely effects on parties outside the jurisdiction.

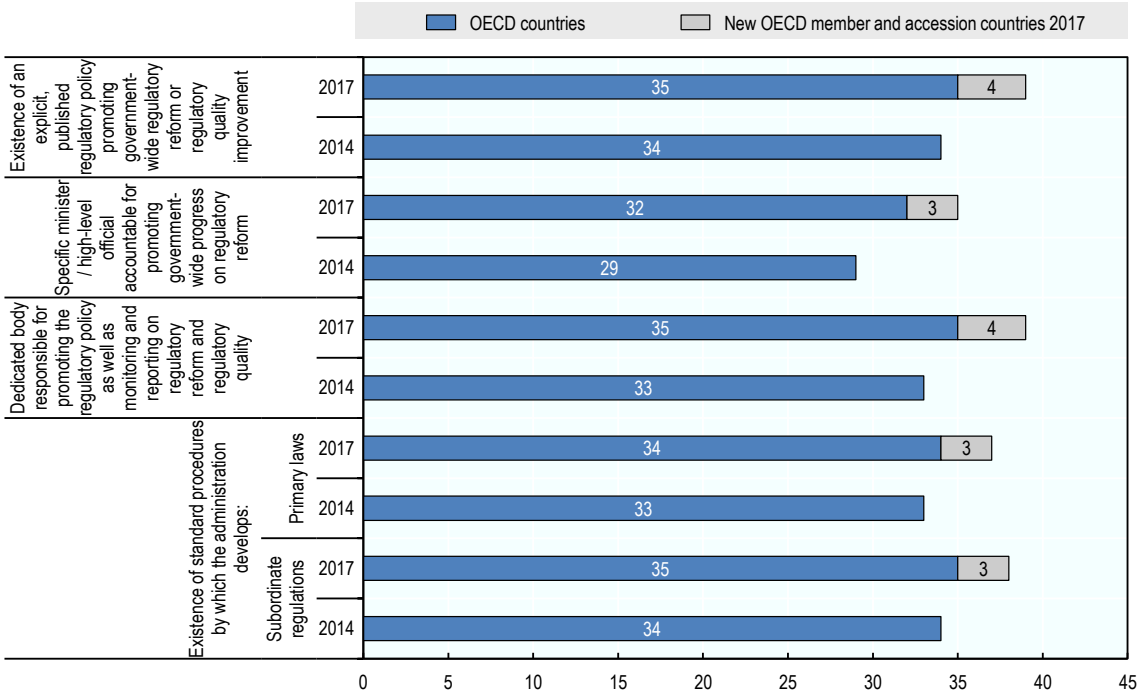
Source: (OECD, 2012[3]), *Recommendation of the Council on Regulatory Policy and Governance*, www.oecd.org/gov/regulatory-policy/2012-recommendation.htm.

An effective regulatory policy is built on three basic components that are mutually reinforcing: it is adopted at the highest political level; contains explicit and measurable regulatory quality standards; and provides for continued regulatory management capacity (OECD, 2002[4]). Most countries have adopted an explicit whole-of-government approach to regulatory policy (see Figure 2.1).

In Croatia, a well-functioning legislative framework for regulatory policy has been introduced, but a whole-of-government approach adopted at the highest political level is still missing.

Implementing a whole-of-government approach for regulatory quality is not an easy task and there is no one-size-fits-all recipe that can be applied to all different country contexts. However, important lessons can be learnt from other countries' experiences with introducing a single policy for regulatory quality at the highest political level (Box 2.2).

Figure 2.1. Adoption of a whole-of-government approach for regulatory quality in OECD countries



Notes: Data for OECD countries is based on the 34 countries that were OECD members in 2014 and the European Union. Data on new OECD member and accession countries in 2017 includes Colombia, Costa Rica, Latvia and Lithuania.
Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, http://oe.cd/ireg.

Box 2.2. Building "whole-of-government" programmes for regulatory quality

Countries considering the introduction of a policy for regulatory quality across the whole of government face the issue of where and how to start the process of embedding regulatory policy as a core element of good governance. An incremental approach has worked in some settings, such as the Netherlands or Denmark, while other countries like the United Kingdom, Australia or Mexico have used a more comprehensive approach.

In **Canada**, the first whole-of-government policy was introduced in 1999 with the *Government of Canada Regulatory Policy*, which was later replaced by the *Cabinet Directive on Streamlining Regulations* in 2007, *Cabinet Directive on Regulatory Management* in 2012 and the *Cabinet Directive on Regulation* in 2018. The latest version of the directive sets out the government's expectations and requirements in the development, management, and review of federal regulations. It outlines four guiding principles for departments and agencies:

1. *Regulations protect and advance the public interest and support good government:* Regulations are justified by a clear rationale in terms of protecting the health, safety, security, social and economic well-being of Canadians, and the environment.
2. *The regulatory process is modern, open, and transparent:* Regulations, and their related activities, are accessible and understandable, and are created, maintained, and reviewed in an open, transparent, and inclusive way that meaningfully engages the public and stakeholders, including Indigenous peoples, early on.

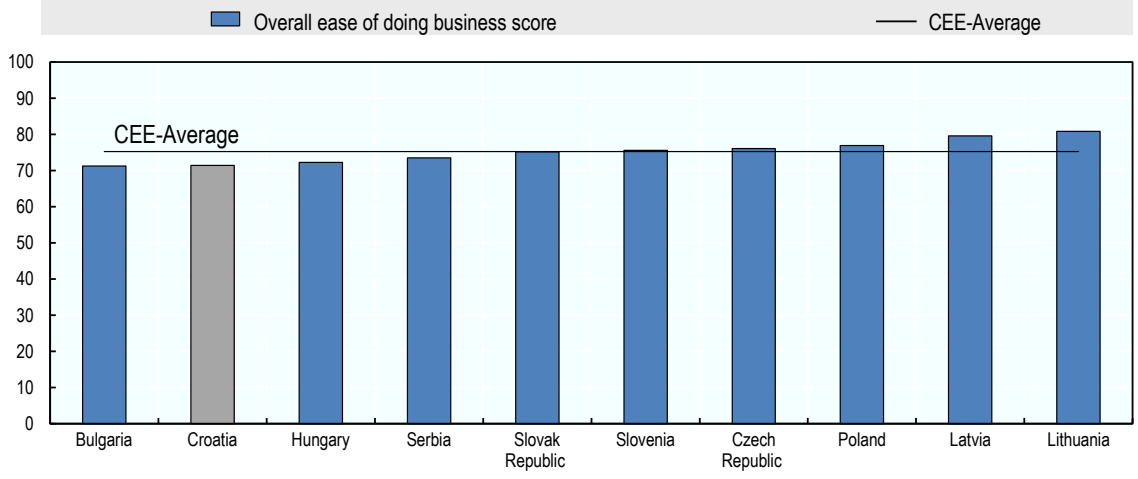
3. *Regulatory decision-making is evidence-based:* Proposals and decisions are based on evidence, robust analysis of costs and benefits, and the assessment of risk, while being open to public scrutiny.
4. *Regulations support a fair and competitive economy:* Regulations should aim to support and promote inclusive economic growth, entrepreneurship, and innovation for the benefit of Canadians and businesses. Opportunities for regulatory co-operation and the development of aligned regulations should be considered and implemented wherever possible.

Source: (OECD, 2010[2]), (Treasury Board of Canada Secretariat, 2018[5]).

History of Better Regulation in Croatia

Croatia has made some progress in strengthening its regulatory policy framework in recent years. In 2017, a new RIA law entered into force, simplifying the procedure and significantly shortening the process of assessing the effects of primary laws. Between 2015 and 2017, Croatia already improved its ranking in the World Bank Ease of Doing Business indicator from 71st to 58th (The World Bank, 2019[6]). However, businesses in Croatia still face high administrative and regulatory burdens and based on the distance-to-frontier metric, the ease of doing business in Croatia is still below regional average (Figure 2.2).

Figure 2.2. World Bank Ease of Doing Business Index for selected CEE-countries by Distance-to-Frontier Metric, 2019



Note: An economy's ease of doing business score is reflected on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance.
Source: (The World Bank, 2019[6]), Ease of Doing Business Ranking & Ease of Doing Business Score 2019, http://www.doingbusiness.org/en/data/doing-business-score.

Croatia has started to introduce countermeasures with the *Action Plan on Administrative Burden Reduction* that aims at creating investment incentives and providing easier market access, simplifying administrative procedures that weigh on firms operating in Croatia. Estimated cost savings due to the Action Plan amount to HRK 625.9 million with a 12% reduction of administrative burdens for businesses (OECD, 2017[7]). The focus of Croatia's better regulation efforts continues to be on administrative burden reduction and the objective is to reduce burdens by 21% by 2021 through the implementation of the Action Plan.

Regulatory impact assessment

Until the early 2000s, the regulatory environment in Croatia was perceived as both relatively high cost and high risk. The public administration had almost no experience with assessing the consequences of its actions on businesses and citizens and there was no clear commitment to a systematic impact review of new legislation to ensure that it met the intended objectives. Impacts of amendments to existing legislation were assessed on an *ad hoc* basis and there was no systematic approach in place.

In 2005, the Croatian government first put a system in place to assess likely impacts of legislation, following an initiative by the Ministry of Finance. At the time, the assessment was limited to impacts on budget, health and environment.

The legal framework for RIA was based on the following legislation:

- Law on Budget (Official Gazette 87/08) Art.5.3.
- Decree on Amendments to the Decree of establishing the Government Legislation Office (GLO) (Official Gazette 140/09)
- Croatian Parliament's Standing Orders (Official Gazette 06/02, 41/02, 91/03, 58/04, 39/08, 86/08) Art.132.1, indented line 2
- Croatian Government's Standing Orders (Official Gazette 107/00, 24/01, 22/05, 68/07, 10/08, 102/09, 107/09, 140/09, 144/09 consolidated text) Article 27(a) and 27(b)
- Decision on the Standard methodology form for fiscal impact assessment (Official Gazette 73/08)
- Decision on the Standard methodology form for environmental impact assessment (Official Gazette 57/07)
- Decision on the Standard methodology form for social impact assessment (Official Gazette 38/07)
- Decree on Abolishing the Government's RIA Coordination Office (Official Gazette 96/09).

At the time, the Croatian government lacked co-ordination and planning capacities necessary to implement a whole-of-government policy for regulatory quality and the high fragmentation of the legal framework for RIA proved to be ineffective. (Malyshev, 2008[8]).

The first attempt to improve the regulatory environment in Croatia followed in 2006 with the regulatory guillotine project HITROREZ (see Box 2.3).

Box 2.3. Regulatory guillotine in Croatia

To improve the regulatory environment in Croatia, a short-term statute law revision (regulatory guillotine) project, known by its Croatian acronym as **HITROREZ**, was launched in 2006. The Government initiative co-founded by USAID and UNDP aimed at counting, reviewing and streamlining business regulations in Croatia.

The regulatory guillotine was conducted in the following phases:

- First, the government asked all ministries and agencies to prepare **inventory lists** of their regulations by a certain date. Each administrative body in co-operation with stakeholders from the private sector prepared a complete list of all regulations with an impact on businesses and citizens and submitted the list to the Special Unit of HITROREZ together with all associated forms. The process was overseen by a central body.
- Then, Government authorities reviewed each business regulation and its associated forms and fees based on standardised criteria and a questionnaire. Each business regulation was assessed with a recommended action: **keep, change or cancel**. Those identified as unnecessary, outdated or illegal were excluded from the list.

The special Unit for HITROREZ reviewed each business regulation taking into account feedback from government authorities and the business community, as well as comments from consultations with other relevant stakeholders. The Unit developed final recommendations and presented it to the government of Croatia. As a result, 27% of business regulations were eliminated and 30% were simplified.

Source: OECD SIGMA (2014), *Review of Policy on RIA and Legislative Drafting Capacities of the Republic of Croatia*; World Bank Group (2010), Better Regulation for Growth (BRG), *Governance frameworks and tools for effective governance reform. Tools and processes to review existing legislation*.

The World Bank (IFC) concluded that HITROREZ led to USD 66 million in annual savings for the Croatian economy (OECD SIGMA, 2014[9]). However, the project was later criticised for merely "cutting dead wood" (removing regulations that are not in force anymore and have no real economic impact) and encouraging ministries to exaggerate the benefits of some regulations. Most importantly, HITROREZ did not prioritise the most burdensome areas of regulation. Nevertheless, the project laid the foundation for a system-wide reform of the RIA process.

With the aim to create a whole-of-government framework for impact assessment co-ordinated from the centre of government, the Croatian government established the *Office for Co-ordination of the RIA system* in 2007. This undertaking was short-lived, as the office lacked government support in terms of funding and administrative capacity. In 2009, the office was closed due to budgetary cuts and austerity measures taken to combat negative externalities of the global financial crisis to the state budget.

The second significant step towards creating a comprehensive RIA framework was undertaken in 2010 by the Government Legislation Office (GLO). The GLO developed a horizontal strategy with the vision to establish an efficient, independent and sustainable RIA system as support for the Government's evidence-based decision-making process. The action steps included developing a new RIA system and methodology, building administrative, technical and financial capacities of GLO and key ministries, fostering knowledge and skills on RIA methodology across government by conducting workshops and pilot studies and communicating the strategy and action plan to relevant government bodies, stakeholders and the public.

An OECD SIGMA project in Croatia in 2014 laid the foundation for the future RIA legislative framework (OECD SIGMA, 2014[9]). The framework was further developed during a twinning project conducted together with the United Kingdom and Estonia. The project also supported the GLO in setting up RIA co-ordination mechanisms by building administrative capacities within the GLO and the relevant government bodies.

In 2012, the RIA legislative framework consisted of:

- RIA Law (in force from 1 January 2012 until 12 May 2018) applied only for primary legislation (laws) proposed by Government
- RIA Regulation (in force from 22 June 2012 until 9 June 2017)
- RIA Strategy 2013-15
- RIA Guidelines were also in force for that period of time as an additional guidance on RIA methodology and process, and have been replaced by the current RIA guidelines as of October 2017.

Three years after the implementation of the 2012 RIA legislative framework, the GLO as the designated co-ordinating body evaluated its effectiveness in the implementation report of the RIA strategy 2013-15. The report assessed the project's success in achieving its objectives and provided an analytical overview of the 2012 RIA system implementation. The report's recommendations as well as best practice examples

from other EU members and the European Commission inspired the new RIA framework drafted by the GLO subsequently. The goal was to simplify the RIA process and further strengthen the GLO's quality oversight role in order to support a better law making process.

Currently, RIA is embedded in the Croatian legislative framework by the following legislation:

- RIA Law (in force as of 13 May 2017) – applies only for primary legislation (laws) proposed by Government
- RIA Regulation (in force as of 10 June 2017)
- RIA Strategy 2018 - 2023 (in force as of 21 December 2017)
- RIA Guidelines, issued by GLO (GLO) in October 2017, as a guidance for implementing RIA methodology and RIA process.[1]

The new RIA law simplified the procedure and significantly shortened the process of assessing the effects of primary laws. However, the general effects of subordinate regulations, which are the biggest source of administrative burden in Croatia, are not assessed. The law was introduced with an "SME friendly approach" – the assessment of the effects of the draft law on small businesses through the SME Test and the administrative cost estimate by using the SCM plays a significant role. Also, the co-operation between the GLO and the MoE on better regulation issues has been institutionalised within the new legislative framework.

The RIA strategy 2018-2023 sets out the vision of a modern legislative framework for the benefit of civil society and businesses, outlining four strategic goals for further enhancement of the RIA process:

- Improve regulatory quality by focusing on a proportional RIA process. The new framework emphasises the importance of identifying draft regulations with significant impacts on businesses and citizens by conducting a simplified RIA. These regulations will then have to undergo a full impact assessment in the second stage. This proportionate approach will ensure that the limited analytical capacities for impact assessment are used efficiently to target the most burdensome regulations.
- Ensure high quality RIAs by conducting regular quality checks of the impact assessments accompanying draft legislation. Periodic evaluations will lead to a gradual increase in the quality of RIAs and therefore of legislative proposals in this period.
- Increase analytical capacity to effectively assess the impact of regulations in government bodies by providing guidance and training to civil servants responsible for conducting the impact assessments. It is also envisaged to provide further training on the MoE's SME-test and the SCM methodology.
- Ensure openness and transparency of the RIA process by releasing RIA documents for consultation with the general public. The new RIA framework complies with laws governing the right of access to information and other regulations and acts concerning public participation in the legislative procedure to ensure that citizens and businesses affected by the regulation can voice their opinion throughout the legislative process.

Transparency, e-government and Better Regulation

The legislative framework for consultations with the general public in the Republic of Croatia is based on the Law on the Right to Access to Information (Official Gazette 25/2013, 85/2015), the RIA Law (Official Gazette 44/2017) and the Code of Practice on Consultation with the public in the process of adopting laws, other regulations and policies (Official Gazette 140/2009).

With adopting the Code, Croatia introduced a set of clear standards and measures for consultations of the public in the process of making new laws and regulations. The code maps out the required duration and publication process of consultations, the regulator's obligation to respond to consultation comments as well as the co-ordination of consultation procedures among the state bodies.

An important step towards improving the legislative framework for consultations with the public was the adoption of the Law on the Right of Access to Information (Official Gazette No. 25/2013) in February 2013. In accordance with art. 11 of the Law, the bodies in charge of drafting laws and regulations with an impact on citizens and businesses are obliged to conduct an online public consultation for a period of 30 days. The government bodies carry out public consultations by making the draft available on the state central website for consultations with the public, along with the reasons for their adoption, as well as the goals that will be achieved by this consultation. Upon the finalisation of the consultation process, the state administration body is obliged to publish the draft report on the consultation conducted including the justification of acceptance or refusal of each recommendation or proposal submitted by the public. The public consultations report has to be attached to the draft proposal of the bill or by-law according to the Rules of Procedure of the Government (Article 30§4) and the Rules of Procedure of the Croatian Parliament (art. 174§4).

In April 2015, the Government Office for the Cooperation with NGOs launched the central consultation portal *e-Savjetovanja*. The portal was a significant step towards ensuring the consultation of the general public in the process of adopting laws, by-laws, strategic plans and other acts. Consolidating all open consultations in one place, the portal facilitates commenting on draft legislation for the public and therefore contributes to an improved participation of citizens and all interested social groups in the process of public policy formation.

In May 2017, the Croatian government adopted the e-Croatia 2020 Strategy, including the Action Plan for its implementation, following an EU-initiative on digital growth. The strategy was developed in line with the Digital Agenda for Europe (DAE) and in co-operation with other ministries, state and public institutions, as well as representatives from businesses and academia. The main objective of the strategy is to ensure more government services can be provided online and citizen's interaction costs with public administration are reduced.

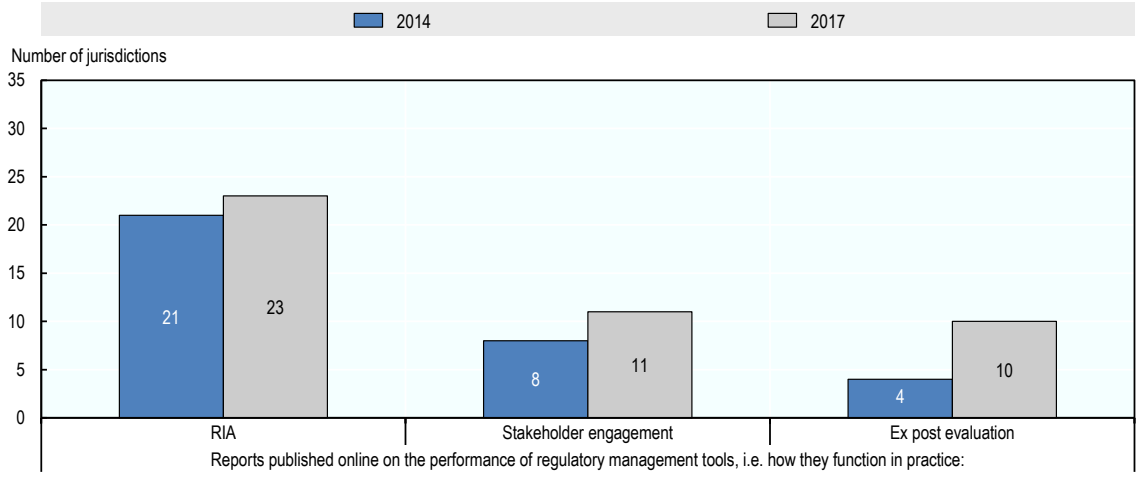
Despite these significant efforts, the Croatian government does not systematically communicate the benefits and costs of regulatory reform to the general public. This rather happens on an ad hoc basis, for example in the scope of the HITROREZ project, where videos and radio shows were used to inform the public on the issue of administrative burdens and regulatory compliance costs. For the RIA legislative framework 2010-12, the GLO organised several public events to communicate the benefits of RIA and the efforts that were undertaken to introduce impact assessments as part of the legislative process. An overarching communication strategy on regulatory reform has not yet been implemented.

Ex post *evaluation of regulatory policy*

Evaluating the performance of regulatory policy tools and reform programmes is necessary to identify if regulatory policy is being implemented effectively and if reforms are having the intended impact. This helps to assess where future investments in efforts to improve the regulatory management system should be focused to foster economic growth and societal welfare (OECD, 2014[10]).

Croatia systematically evaluates the performance of regulatory policy tools like RIA and stakeholder engagement. In Croatia, like in a majority of OECD countries, reports are published online on the performance of the RIA system (see Figure 2.3, left pane). The Government Legislation Office regularly prepares a report on the implementation of the annual plan of normative activities.[2]

Figure 2.3. Reports on the performance of regulatory policy tools



Note: Data is based on 34 OECD member countries and the European Union.
Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, oe.cd/ireg.

Croatia is one of the few countries publishing reports on the performance of its consultation system.[3] The Office for Co-operation with NGOs annually prepares a report on the implementation of consultation with the interested public in the procedures for the adoption of laws, other regulations and acts.

Like many better regulation units in OECD countries, the MoE in Croatia has also tracked the total impact measures to reduce administrative burden. The implementation of the Action Plan for administrative burden reduction[4] led to estimated savings of HRK 625.9 million with a reduction of administrative burdens of 12%. For more information on the Action Plan on administrative burden reduction, see Chapter 6.

The reports contain recommendations for future improvement of the regulatory management system. The 2013-15 evaluation report of the RIA system suggested to provide training on regulatory impact assessment and improve analytical capacities within the GLO. Shortly after, the MoE organised trainings for civil servants on how to assess impacts of regulation on small- and medium-sized businesses.

Croatia also closely monitors the World Bank's "Doing Business" indicators (last mentioned in the Croatian Chamber of Commerce 2019 business climate report). These indicators are used as a benchmark with the aim to improve business conditions in Croatia. In the last years, several measures have been undertaken to improve Croatia's business environment and in particular to reduce burdens for businesses, for example by introducing the SME-test. While using indicators developed by international organisations can be helpful to identify priority areas for reform, real-life effects of certain measures that help improve the country's indicator score can be limited (for example, shortening the time needed to register a business by a couple of hours). It is therefore essential to formulate specific reform goals outlining the benefits for society and then evaluate their achievement.

Assessment and recommendations

Croatia has introduced a set of useful and important reforms to strengthen regulatory policy and made a great effort bundling the fragmented legislative framework. The recently introduced RIA law and the law on access to information set out requirements to conduct impact assessments and public consultations. Accompanying guidance documents have been provided to regulators to help them implement practices as set out in the *OECD 2012 Recommendation on Regulatory Policy and Governance*. The initially highly fragmented legal set-up was consolidated over time. The performance of regulatory policy tools and reform

programmes is evaluated regularly and the government's annual evaluation reports contain recommendations for improvement of the regulatory management system.

While this important regulatory framework has been set up, an overall policy for better regulation is still missing. There is currently no single whole-of-government regulatory policy in place in Croatia and the legislative framework is still fragmented. The lack of a formal and uniform regulatory policy at the centre of government has resulted in ministries and other administrative bodies pursuing their own regulatory reform initiatives in isolation. In addition, implementation of regulatory policy remains a challenge. In practice, tools like RIA are often completed as a box-ticking exercise and a partial lack of oversight over the quality of the process continues to hamper better regulation efforts. The Government of Croatia should go beyond current reforms to further implement better regulation across the whole of government.

The objectives and results of Better Regulation are not systematically communicated to the general public. Rather, the benefits and costs of regulatory reform are communicated on an ad hoc basis. This is due to the lack of a common strategy and coherent action plan, and limits the capacity to gather support and buy-in for reforms across the administration, in parliament and from the general public.

The momentum of regulatory reform should be used to renew the political support for regulatory policy. The Government of Croatia should relaunch Better Regulation to bring evidence-based policy back into focus in Croatia. Maintained political support from both the administration and the political arm is crucial for restarting the process of Better Regulation. In a first step, this political support could be expressed by adopting a whole-of-government policy instrument on regulatory quality. Generating buy-in from stakeholders external to government can help increase the demand for quality regulatory management tools and secure political commitment. Citizens and businesses engaged in the process can provide the information and opinions that the government needs to truly improve policy.

The Croatian government should introduce an explicit and binding whole-of-government policy instrument on regulatory quality with identified objectives and a clear communication strategy. This strategic instrument could take the form of a law or government resolution that would bring together the provisions on better regulation that are currently spelled out in different laws and resolutions. It should have frameworks for implementation to ensure that, if regulation is used, the economic, social and environmental benefits justify the costs, the distributional effects are considered and the net benefits are maximised (OECD, 2012[3]). This framework could be realised as a high-level strategic plan outlining the specific responsibilities for different actors in the regulatory process and ensure co-ordination between the various institutions such as the Government Legislation Office, the Ministry of the Economy and the Office for Co-operation with NGOs. The strategy could also include a renewed political commitment from the centre of government (e.g. Cabinet) and have a clear communication strategy to help engage the public in the scrutiny of the regulatory process. The realisation of this policy should be supported through a high-level institutional body to oversee the implementation and co-ordination of regulatory policy in Croatia.

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Treasury Board of Canada Secretariat (2018), *Cabinet Directive on Regulation*, https://www.canada.ca/en/treasury-board-secretariat/services/federal-regulatory-management/guidelines-tools/cabinet-directive-regulation.html (accessed on 16 January 2019). [5]

Notes

[1] The current official guidance is based on a RIA guidelines developed under a twinning project (IPA 2012 Strengthening capacity for implementation of RIA Strategy 2013-2015). The results of this project are available online: https://zakonodavstvo.gov.hr/istaknute-teme/ipa-2011-twl-jacanje-kapaciteta-za-provedbu-strategije-procjene-ucinaka-propisa-2013-2015/377.

[2] For the 2016 report, see https://zakonodavstvo.gov.hr/UserDocsImages//dokumenti//170517%20UZVRH%20Izvjesce%20GPNA2016%20final%202.0.pdf and for the 2013-2015 report, see https://zakonodavstvo.gov.hr/UserDocsImages//dokumenti//160721UZVRH%20Izvjesce%20SPUP%202013-2015%205.1.pdf.

[3] For the 2017 report, see https://udruge.gov.hr/UserDocsImages/dokumenti/Izvje%C5%A1%C4%87e%20o%20provedbi%20savjetovanja%202017%20-%20usvojeno.pdf.

[4] Evaluation report of the Action Plan for administrative burden reduction: https://vlada.gov.hr/UserDocsImages/Sjednice/2018/03%20o%C5%BEujak/84%20sjednica%20VRH/84%20-%206.pdf.

3 Institutional framework and capacities for regulatory policy

This chapter examines the institutional framework for regulatory policy in Croatia. Regulatory management needs to find its place in a country's institutional architecture, and capacities for promoting and implementing Better Regulation need to be built up.

Key institutions and regulatory policy oversight of the regulatory process in Croatia

The institutional set-up of regulatory policy matters. Regulatory management needs to find its place in a country's institutional architecture and have support from all the relevant institutions. The institutional framework extends well beyond the executive centre of government, although this is the main starting point. The legislature and the judiciary, regulatory agencies and the sub-national levels of government also play critical roles in the development, implementation and enforcement of policies and regulations.

The *2012 OECD Recommendation on Regulatory Policy and Governance* (OECD, 2012[1]) advises governments to "establish mechanisms and institutions to actively provide oversight of regulatory policy procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality."

Oversight is a critical aspect of regulatory policy. Without proper oversight, undue political influence or a lack of evidence-based reasoning can undermine the ultimate objectives of policy. Careful, thoughtful analysis of policy and an external check of policy development are required to ensure that governments meet their objectives and provide the greatest benefits at the lowest costs to citizens (see Box 3.1).

Box 3.1. Main features of oversight bodies to promote regulatory quality

According to the 2012 OECD Recommendation of the Council on Regulatory Policy and Governance, oversight of regulatory procedures and goals should be promoted through:

A **standing body charged with regulatory oversight** should be established **close to the centre of government**, to ensure that regulation serves whole-of-government policy.

The specific institutional solution must be adapted to each system of governance. The authority of the regulatory oversight body should be set forth in mandate, such as statute or executive order. In the performance of its technical functions of assessing and advising on the quality of impact assessments, the oversight body should be independent from political influence.

The regulatory oversight body should be tasked with a variety of functions or tasks in order to promote high-quality evidence-based decision making. These tasks should include:

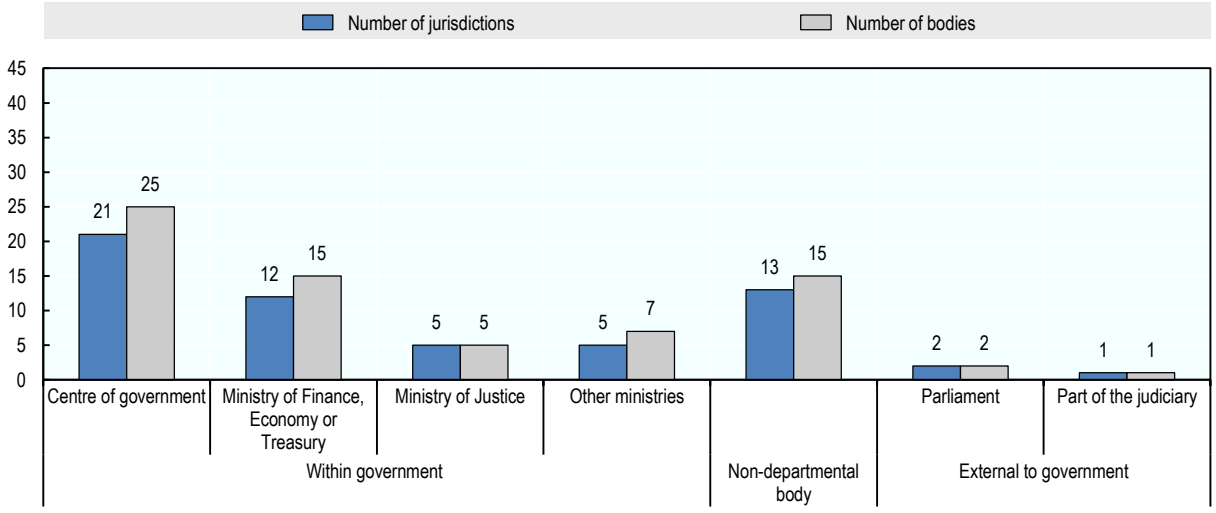
- Quality control through the review of the quality of impact assessments and returning proposed rules for which impact assessments are inadequate
- Examining the potential for regulation to be more effective including promoting the consideration of regulatory measures in areas of policy where regulation is likely to be necessary
- Contributing to the systematic improvement of the application of regulatory policy
- Co-ordinating *ex post* evaluation for policy revision and for refinement of *ex ante* methods
- Providing training and guidance on impact assessment and strategies for improving regulatory performance. The performance of the oversight body, including its review of impact assessments should be periodically assessed.

Source: (OECD, 2012[1]), *Recommendation of the Council on Regulatory Policy and Governance*, www.oecd.org/governance/regulatory-policy/2012-recommendation.htm.

Croatia does not have a single institution in charge of regulatory quality and an accompanying specific regulatory oversight role. The responsibility for regulatory management tools and policies is spread across ministries, divided between the Government Legislation Office, the Ministry of Economy, Entrepreneurship and Crafts, the Government Office for Co-operation with NGOs and the Information Commissioner.

In a majority of OECD countries, bodies with regulatory oversight functions responsible for the quality control of regulatory management tools (RIA, stakeholder engagement, *ex post* evaluation) are located at the centre of government (see Figure 3.1).

Figure 3.1. Location of bodies responsible for quality control of regulatory management tools



Notes: This figure is based on information available for 161 bodies reported in the survey from all OECD countries, as well as Colombia, Costa Rica, Lithuania and the European Union. Data presents the number of jurisdictions with at least one body in a particular location.
Source: Survey questions on regulatory oversight bodies, Indicators of Regulatory Policy and Governance Survey 2017, http://oe.cd/ireg.

Government Legislation Office

The Government Legislation Office (GLO), located at the centre of government, is the central body co-ordinating the RIA process and promoting the application of RIA across government. Its primary function is the general oversight of law quality and of use of impact assessment when preparing legislation. The GLO reviews all preliminary assessments and full RIA reports, provides advice and issues a formal opinion on the quality of the RIA. The GLO does not have the power to stop a regulation from going forward if concerns with the analysis and evidence provided are not addressed, however it can request to postpone the regulation. In practice, administrators usually follow the GLO's requests for improvement of RIA quality. As a government expert service, the GLO is responsible for ensuring the legal quality of regulations and for co-ordinating the drafting of the annual Legislative Activity Plan of the Government of the Republic of Croatia.

Ministry of Economy, Entrepreneurship and Crafts

All subordinate regulations, which in practice are the main source of administrative burdens in Croatia, have to undergo an SME-test under the authority and the supervision of the Ministry of Economy. This means that central administrative bodies have to assess the impacts of their subordinate regulations on SMEs and obtain the opinion of the Ministry of Economy, which performs its supervisory function through its Business Environment Improving Service. The ministry also co-ordinates the "Action Plan for Administrative Burden Reduction" and provides guidance and training to civil servants on the SME-test and the Standard Cost Model.

Government Office for Co-operation with NGOs

The Government Office for Co-operation with NGOs co-ordinates the central consultation portal *e-Savjetovanja* and provides trainings to civil servants on the use of the portal together with the Information Commissioner. The Office also provides trainings to civil servants on preparing and conducting consultations on with the general public in the process of adopting laws, regulations and other acts.

Information Commissioner and his/her Office (OIC)

The Information Commissioner protects, monitors and promotes the right of access to information and reuse of the information provided by the Constitution of the Republic of Croatia and the Law on the Right to Access to Information. He/she is elected by the Parliament for a term of five years with the possibility of re-election.

The Commissioner and his/her office, as an independent body, oversee compliance with art. 11 of the Law on the Right to Access to Information (which requires public consultation to be conducted for all draft legal texts), act upon complaints of the public if the law was not respected and report on the implementation of the law to the Croatian parliament.

The OIC provides consultation guidelines to the bodies that are responsible for drafting laws and other acts and controls whether a report on the consultation process was produced and published on the e-consultation portal. The Office also conducts regular inspections of administration authorities on the implementation of the Law on the Right of Access to Information, which focus, inter alia, on individual public consultations and consultation plans of individual ministries.

Ministry of Finance

Line ministries are required to consult and obtain the opinion of the Ministry of Finance for all regulatory proposals. All government materials, submitted to the government, must include an assessment of the financial implications for the budget, reflecting whether the proposed regulation increases or reduces the revenues or expenditures of the budget.

The Ministry of Foreign Affairs and European Affairs

The Ministry of Foreign Affairs and European Affairs (MFEA) is the national body responsible for the transposition and implementation of the EU *Acquis*. All draft legislation has to be examined by the MFEA for compliance with EU regulations. It monitors and manages a database on transposition of EU *directives* and co-ordinates drafting of the Annual Government Program on implementation and transposition of the EU Acquis into Croatian legislative. The MFEA prepares weekly reports on the implementation of the EU *Acquis* and presents them to the permanent working bodies of the Government. MFEA also, as central contact point, officially notifies the EC on all the measures transposing Directives into Croatian legislation via the electronic EC database.

Ministry of Justice

All draft regulation prescribing misdemeanor provisions has to be submitted for opinion to the Ministry of Justice. The Ministry initiated the “eBulletin board and court networking” project in 2014, which established a single intranet and Internet network for judicial bodies, facilitating information exchange within the judiciary. The bulletin board is a free and public service that allows search of court decisions and other information published by all courts in the Republic of Croatia.

Ministry of Administration

If a draft regulation relates to administrative proceedings, the regulation is submitted to the Ministry of Administration for scrutiny.

Other institutions

Parliament

In accordance with the Standing Orders of the Croatian Parliament (Official Gazette 81/2013, 113/2016, 69/2017, 29/2018), laws are enacted under regular or urgent procedure. Regular procedure implies two readings in parliament while urgent procedure means that only one reading will take place. Legislation is usually passed through two readings in the Parliament.

In order to improve the quality of regulations, Article 174 of the Standing Orders stipulates that draft laws must contain:

- the constitutional grounds for the enactment of the law
- an assessment of the status and fundamental issues to be regulated by the law and the consequences that will follow from the enacted law
- an assessment and sources of necessary funds to implement the law
- the text of the draft law, with explanation
- the text of the provisions of the existing law being amended or supplemented, if it is a matter of amending a law
- a report on the conducted consultations with the interested public
- a statement on the regulatory impact assessment in line with a special regulation.

If a draft law does not contain the required elements, the Speaker of Parliament requests the adjustment of the draft act within a given period of time. In case the missing elements are not submitted 15 days after the request to do so, the draft law is not considered.

With the amendment of the Standing Orders in 2013 public consultations have been introduced to the parliamentary procedure. Consultations with the general public on bills introduced by Members of Parliament,[1] working bodies of Parliament and political groups are conducted regularly through the central consultation portal.

Also, in accordance with the Act on the Co-operation of the Croatian Parliament and the Government of the Republic of Croatia in European Affairs, the parliamentary Committee on European Affairs is authorised to order the government to assess the impacts of the EU directive to be transposed.

The Standing Orders also stipulate that, when a regulatory proposal is initiated, the Parliament may set up working bodies to discuss the necessity and potential impacts of the draft regulation. The positions, opinions and proposals developed in this working body are then submitted to the sponsor of the regulation, who is obliged to take them into account.

State Audit Office

The State Audit Office comments on draft legislation that relates to matters of budget and audit and participates in working bodies responsible for drafting the legislation. If the Office identifies the need to regulate a certain area involving financial matters, it can order certain types of provisions to be adopted.

Judiciary

The Constitutional Court determines the legality and constitutionality of laws and regulations. The Constitutional Act on the Constitutional Court of the Republic of Croatia (*Official Gazette* 99/99, 29/02, 49/02) stipulates that the Court may abrogate laws that do not conform to the Constitution. Until a final decision is made, the Constitutional Court may also suspend the implementation of challenged regulations if their execution could result in serious and irreparable consequences.

As set out in Articles 83 – 88 of the Administrative Disputes Act (*Official Gazette* 20/10, 143/12, 152/14, 94/16, 29/17), the High Administrative Court assesses the legality of all other general acts (acts adopted by local and regional governments, legal persons with public authority and legal entities performing a public service). If the Court deems part of a regulation unconstitutional, it initiates a review of the regulation's constitutionality and may suspend the execution of the disputed general act.

After the final decision of the administrative authority, the individual always has the right to judicial protection by bringing the case to the Administrative Court in accordance with the Administrative Disputes Act.

Local governments

Croatia has three levels of government: central, regional and local level. The powers of the governments are laid out in the Croatian constitution, which includes the constitutionally guaranteed rights and limits to local and regional self-government.

According to the Constitution, local and regional self-government units adopt general acts and regulations in all areas falling within their self-government scope as defined by law. They are responsible for the provision of services in all areas included in their self-government scope, as well as services in other areas when authorised by special regulations. For example, counties are responsible for secondary education, health care (including hospitals), housing and community planning, economic development, traffic and transport infrastructure, waste management, waste water, and social services (OECD, 2016[2]).

Ultimately, local governments are responsible for the quality of the regulations they adopt. The national government supervises the regulations and acts for the purpose of ensuring constitutionality, but it does not monitor their quality. The final quality check of local government regulations can only be conducted by the High Administrative Court of the Republic of Croatia through the review procedure to their general acts. For further information, see Chapter 8.

National Competitiveness Council (NCC)

The National Competitiveness Council was established in 2002 at the initiative of the Croatian business society and the Croatian Employers' Association based on a Government decision. The Council is an independent advisory body comprised of 24 members and four key interest groups – the business sector, government, trade unions, and the academic community – with the goal of creating dialogue, partnership and consensus on programs and policies that are critical to sustainable growth and development of the country. To achieve these objectives, the Council encourages policies for reform, recommends and creates guidelines for development policies, encourages dialogue between public and private sectors and monitors and evaluates reforms that have been implemented (OECD, forthcoming[3]).

Co-ordination of the Better Regulation policy across government

The Rules of Procedure of the Government of the Republic of Croatia provide for all proposals of laws, Government resolutions and other legal texts that are submitted to the Government to be consulted with ministries, government agencies, and other institutions and bodies within their respective competencies.

With respect to Better Regulation policies, no formal inter-ministerial co-ordination mechanism has been established, whether at the political or administrative level. This reflects the lack of a global approach to regulatory policy. Currently, the vice prime minister organises inter-ministerial exchanges.

Inter-ministerial co-ordination during the development of regulations

Central government bodies (ministries, central government offices and state administrative organisations) usually organise working groups for drafting laws and regulations. These working groups consist of civil servants from government bodies responsible for draft laws, but also civil servants from other bodies. External experts can be involved as well as representatives of the Government Legislation Office (GLO).

A public consultation is conducted on the draft regulation and the draft is revised accordingly. The regulation is then submitted for opinion to other central government bodies depending on the issue being regulated. It is mandatory to gather opinions from the Ministry of Foreign Affairs and European Affairs, the Ministry of Finance and the GLO. The Ministry of Foreign Affairs and European Affairs determines the compliance of regulations with EU regulations. The Ministry of Finance determines the financial effect of regulations. The GLO provides an opinion on the compliance of regulations with the constitution and the legal order of the Republic of Croatia, while respecting the legal system of the European Union. If a regulation relates to administrative proceedings, the regulation is submitted to the opinion of the Ministry of Administration. If the regulation prescribes misdemeanor provisions, it is submitted for opinion to the Ministry of Justice. For the purpose of carrying out a test on the impacts of the regulation on small and medium-sized enterprises, the regulation is submitted to the Ministry of Economy, Entrepreneurship and Crafts.

Once the relevant ministries have stated their opinion on the draft proposal, the regulation is referred to the permanent working bodies of the Government for scrutiny. As laid out in *Art. 9 of the Rules of Procedure of the Government of the Republic of Croatia,* the government has 5 permanent working bodies with different areas of expertise: Coordination for Foreign and European Policies and Human Rights; Coordination for Homeland Security and War Veterans; Coordination for Economy and Structural Reforms; Coordination for Sectoral Policies and Coordination for State Property Management. The working bodies are responsible for checking compliance of legislative drafts with the Constitution and the legal system of the Republic of Croatia and the European Union. If the state administration body responsible for the draft regulation does not accept another bodies' opinion, the reasons have to be explained and an agreement between the bodies has to be found.

The draft regulation is then sent to the government, which adopts regulations and other acts, and passes laws to the parliament for adoption. All subordinate regulations have to undergo the SME-test conducted by the MoE, to assess the burdens imposed by the draft regulation on small- and medium-sized enterprises (Ordinance OG 43/17). This means that all central administrative bodies have to assess the impacts of their draft regulations on SMEs and send their assessment to the MoE for their review via the Independent Business Environment Improving Service.

Box 3.2. Inter-ministerial co-ordination in Germany

In **Germany**, the preparation of bills is mainly the prerogative of the line ministries (*Ressortprinzip*). Before a draft bill is submitted to the Federal Government for adoption, the lead ministry must involve other federal ministries and offices affected by the bill as well as the German body responsible for regulatory oversight, the National Regulatory Control Council, and the Federal Commissioner for Efficiency in Public Administration, at an early stage.

The Chancellery takes on an active role in the inter-ministerial co-ordination during the legislative process. The co-ordinator of the Federal government on Better Regulation (Minister of State to the Chancellor) has to be consulted and gives his opinion on each draft according to Section 21 of the joint rules of procedure (GGO). The Better Regulation Unit (BRU) is the responsible working unit, fulfilling this function on behalf of the Minister of State.

The work of the Federal government is based on the **principle of consensus**: If there are differences of opinion between the main federal ministries involved or between the ministries and the chancellery, "extensive or expensive preparations should not be started or instigated (…)" before the cabinet has agreed on the matter. This also means that ministries will likely address and resolve issues with the quality of the RIA accompanying the legislative draft.

When transmitting the Ministry draft, steps must be taken to ensure that those involved have sufficient time to examine and debate questions falling within their competence. The lead Federal Ministry is responsible for involving all parties, ensuring sufficient time for debate.

Source: (Federal Government of the Republic of Germany, 2011[4]), Indicators of Regulatory Policy and Governance Survey 2017, http://oe.cd/ireg.

Resources, training and guidance

Continuous training and capacity building within government, supported by adequate financial resources, contributes to the effective application of Better Regulation. Beyond the technical need for training in certain processes such as impact assessment or plain drafting, training communicates the message to administrators that this is an important issue, recognised as such by the administrative and political hierarchy. It can be seen as a measure of the political commitment to Better Regulation. It also fosters a sense of ownership for reform initiatives, and enhances co-ordination and regulatory coherence.

Resources

A small number of officials work directly on regulatory policy, as part of a unit dedicated to regulatory management issues in the Government Legislation Office, the Ministry of Economy and the Office for the Co-operation with NGOs. There are no RIA units in ministries and preliminary RIA is conducted by non-economists and untrained staff. However, there is a network of RIA co-ordinators in each line ministry.

Indirectly, a larger number of civil servants works on regulatory policy issues as part of their portfolio.

Training and guidance

The Government Legislation Office provides a "Public Policy" training programme to civil servants in the State School for Public Administration. In the scope of the programme, workshops are organised at beginner- and advanced levels to train civil servants on the principles for drafting regulations in accordance with the *Uniform Methodological-Nomotechnical Rules for Drafting the Acts* issued by the Croatian Parliament. From January 2017 to June 2018, 313 civil servants attended this training at the national and local level. In addition, workshops on the new legal framework for assessing the impacts of regulations have been conducted for a total of 70 civil servants.

The Ministry of Economy provides guidance and training to civil servants on the SME-test and the Standard Cost Model. In 2018, over 200 civil servants were trained on how to assess correctly the impacts of draft legislation on SMEs.

In the scope of the two twinning projects with the United Kingdom and Estonia, a set of workshops on RIA methodology have been conducted. These workshops provided training to civil servants on the basics of RIA methodology (identifying of issues, setting objectives, identifying potential policy solutions incl. alternatives to regulation, and assessing impacts to businesses and citizens). Approximately 400 civil servants participated in the trainings. In addition, a "train the trainers" seminar had been organised for 20 civil servants with the intention to make a good practice of impact assessments in ministries more sustainable.

Guidance on how to conduct impact assessments for all draft laws has been issued by the Government Legislation Office and last updated in 2017. The guidance document includes technical guidance on cost-benefit analysis, cost effectiveness analysis, and milestones for monitoring and evaluating a legislative proposal.

The Government Office for Co-operation with NGOs conducted a training programme for consultation co-ordinators within state bodies and government offices during the EU-funded IPA 2009 project. In accordance with the *Code of Practice on Consultation with the Public* in the process of adopting laws, other regulations and policies, consultation co-ordinators were appointed as permanent contact points for both public stakeholders and the body drafting the legislation. Corresponding guidelines were published in 2010.

The Government Office for Cooperation with NGOs and the Information Commissioner also provide trainings to civil servants on preparing and conducting consultations with the general public and the use of the central consultation portal *e-Savjetovanja* through the State School for Public Administration. The number of officials trained is approximately 150 annually.

The Information Commissioner provides online webinars on public consultations to approximately 50 civil servants per year on national level and to 150 civil servants on the local level.

In co-operation with the Government Office for Co-operation with NGOs, the Information Commissioner prepared and published a handbook on public consultation on the local level as well as a leaflet for citizens explaining why and how they should participate in the policy making process. Detailed guidelines for the implementation of art. 11 of the Law on Access to Information has been distributed to all public bodies that have the relevant obligations.

A number of guiding documents have been issued on law drafting, administrative simplification and drafting instruments for the alignment of the legislation of the Republic of Croatia with the *acquis* (OG 44/2017 Annexes I, II and III).

Assessment and recommendations

Within the Croatian government, the competencies for supporting regulatory quality are distributed between several key ministries and institutions. The Government Legislation Office has responsibility for the general overview of law quality and use of impact assessment when preparing legislation and prepares the Annual Legislative Activities Plan. The Ministry of Economy, Entrepreneurship and Crafts leads the administrative burden reduction programme and reviews burdens for businesses stemming from regulation. Other key actors include the Information Commissioner, the Government Office for Co-operation with NGOs, the Ministry of Finance and the Ministry of Foreign Affairs and European Affairs. Overall, there is a small network of officials who work on the development of regulatory management policies and tools and there is room for improvement in terms of co-ordination and coherence of such efforts.

While the current institutional framework is well set up, stronger political support and leadership from the centre is required to move forward. A clear mandate consolidating Better Regulation and oversight responsibilities at the core of government would help promoting and implementing regulatory management

policies through effective monitoring. Currently, the GLO can review the quality of regulatory management tools (impact assessments, consultations as part of RIA) for primary laws. It is however not doing so for subordinate regulations due to its role as a government expert service. Oversight responsibilities are shared with the Ministry of Economy, which reviews impact assessments for subordinate regulations on SMEs; and the Information Commissioner, which oversees consultation processes. Consolidating at least some of these powers in one unit close to the centre of government specifically in charge of regulatory management could improve co-ordination between existing ministries and agencies and would help ensure that regulatory quality principles are successfully applied.

A lack of analytical capacities for regulatory quality in GLO and line ministries compromises the quality of regulatory management tools. Currently, few civil servants work directly on regulatory policy issues and a majority of employees does not have an economic background, including those in the GLO who oversee RIA for primary legislation. Units in charge of regulatory oversight would require sufficient analytical capacities and staff with diverse educational backgrounds, in particular public policy specialists and/or economists. Like many other administrations, the public sector in Croatia faces budgetary restrictions that hamper its ability to provide conditions that attract qualified staff and keep them long-term. Efforts to invest in training of existing staff proved partly ineffective because of the high employee turnover. In addition, ministries rely on the State School for Public Administration to provide training and guidance, as they do not have sufficient skilled staff internally to act as contact points.

Croatia could consider establishing a high-level conference to facilitate inter-ministerial co-ordination. While there is already good horizontal co-ordination between ministries at an operational and higher level in place, involvement of other line ministries in the working groups happens on a voluntary basis and no body has the vertical authority to facilitate inter-ministerial co-ordination. Increased horizontal co-ordination and co-operation across the administration would allow for a whole-of-government approach to regulatory policy to help identify strategic priorities for Better Regulation and solve potential conflicts early on. This body should include ministers or deputy ministers from line ministries and could take the form of a ministerial steering committee led by the vice prime minister meeting bi-annually to discuss legislative proposals.

Promoting regulatory oversight to strengthen quality control of both primary and secondary legislation will be necessary. Currently, responsibilities for quality checks of regulatory management tools are shared between different bodies and the quality of regulatory policy tools for subordinate regulations is reviewed only concerning administrative burdens to businesses with the SME-test. The MoE could consider extending the scope of its scrutiny to other regulatory costs to address the substantial burdens stemming from secondary legislation. A strengthened inter-ministerial process would give ministries the opportunity to comment on impacts of secondary legislation. Generally, extending the scope of activities of the MoE would require a clearer definition of responsibilities between the different oversight bodies to ensure mutual understanding of the respective roles. Alternatively, it could be envisaged to move regulatory oversight functions to the GLO to consolidate oversight functions in one body at the centre of government. The GLO would conduct quality control of regulatory management tools for both primary laws and subordinate regulations. As the central oversight body it could serve as an advocate for regulatory reform, as a co-ordinator, as expert and as a source of practical and technical support for the use of regulatory tools.

To promote analytical capacity, analytical centres with "RIA champions" should be created in key ministries. These centres could combat the lack of analytical capacity in ministries and therefore improve problematic quality of regulatory management tools. They would act as "knowledge centres" staff from other ministries could turn to for guidance on regulatory policy tools. The champions would receive special training on regulatory impact assessment and could share experiences in overcoming challenges through bi-annual or quarterly meetings. An alternative or complementary strategy to support analytical capacities could be to consult external analysts. It is crucial that these external consultants work hand in hand with the ministry and that their analysis informs the processes and not vice versa.

There is a need to further invest in training of already employed staff and to hire additional staff, in particular public policy specialists and/or economists. Croatia already invests in staff trainings, e.g. on the SCM and SME-test, but a high employee turnover means some of these efforts are lost. Targeted training of GLO staff, which in turn would provide training and guidance to line ministries, could help establish a more change-resilient knowledge infrastructure. In addition, there is a need for in-depth trainings on methods of cost benefit analysis. However, further training could potentially be expensive and resource intensive. A more cost efficient solution could be the MoE helping ministries who already implement good regulatory policy practices to share their experiences with other ministries, encouraging good practice across government. The MoE could also provide easy access to publically available tools from other countries and, if necessary, could have them translated. Furthermore, Croatia could take advantage of examples, guides, and trainings that are available publically from other countries. For example, it could be envisaged to provide a "Better Regulation toolbox" in the form of short practical guidance to staff responsible for conducting RIA, following the example of the European Commission.

References

Federal Government of the Republic of Germany (2011), *Gemeinsame Geschäftsordnung der Bundesministerien*, http://www.verwaltung-innovativ.de (accessed on 20 March 2019). [4]

OECD (2016), *Regional policy: Croatia country profile*, https://www.oecd.org/regional/regional-policy/profile-Croatia.pdf (accessed on 29 January 2019). [2]

OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*, OECD, http://www.oecd.org/gov/regulatory-policy/2012-recommendation.htm (accessed on 7 November 2018). [1]

OECD (forthcoming), *Croatia: Review for Adherence to the OECD Declaration on International Investment and Multinational Enterprises. Draft Investment Policy Review Report*. [3]

Note

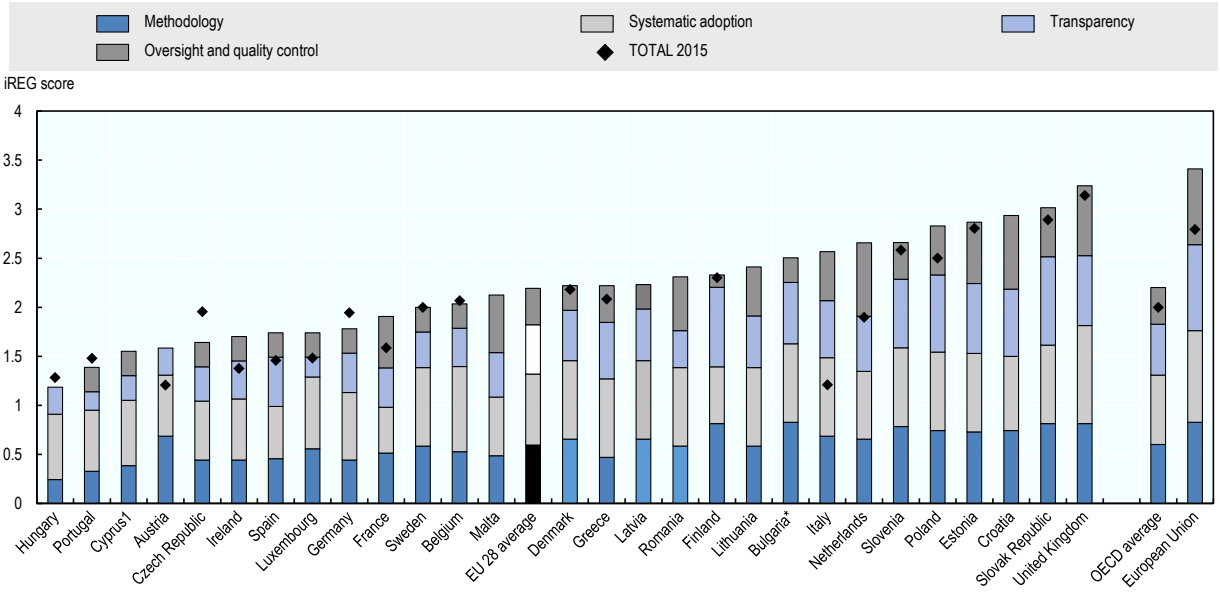
[1] Nine per cent of all primary laws in Croatia are initiated by the legislative, see OECD (2019), *Better Regulation Practices across the European Union*, https://doi.org/10.1787/9789264311732-en.

4 Stakeholder engagement and public consultations

Chapter 4 sheds light on the processes in place for consultation and dialogue with affected stakeholders and the general public and to what extent the outcomes can influence policy makers. It describes and evaluates the regulatory and institutional framework for stakeholder engagement, the practices in place for e-consultations, and the role of stakeholder engagement in *ex ante* and *ex post* regulatory impact assessment. In doing so, the chapter assesses the level of transparency of the legislative process in Croatia, which is one of the central pillars for effective regulation.

Croatia has a well-developed framework for public consultations at the central state administration level focusing mostly on web-based consultations in the later stage of the regulation-making process, with some important elements of early-based consultations, which could be developed further. As illustrated in Figure 4.1, Figure 4.2 and Figure 4.3, Croatia scores relatively high with regards to stakeholder engagement in developing both primary and secondary regulations in comparison to most of the OECD countries.

Figure 4.1. Stakeholder engagement in developing primary laws, 2018



Notes: Data for 2015 is based on the 34 countries that were OECD members in 2014 and the European Union, which included 21 of the current 28 EU Member States. The OECD average is based on the 34 member countries at the time of the survey. Data for 2018 includes the remaining EU Member States of Bulgaria, Croatia, Cyprus,[1] Malta and Romania. The more regulatory practices as advocated in the 2012 Recommendation (OECD, 2012[11]) a country has implemented, the higher its iREG score. * In the majority of EU Member States, most primary laws are initiated by the executive, except for Bulgaria, where a higher share of primary laws are initiated by the legislature.

1. Note by Turkey:

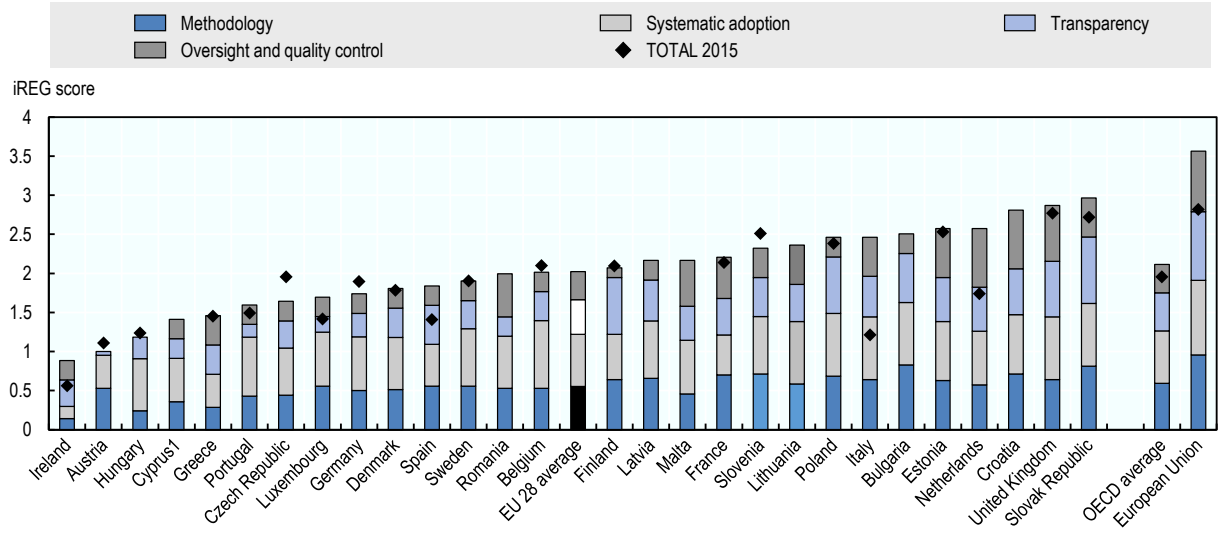
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

Note by all the European Union Member States of the OECD and the European Union:

The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, http://oe.cd/ireg.

Figure 4.2. Stakeholder engagement in developing subordinate regulation, 2018



Notes: Data for 2015 is based on the 34 countries that were OECD members in 2014 and the European Union, which included 21 of the current 28 EU Member States. The OECD average is based on the 34 member countries at the time of the survey. Data for 2018 includes the remaining EU Member States of Bulgaria, Croatia, Cyprus,[1] Malta and Romania. The more regulatory practices as advocated in the 2012 Recommendation (OECD, 2012[1]) a country has implemented, the higher its iREG score.

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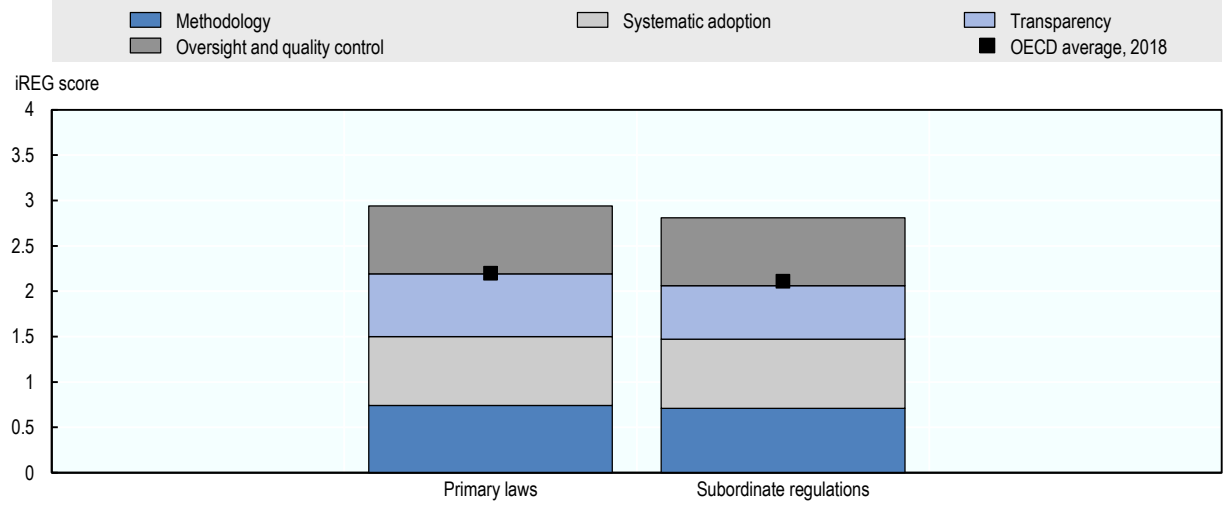
Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, http://oe.cd/ireg.

Figure 4.3. Croatia stakeholder engagement scores 2018



Notes: The more regulatory practices as advocated in the 2012 *OECD Recommendation on Regulatory Policy and Governance*, (OECD, 2012[1]) a country has implemented, the higher its iREG score. The indicators on stakeholder engagement and RIA for primary laws only cover those initiated by the executive (91% of all primary laws in Croatia).

Source: OECD Indicators of Regulatory Policy and Governance (iREG) 2018 and its extension to all EU Member States, www.oecd.org/gov/regulatory-policy/indicators-regulatory-policy-and-governance.htm.

Regulatory framework for stakeholder engagement

Like many other countries, Croatia focused on transparency policies as a starting point for enhancing open government. The legislative framework for public consultations was set by the Law on the Right of Access to Information adopted in 2003, which required public bodies to disclose draft laws and to ensure that the public has an opportunity to comment.

Since the original provisions of the Law did not require that consultations actually had taken place, Croatia adopted the Code of Practice on Consultation with the interested public in the process of adopting laws, other regulations and policies in 2009[1] as part of reforms undertaken during the European Union accession process. The Code serves as a guidance for public consultations and sets standards, for example, for the form and duration of public consultations, ways to inform on ongoing consultations, providing feedback as well as the co-ordination of consultation procedures among the state bodies.

While the adoption of this Code was a significant step forward, it did not guarantee real change towards more inclusive and effective consultations because it is not legally binding. Achieving such change required additional implementation efforts (in terms of training, creation of institutional spaces for consultation, disclosure of information, etc.) and effective commitment from public institutions (Montero and Taxell, 2015[2]).

Detailed guidelines on how to implement the Code have been issued. These are complemented by training programmes for public servants and by creating a network of consultation co-co-ordinators (see below). Annual reports are being published on the implementation of the Code.

When the Law on the Right of Access to Information was amended in 2013,[2] it finally stipulated that all public administration authorities responsible for drafting laws and subordinate regulations would be required to publish these drafts on their websites and conduct consultations with the interested public on these drafts. These drafts are published for 30 days and the dossier includes a statement on the objectives of consultations. Following the consultation process, public administration authorities are required to inform the interested public on accepting or rejecting submitted comments, remarks and suggestions. They are also required to publish reports on the conducted consultations and submit them to the Croatian Government together with the legislative draft. In exceptional cases, it is possible to shorten the period but these cases are becoming less and less frequent.

The Croatian Government's Rules of Procedure adopted in 2011 and amended several times[3] also contain important provisions with regard to public consultations. They confirm that public consultation and reporting on the results of consultations are an integral part of decision-making process on the level of the Croatian Government. Namely, a provision was added to the Rules of Procedure in 2012 obliging central government bodies to submit to the Government relevant reports on the conducted consultations together with drafts laws, other draft regulations and acts, provided that such consultations were conducted, in line with the special regulation or the Code of Practice on Consultation.

The Rules of Procedure also contain relevant provisions pertaining to the procedure of adopting general acts by the local and regional self-government units as well as legal persons vested with public authority to regulate issues in connection with the direct exercise of citizens' rights and other issues of interest for the public good of citizens and legal persons in their area or in the area of their activity (e.g. urban design and physical planning, housing issues, public utilities and other public services, environmental protection, etc.). For those bodies, public consultations should be carried out online, through their respective websites. However, since local administration authorities are independent, it is difficult to enforce these provisions in reality.

Electronic consultations

Since 2015, public consultations are conducted through the central state consultations portal "*e-Consultations*" (*e-Savjetovanja*).[4] The portal presents a unique single access point to all open public consultations of all laws, other regulations and acts carried out by public administration bodies. It was developed in co-operation with civil society organisations as well as the private sector. The system is continuously updated based on the input of all users. Civil servants are trained in using the portal and providing expert support in conducting consultations.

The portal has a simple and user-friendly interface and is searchable by the topic, institution responsible for the draft, date of issue or specific text. Anyone may submit comments after a simple registration on the portal. All submitted comments are then visible to other users and users can "like" other users' comments. The portal also enables to group similar comments.

The responsible public administration authority is obliged to respond to all submitted comments individually. The form of response is not prescribed, so, in theory, it can only present a simple 'duly noted' statement. The reactions are visible to all users of the portal.

More than 2 000 legislative drafts were published for public consultations on the portal between April 2015 and September 2018 by 51 different public administration bodies. The portal had almost 20 000 registered users including more than 16 000 citizens, 1 200 companies and 790 CSOs. During this period, more than 40 000 comments were received through the portal. 5 821 legal and physical persons submitted one or more comments during 2017.

While in 2012, only 144 public consultations on draft laws, other regulations and acts were carried out, in 2017 there were already 706 public consultations taking place. This means a 490% increase in the number of consultations, also thanks to the introduction of the electronic portal.

According to the 2017 Annual report published by GOfCNGO, 22 566 comments were analysed during this year; 4 288 fully accepted, 2 382 partially accepted, 7 545 rejected, 6 430 duly noted and 1 132 unanswered.

The number of comments often varies depending on the "attractiveness" of the topic discussed but also on the level of activity of the responsible ministry in advertising consultations, for example through mass media.

Public consultations and RIA

When a regulation is foreseen to undergo the regulatory impact assessment procedure (see Chapter 5), the consultation process is also prescribed in the RIA Law. The responsible administrative bodies responsible for drafting regulations are then required to consult the public and stakeholders on the draft law and the RIA Statement.

Also in this case, consultation lasts a minimum of 30 days whereby a draft law and the RIA Statement are published on the central government consultation site. If the body responsible for drafting the regulation deems necessary, depending on the complexity of the matter, the period might be extended.

During the consultation period, the authority responsible for drafting the regulation is supposed to carry out one or more public presentations of the matter which is the subject of the consultation for the stakeholders.

Similarly to the standard consultation process, after the consultation is completed, the responsible body examines all the comments, proposals and opinions of the public and interested parties and notifies the public and the stakeholders about the accepted and rejected remarks and proposals by posting the information on the central e-government consultation site.

In the changes to the RIA Law, which entered into force in May 2017, an obligation was set regarding consulting the public in the earliest stages of the regulatory impact assessment process. Namely, the responsible body carries out the initial RIA assessment for each draft law set out in its Plan of Legislative Activities. The Plan as well as the initial RIA assessment for each of the proposed law is published for consultation on the central government consultations site in the period from 1 to 30 September, lasting at least 15 days.

Early stage consultations

Early-stage consultations (i.e. stakeholder engagement before a legislative draft is ready, usually aiming at identifying a problem and gathering initial ideas on its potential solutions) can be helpful in giving stakeholders an opportunity to provide input into the regulatory process at a stage where other options could be put forward by affected parties and assessed by policymakers. Stakeholders are likely to have far less influence once a regulatory decision has been made.

Early-stage consultation are not yet firmly embedded in the regulation-making process in Croatia. Nevertheless, examples of good practice exist across the administration. These examples could be built on to make early-stage consultations systemic.

The early-stage consultations usually take place through working groups formed by particular ministries consisting of representatives of the ministry, civil servants from other parts of the administration and other affected stakeholders. The process for the establishment and composition of these working groups is not formally prescribed by any of the guiding documents, although the *Code for Consultations* provide some guidance on early stage consultations. In particular, the Code says that "[d]uring the procedure for drafting laws, experts, as representatives of the interested public, may be appointed members of expert working groups … in an attempt to ensure the representation of interest groups and natural and legal persons who may be directly affected by the law or other regulation to be adopted, or who are to be included in its implementation. When members of expert working groups are appointed from the ranks of the representatives of the interested public, account should be taken of criteria such as: expertise, previous public contributions to the subject-matter in question, and other qualifications relevant to the matters regulated by the law or other regulation, or established by the act of the state administration body."

For example, in the case of the process of preparing the draft Law on the State Inspectorate (see Chapter 7), the Ministry of Economy has established a working group with some 30 members, including representatives of businesses, trade unions, academics and citizens. Meetings of the working group were held regularly and substantively informed the new law.

There are no rules of procedure for how the discussions should be organised in the working groups. In some cases during the interviews conducted as part of the fact-finding mission, participants complained that the establishment of working groups was rather a box-ticking exercise and that their meetings were rather used to inform the external stakeholders than to have a proper discussion with them and use their input.

If a ministry or another body drafting a regulation decides to include representatives of civil society organisations in a working group, it should inform through an official letter the Council for Civil Society Development, which performs selection procedure for CSOs representatives in working groups.

In addition, some ministries use other means of stakeholder engagement at the early stage, such as roundtables, focus groups, public events, etc. but this is not regular practice. The Ministry of Economy, Crafts and Entrepreneurship has well-established relations with business representatives, such as the Chamber of Commerce, Association of Crafts, Association of Foreign Investors, etc. and tires to communicate with them on a regular basis through working lunches, hearings, workshops, etc.

In some cases, working groups are established also by the Parliament when developing new laws. For example, Parliament's constitutional committee organised consultations on the draft regulation on electronic media. They used mixed methodologies for consulting with the public, and presented a good quality report on the outcomes of the consultation process.

On the contrary, subnational level institutions hardly implement any public consultations. The autonomy of local government units affects the limited implementation at the sub-national level. In addition to the 40 state level institutions that GOfCNGO co-ordinates and oversees, there are 575 local government units and several hundred legal persons with public authority, which should also follow the legal obligations when it comes to public consultations. Developing a central consultation portal for local levels of the administration would be useful. Discussions with the local administrations are under way on setting up a similar platform to the national one for local levels, sharing know-how and providing support.

Institutional set up for overseeing the quality of stakeholder engagement

The Information Commissioner[5] and his Office (OIC) is responsible for overseeing the quality of the public consultations process. Mostly, the office checks whether consultations took place through the consultation portal and whether the 30 days consultation period was complied with. The Office also controls whether a report on the consultation process was produced and published on the portal.

The Information Commissioner also conducts regular inspections of administration authorities on the implementation of the Law on the Right of Access to Information, which focus, *inter alia*, on individual public consultations and consultation plans of individual ministries.

Any member of the public can complain to the Information Commissioner about public consultations not being carried out in line with the law (or at all) and the OIC has a right to issue a warrant on extending the consultation period in case of found irregularities.

The Council for Civil Society Development is an advisory body to the Government of the Republic of Croatia acting towards developing co-operation between the Government with the civil society organisations in Croatia in the implementation of the National Strategy for Creating an Enabling Environment for Civil Society Development; the development of philanthropy, social capital, partnership relations and cross sector co-operation.

The Council has 37 members out of which 17 representatives of relevant state administrative bodies and the Croatian Government offices, 14 representatives of nongovernmental, non-profit organisations, 3 representatives of civil society from foundations, trade unions and employers' associations and 3 representatives of national associations of counties, cities and municipalities. The logistics and administrative work for the Council are carried out by the Government Office for Cooperation with NGOs of the Croatian government (GOfCNGO).

The following belong among the tasks of the Council for Civil Society Development:

- participation in constant monitoring and analysis of public policies referring to or affecting civil society development in Croatia and cross sector co-operation and
- participation in expressing opinions to the Government on legislation drafts affecting the development of civil society in the Republic of Croatia as well as participation in the organisation of an apt way to include and engage civil society organisations in discussions about regulations, strategies and programmes affecting the development and functioning of civil society and co-operation with the public and private sector on the national and European level.

The task of the GOfCNGO is to co-ordinate the work of ministries, central state offices, Croatian Government offices and state administrative organisations, as well as administrative bodies at local level in connection with monitoring and improving the co-operation with the non-governmental, non-profit sector in the Republic of Croatia.

A network of "consultation co-coordinators" has been established in all ministries and government offices. These contact points are providing assistance and methodological help in organising stakeholder engagement activities run by their ministries. They meet annually with the GOfCNGO to exchange experience and good practice examples and to ensure the harmonised application of the Code. The network has helped routinise public consultations by strengthening the skills of the public officials responsible for implementing consultations at national level institutions.

In 2012, the GOfCNGO trained consultation co-ordinators within state bodies and government offices. In accordance with the *Code of consultation*, consultation co-ordinators were appointed as permanent contact points for both public stakeholders and the body drafting the legislation. Corresponding guidelines were published in 2010. GOfCNGO continued providing trainings together with Information Commissioner to civil servants on preparing and conducting efficient consultations with the interested public in procedures of adopting laws, other regulations and acts through the State School for Public Administration. Approximately 150 officials have been trained annually on both conducting efficient consultations and the use of the *e-Savjetovanja*. The GOfCNGO has been also responsible for preparing annual reports on the implementation of the Code of consultation since 2010. The Information Commissioner also provides online webinars on public consultations to approximately 50 civil servants per year and education for civil servants in local administration.

The tripartite also plays an important role in public consultations. Tripartite social dialogue in Croatia is institutionalised through economic and social councils which are established primarily at the national and county level, and a few have been established at the level of a city. The Economic and Social Council of the Republic of Croatia is composed of representatives of the government, employers' associations and five trade union associations of a higher level. The Government and the social partners have an equal number of representatives.

When the Croatian government approves its Legislative Plan, it sends the Plan to the Council for opinion. The Council can then either ask to be a member of a working group if it is going to be established, or demand that the proposal is discussed in one of its committees or directly at the tripartite meeting.

The employers' and employees' associations also receive legislative proposals directly, however, they often complain that the time provided for comments is insufficient. When interviewed, representatives of the trade unions expressed their discontent with their level of involvement, arguing that their comments are often disregarded. They also did not see too much use in submitting comments through the consultation portal.

The discussions in the tripartite might often come too late in the decision making process. In fact, this is also something representatives of trade union were complaining about during interviews.

Stakeholder engagement in reviewing regulations

There is no policy on how to involve stakeholders in the process of reviewing regulations. It is left to the discretion of the ministries and government agencies whether they consult the regulated subjects and discuss potential issues with the quality of the regulatory framework. Some ministries have regular contact with stakeholders, especially businesses operating in the sectors regulated by those ministries (i.e. the Ministry of Economy, Entrepreneurship and Crafts). It is not, however, a general rule.

Most of the contact with stakeholders in reviewing the existing stock of regulations is limited to measuring administrative burdens (see Chapter 6). The citizens also have a right to report excessive administrative burdens via e-mail to poslovna-klima@mingo.hr.

Access to regulations

According to the Constitution, all laws and regulations issued by government bodies are published in the Official Gazette of the Republic of Croatia before they enter into force. This process is taken care of by the director of the Government Legislation Office who is also the editor-in-chief of the Official Gazette. The Official Gazette is available both in the printed and electronic form.[6] A law shall enter into force no earlier than the eighth day after its publication in the Official Gazette, unless otherwise specifically determined by law for particularly justified reasons (e.g. on a specific day or the day after publication).

Central government bodies responsible for drafting laws and regulations are obliged to apply rules that oblige them to write laws and other regulations in a clear style, simple words and in precise and clearly expressed intentions.

Access to all official documents including international treaties, regulations issued by local self-government bodies and is also ensured electronically via the Central catalog of official documents of the Republic of Croatia.[7]

Assessment and recommendations

The legal and policy framework in Croatia creates conditions for efficient stakeholder engagement in regulatory policy, especially with regard to developing new regulations and their amendments. Croatia is comparing well even with many OECD countries, especially in the field of late-stage consultations, thanks to the use of the electronic consultations portal. Evidence suggests that strong political support, the process of adoption of commitments, the role of the co-ordinating unit, and an informal network of consultation co-ordinators are among the most important factors that explain the successful implementation of consultation commitments in Croatia.

While the number of public consultations carried annually is increasing and so is the number of comments received and stakeholders involved in the regulation-making process, there is still room for improvement, especially in terms of increasing awareness of the consultation process among some groups of stakeholders.

Most institutions rely exclusively on online consultations rather than combining several consultation methodologies, including early-stage consultations.[8] While some ministries engage with stakeholders early in the regulation-making process, few of them are doing it systematically and this practice has not yet been fully embedded.

Local governments' autonomy, and limited resources and capacities at the local level make consultation very rare, with only few examples of good practice.[9]

There is no systematic policy on engaging stakeholders in the process of reviewing existing regulations. While some ministries are in regular contact with regulated subjects, it is not a general rule. Most of the contacts with external stakeholders is limited to the process of calculating administrative burdens. This is related to the lack of experience with systemic *ex post* reviews of regulations.

The access to regulation is in line with the OECD best practice, all regulations in force are available both in the printed form and electronically through the Official Gazette with free access.

While there has been a significant progress in stakeholder engagement, especially regarding public consultations through the government portal, **ministries and other government bodies should be more proactive in reaching out to external stakeholders** to improve opportunities for all groups of stakeholders to get involved. Promoting the consultation process as well as individual consultations through the media, social networks and other channels might be useful.

More emphasis should be given to systematically conducting public consultations prior to a preferred solution being identified – **the early-stage consultations**. Guidance and training might be strengthened on establishing working groups, including their composition, rules of procedure and transparency of their work. Conclusions from the work of the working groups should be systematically published. Good practice examples mentioned above might serve as an example.

Stakeholders' engagement in reviewing existing regulations should be strengthened. A permanent discussion and collaboration forum between the administration and external stakeholders (e.g. businesses) could be established to strengthen the dialogue (a good example of such body is the Danish Business Forum – see Box 4.1). This would enable that stakeholders systematically provide input on problematic and excessively burdensome areas of regulations. Potentially, the National Competitiveness Council could form a basis for creating such forum.

Box 4.1. Denmark's Business Forum for Better Regulation

The Business Forum for Better Regulation was launched by the Danish Minister for Business and Growth in 2012. It aims to ensure the renewal of business regulation in close dialogue with the business community by identifying those areas that businesses perceive as the most burdensome, and propose simplification measures. These could include changing rules, introducing new processes or shortening processing times. Besides administrative burdens, the Forum's definition of burdens also includes compliance costs in a broader sense as well as adaptation costs ("one-off" costs related to adapting to new and changed regulation).

Members of the Business Forum include industry and labour organisations, businesses, as well as experts with expertise in simplification. Members are invited by the Ministry for Business and Growth either in their personal capacity or as a representative of an organisation. The Business Forum meets three times a year to decide which proposals to send to the government. So far, the proposals covered 13 themes, ranging from "The employment of foreign workers" to "Barriers for growth". Interested parties can furthermore submit proposals for potential simplifications through the Business Forum's website. Information on meetings and the resulting initiatives is published online.

Proposals from the Business Forum are subject to a "comply or explain" principle. This means that the government is committed to either implement the proposed initiatives or to justify why initiatives are not implemented. As of October 2016, 603 proposals were sent to Government, of which so far 191 were fully and 189 partially implemented. The cumulated annual burden reduction of some initiatives has been estimated at DKK 790 million. Information on the progress of the implementation of all proposals is available through a dedicated website. The results are updated three times a year on www.enklereregler.dk. The Business Forum publishes annual reports on its activities. The Danish Minister for Business and Growth also sends annual reports on the activities of the Business Forum to the Danish parliament.

Source: (OECD, 2016[3]), "Pilot database on stakeholder engagement practices in regulatory policy", http://www.oecd.org/gov/regulatory-policy/pilot-database-on-stakeholder-engagement-practices.htm; www.enklereregler.dk.

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Montero, A. and N. Taxell (2015), *Open government reforms The challenge of making public consultations meaningful in Croatia*, https://www.opengovpartnership.org/sites/default/files/U4-Report-2015-03-221215a.pdf (accessed on 1 February 2019). [2]

OECD (2016), *Pilot database on stakeholder engagement practices in regulatory policy*, http://www.oecd.org/gov/regulatory-policy/pilot-database-on-stakeholder-engagement-practices.htm. [3]

OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264209022-en. [1]

Notes

[1] Official Gazette 140/2009.

[2] Official Gazette no. 25/2013.

[3] Official Gazette no. 54/11, 121/12, 7/13, 61/15, 99/16, 57/17.

[4] https://esavjetovanja.gov.hr/.

[5] The Information Commissioner protects, monitors and promotes the right of access to information and reuse of the information provided by the Constitution of the Republic of Croatia. The Commissioner is independent, reports to the Parliament and is elected by the Parliament for a term of five years with the possibility of re-election.

[6] https://narodne-novine.nn.hr.

[7] http://www.digured.hr/.

[8] For example, in 2013, public agencies conducted 344 online consultations but only 84 public hearings, 97 consultation meetings and several focus groups and informal consultations; in 2014, there were 499 online consultations, 61 public hearings, and 354 advisory meetings (Croatia 2014, 2015).

[9] For example a local e-consultation platform https://ekonzultacije.rijeka.hr/.

5 The development of new regulations in Croatia

This chapter reviews the processes for developing new regulations in Croatia, with special attention to forward planning and trends; administrative procedures and legal quality; *ex ante* impact assessment; and considering alternatives to regulation.

RIA in OECD countries

Regulatory impact assessment is a cornerstone of regulatory policy. Governments must use evidence-based policy when they choose to use regulation as a policy lever to modify the behaviour of businesses and citizens for the benefit of society.

Governments should be weighing the costs and benefits of proposals extremely early in the development of a policy solution to an identified problem (see Box 5.1). To do otherwise, would be using policy-based evidence – RIA used to justify a policy rather than a key part of the decision making process. Virtually all OECD and EU countries now have some *ex ante* evaluation of policy in place, although the exact process varies substantially.

Box 5.1. The Fourth Recommendation of the Council on Regulatory Policy and Governance

4.1. Adopt *ex ante* impact assessment practices that are proportional to the significance of the regulation, and include benefit cost analyses that consider the welfare impacts of regulation taking into account economic, social and environmental impacts including the distributional effects over time, identifying who is likely to benefit and who is likely to bear costs.

4.2. *Ex ante* assessment policies should require the identification of a specific policy need, and the objective of the regulation such as the correction of a market failure, or the need to protect citizen's rights that justifies the use of regulation.

4.3. *Ex ante* assessment policies should include a consideration of alternative ways of addressing the public policy objectives, including regulatory and non-regulatory alternatives to identify and select the most appropriate instrument, or mix of instruments to achieve policy goals. The no action option or baseline scenario should always be considered. *Ex ante* assessment should in most cases identify approaches likely to deliver the greatest net benefit to society, including complementary approaches such as through a combination of regulation, education and voluntary standards.

4.4. When regulatory proposals would have significant impacts, *ex ante* assessment of costs, benefits and risks should be quantitative whenever possible. Regulatory costs include direct costs (administrative, financial and capital costs) as well as indirect costs (opportunity costs) whether borne by businesses, citizens or government. *Ex ante* assessments should, where relevant, provide qualitative descriptions of those impacts that are difficult or impossible to quantify, such as equity, fairness, and distributional effects.

4.5. Regulatory impact analysis should as far as possible be made publicly available along with regulatory proposals. The analysis should be prepared in a suitable form and within adequate time to gain input from stakeholders and assist political decision making. Good practice would involve using the Regulatory Impact Analysis as part of the consultation process.

4.6. *Ex ante* assessment policies should indicate that regulation should seek to enhance, not deter, competition and consumer welfare, and that to the extent that regulations dictated by public interest benefits may affect the competitive process, authorities should explore ways to limit adverse effects and carefully evaluate them against the claimed benefits of the regulation. This includes exploring whether the objectives of the regulation cannot be achieved by other less restrictive means.

4.7. When carrying out an assessment, officials should:

- Assess economic, social and environmental impacts (where possible in quantitative and monetised terms), taking into account possible long term and spatial effects

- Evaluate if the adoption of common international instruments will efficiently address the identified policy issues and foster coherence at a global level with minimal disruption to national and international markets
- Evaluate the impact on small to medium-sized enterprises and demonstrate how administrative and compliance costs are minimised.

4.8. RIA should be supported with clear policies, training programmes, guidance and quality control mechanisms for data collection and use. It should be integrated early in the processes for the development of policy and supported within agencies and at the centre of government.

Source: (OECD, 2012[11]), *Recommendation of the Council on Regulatory Policy and Governance*, https://doi.org/10.1787/9789264209022-en.

Rarely, does a full RIA system appear overnight. Even in countries with a long history of RIA, like in the United States, RIA grew from a desire of the government to reduce administrative burdens and to centralise some of the oversight of the quality of regulation (see Box 5.2).

Box 5.2. The US path from the targeting administrative burdens to regulatory quality

The US Congress passed the Paperwork Reduction Act in 1980. The new Act was developed to encourage agencies of the government to reduce the amount of paperwork burden on businesses and citizens. At the same time, it also established the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget in the executive to oversee the new requirements, such as if agencies' new information requirements were justified by a need from the government.

The role of OIRA and the policies on regulation from the executive changed over time from focusing on administrative burdens to looking at regulatory quality more generally. In 1995, President Clinton issued EO 12866, which had the objective of introducing "a regulatory system that protects and improves their health, safety, environment, and well-being and improves the performance of the economy without imposing unacceptable or unreasonable costs on society..." From 1995, OIRA has been charged with reviewing regulations to see if agencies have considered alternatives and if agencies have analysed both costs and benefits, among other things.

Since then, presidents have maintained the regime with some modifications to enhance regulatory quality even more. President Bush issued amendments in 2007 that required agencies to have a clear problem statement and to describe the market failure the proposed regulation was to address. President Obama created a new requirement for retrospective reviews (*ex post* evaluation) to reduce the costs of rules and regulations.

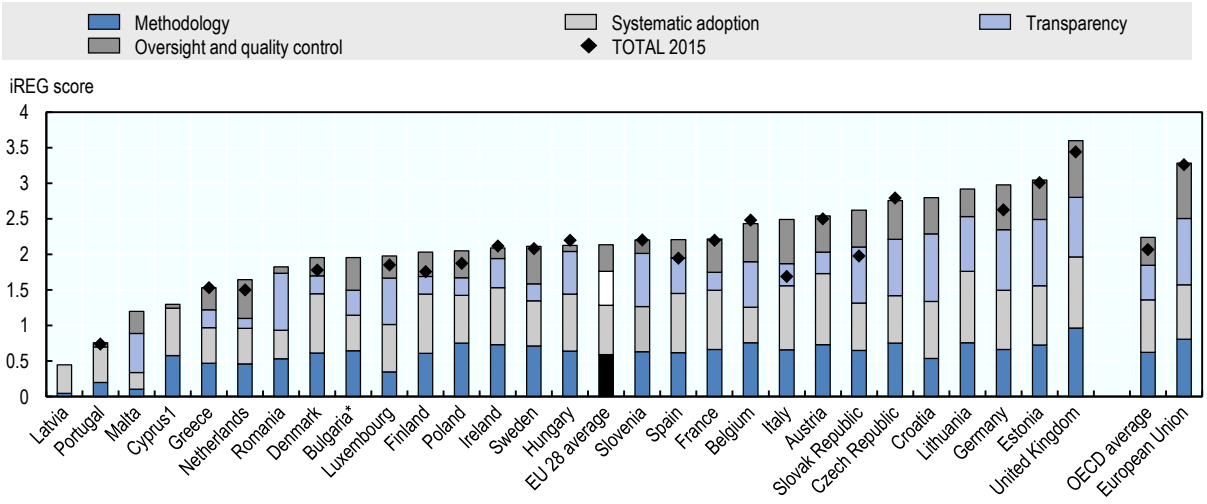
President Trump has strengthened the focus on reducing regulatory compliance costs for business. In 2017, he introduced a requirement for agencies to eliminate two regulations for every new regulation introduced. Proposed regulations that create new regulatory compliance costs for businesses must also offset these costs with reductions elsewhere, similar to policies in Canada and the United Kingdom.

Source: Exec. Order No. 12866 (1995); Exec. Order No. 13422 amendments to Exec. Order 12866 (2007); Exec. Order No. 13563 (2011); Exec. Order No. 13771 (2017).

Croatia actually scores remarkably well in RIA for primary laws on the iREG indicators, especially when compared to its EU peers. As described below, Croatian ministries are required to start considering RIA early in the process and an oversight body located in the centre of government already exists. Overall, Croatia is well above the OECD average for RIA in primary laws. Unfortunately, policy makers are not

analysing subordinate regulations during their development. Most of the RIA procedure in place does not apply to subordinate regulations.

Figure 5.1. Regulatory Impact Assessment for developing primary laws, 2018



Notes: Data for 2015 is based on the 34 countries that were OECD members in 2014 and the European Union, which included 21 of the current 28 EU Member States. The OECD average is based on the 34 member countries at the time of the survey. Data for 2018 includes the remaining EU Member States of Bulgaria, Croatia, Cyprus,[1] Malta and Romania. The more regulatory practices as advocated in the 2012 Recommendation a country has implemented, the higher its iREG score. * In the majority of EU Member States, most primary laws are initiated by the executive, except for Bulgaria, where a higher share of primary laws are initiated by the legislature.

1. Note by Turkey:

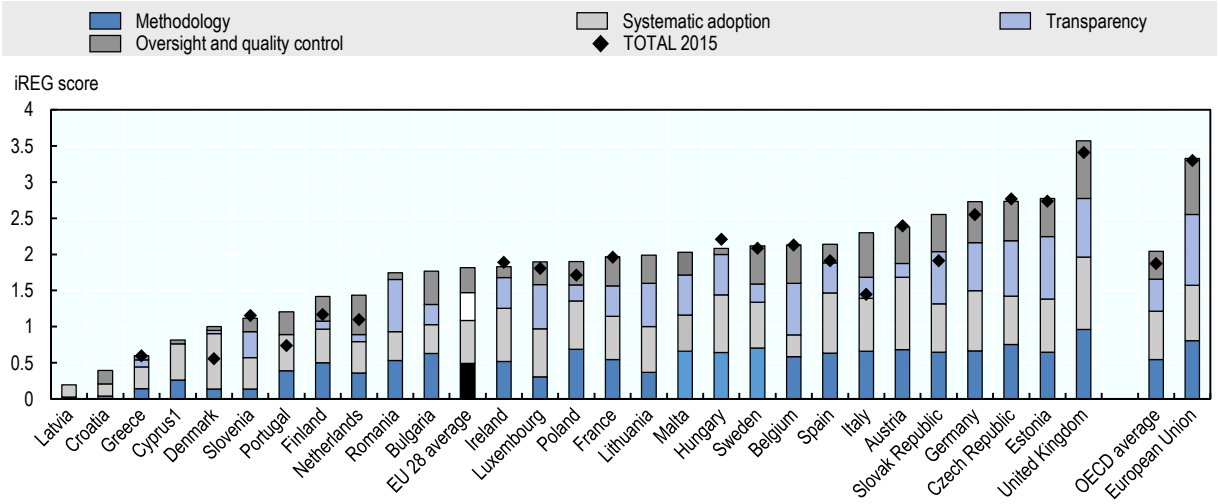
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

Note by all the European Union Member States of the OECD and the European Union:

The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, http://oe.cd/ireg.

Figure 5.2. Regulatory Impact Assessment for developing subordinate regulations, 2018



Notes: Data for 2015 is based on the 34 countries that were OECD members in 2014 and the European Union, which included 21 of the current 28 EU Member States. The OECD average is based on the 34 member countries at the time of the survey. Data for 2018 includes the remaining EU Member States of Bulgaria, Croatia, Cyprus,[1] Malta and Romania. The more regulatory practices as advocated in the 2012 Recommendation a country has implemented, the higher its iREG score.
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Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, http://oe.cd/ireg.

RIA has gone through a number of iterations in Croatia. According to a paper from Romić and Vajda Halak, the Government Legislation Office (GLO) under IPA 2007 started implementing and developing RIA in 2007. After several years of effort, RIA received a boost in support through the 2011 Act of RIA (also see Chapter 2 on the context for Better Regulation).

The legislative process in Croatia

The first Constitution of the Republic of Croatia was adopted on 22 December 1990 based on a history of sovereignty dating back to the 7th century (source Preamble of the Constitution). The constitution clearly divides the powers of the parliament, executive and judicial branches of government.

The Constitution stipulates that the Croatian Parliament and people shall directly, independently and in compliance with the Constitution and law decide upon the regulation of economic, legal and political matters in the Republic of Croatia.

The executive branch of the government may propose laws and acts to parliament, subject to Article 114 of the Constitution, which states, "the organization, mode of operation and decision-making of the Government shall be regulated by law and its standing orders."

The Government of the Republic of Croatia, through the creation of public policies, creates the need to adopt or amend regulations. The procedure for the adoption of regulations (laws, regulations and other acts) is regulated by the Rules of Procedure of the Croatian Parliament and the Rules of Procedure of the Government. The law is passed under the jurisdiction of the Croatian Parliament. The authority of the Government is restricted to the adoption of the Decrees and other acts on issues that are not regulated. It proposes laws to the Croatian Parliament.

The Rules of Procedure of the Government set out the methods of preparing and presenting a law, regulation or other action. According to Article 29 and Article 30 of the Rules of Procedure of the Government, any proposal must contain:

- An overview of all issues necessary for discussion and decision on them and a brief summary of the proposals content
- All the parts prescribed by the Rules of Procedure of the Croatian Parliament, if the proposal is a draft law or amendment
- The opinions of the Legislative Office, the Ministry of Finance and the Ministry of Foreign Affairs and European Affairs, as well as other central government bodies[1]
- The opinion of professional associations and associations, if they are within the scope of the issue
- All the objections received. In addition, it is obligatory to submit written comments for the reasons for not accepting objections
- If required, the Statement of Fiscal Impact Assessment

- The opinion on the statement on the RIA by the GLO. The GLO should give its consent together with the draft proposal
- If necessary, a label of secrecy, in accordance with the regulations on data secrecy.

The Act on Regulatory Impact Assessment lays out the explicit requirements for *ex ante* analysis in Croatia. It governs a wide range of activities related to RIA, including:

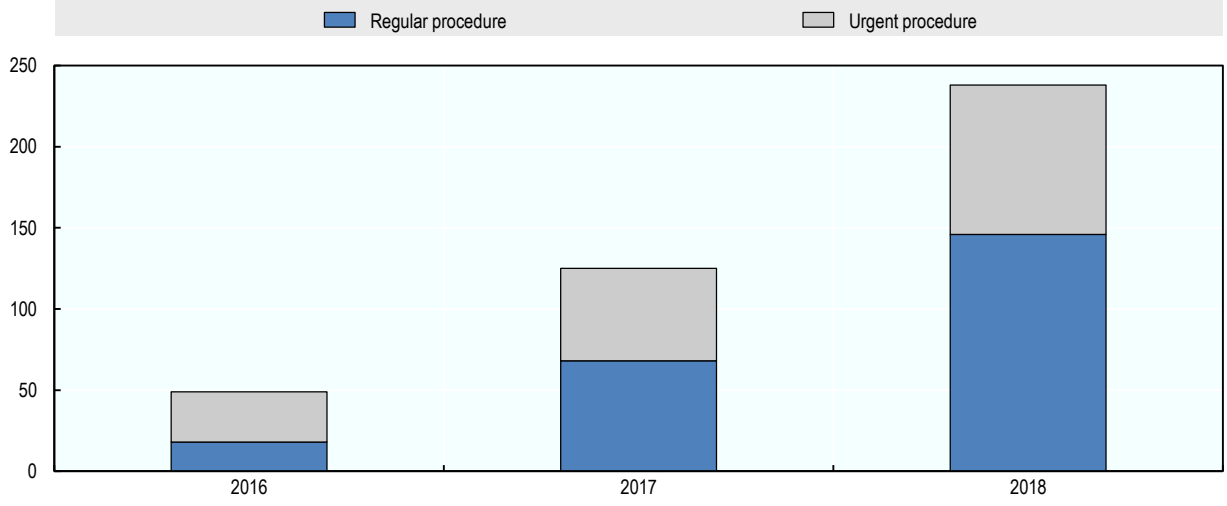
- The process of RIA
- The documents for RIA
- Annual legislative planning
- The bodies in charge of reviewing RIA
- Requirements and methods for public consultation; and
- The training obligations for RIA.

Trends in new regulation

In some countries, the government or policy makers may use an urgent or shortened procedure to shorten the time it takes to put a law in place. Often, the shortened procedure means that the normal legislative process, including RIA and stakeholder engagement, are substantially shortened or eliminated entirely. In cases of real emergencies this is reasonable. For example, the government should use emergency procedure if they need to liberate funds or resources to manage a natural disaster.

In some countries, however, the urgent procedure is misused to evade administrative procedures that assure that legislation is meeting the needs of citizens, namely to protect citizens safety, health and well-being without undue costs to society. Often, ministers feel political pressure to pass legislation without due consideration. They want to appear that they are taking action to solve an issue, and may not want to take the time critically examine a politically appealing but suboptimal solution. A lengthy procedure could also make them appear slow to react to the public at large.

Figure 5.3. Number of laws passed by the current Croatian Parliament, by regular and urgent procedure



Source: Croatian Parliament.

In Croatia, nearly half of all legislation has been passed under an urgent procedure since 2016. In fact, the Croatian parliament passed over two-thirds of laws under an urgent procedure during 2016, although this was most likely due to the national election. Nevertheless, nearly 40% of laws passed in 2018 also fell under urgent procedure. During interviews, representatives mentioned that efforts were underway to discourage the use of the urgent procedure.

The number of laws passed in Croatia has varied quite significantly from a high of 308 laws in 2013 because of the EU accession process to just 72 laws in 2016.

Procedures for new regulation in Croatia

Forward planning

The first RIA Law in 2011 set out the obligation for ministries to create a Legislative Activities Plan. The First Annual Legislative Activities Plan was adopted by the Croatian Government in 2012. In general, this document encompasses draft legislative proposals (but only primary laws) to be sent to the Government of the Republic of Croatia during the calendar year. The expert bodies plan regulations by the quarterly period. The Croatian Government adopts the Integrated Annual Legislative Activities Plan (containing draft legislative proposals of all expert bodies) in December of the current calendar year for the next calendar year.

The process of developing the Annual Legislative Activities Plan starts in September each year. Each body drafts Plan of Legislative Activities from its scope of work and for each draft law contained in the Plan carries out the Initial RIA.

The Legislative Activities Plan as well as the Initial RIA assessment for each of the proposed laws is published for consultation on the central government e-consultations portal during September. Proposals must be posted for at least 15 days. The state administration body then has the obligation to send its Legislative Activities Plan with all the Initial RIAs to the GLO, no later than 31 October of the current year.

The GLO then considers the proposed Legislative Activities Plan and all the Initial RIAs and may request changes. It can send back the submitted assessments and ask for further analyses in regards to the impacts.

The GLO forwards the Initial RIA to the Ministry of Economy, Entrepreneurship and Crafts, which is currently in charge of the SME test and the implementation of the SCM methodology. The Ministry of Economy, Entrepreneurship and Crafts submits an opinion to GLO within eight days on the need to carry out these activities.

The government bodies co-ordinate with the GLO on their proposed plans of legislative activities up to 1 December of the current year. The GLO submits an integrated Legislative Action Plan to the Government, who adopts it by 15 December each year.

Process for developing new regulations in the executive

Ministries, central government offices and state administrative organizations are government bodies. When assessing the need for a new regulation, they are obliged to propose it to the government. All central government bodies establish a plan of legislative activities within its scope for the next calendar year. At the end of the year, the Government adopts an integrated Legislative Activity Plan for the next calendar year.

The central government bodies also form working groups for drafting regulations. Members of the working group are civil servants employed in the central state administration body. Members of the working group may also include other civil servants or external experts dealing with this issue. A representative of the GLO may also join the working group.

Public consultations are conducted on the draft version of regulations. After the comments have been collected, the central government bodies revise the working version of the regulation. They then submit the regulation for opinion of other central government bodies, depending on the issue.

It is mandatory to gather opinions from the Ministry of Foreign Affairs and European Affairs, the Ministry of Finance and the GLO. The Ministry of Foreign Affairs and European Affairs determine the compliance of regulations with EU regulations. The Ministry of Finance determines the financial effect of regulations. The GLO provides an opinion on the compliance of regulations with the Constitution and the legal order of the Republic of Croatia, while respecting the legal system of the European Union. If a regulation relates to administrative proceedings, the regulation is submitted to the opinion of the Ministry of Administration. If the regulation prescribes misdemeanor provisions, it is submitted for opinion of the Ministry of Justice. The Ministry of Economy, Entrepreneurship and Crafts performs the SME Test on the regulation.

After the opinions and declarations of compliance have been collected, the regulation is referred to the permanent working bodies of the Government for further discussion. The government has five permanent working bodies, divided by expert areas, such as Coordination for Economy and Structural Reform, Coordination for Sectoral Policies and so on. Standing working bodies of the Government discuss compliance with the Constitution and the legal order of Croatia, while respecting the legal system of the European Union. When the text of the regulation is in accordance with the Constitution and the legal order of the Republic of Croatia, it is referred to the Government session. The government adopts regulations, as well as other acts such as decisions and conclusions, and passes laws to the Croatian Parliament for adoption. Parliament normally passes regulation after two readings.

All subordinate regulations, which in practice are a major source of administrative burdens, go through the SME Test according to the Ordinance on SME test (OG 43/17) under authority and the supervision of Ministry of Economy, Entrepreneurship and Crafts.

Oversight and inter-ministerial co-ordination

Since January 2013, the GLO has the responsibility for reviewing the extent to which the legal proposals have followed the RIA law in addition its responsibilities to review the legality of legislation. The GLO is responsible for co-ordinating the implementation of the Initial RIA and full Regulatory Impact Assessment as well as reviewing their quality. The GLO also monitors the drafting of the Legislative Activity Plan.

The GLO is also responsible for carrying out training on both legal drafting and RIA. In the RIA Department within the GLO, there are seven advisers involved in the RIA quality control – five lawyers and two political scientists – but no economists or other specialists to thoroughly evaluate quantitative impacts.

In the RIA process, the central government bodies are responsible for the implementation of the Initial RIA, the drafting of the Plan of Legislative Activities within its scope and for the implementation of the Regulatory Impact Assessment in accordance with the RIA Law and RIA Regulation. In order to carry out these activities, each has an appointed RIA co-ordinator responsible to carry out all the activities related to the RIA. The co-ordinator is appointed from the ranks of senior civil servants and may have a deputy. Co-ordinators co-operate with the unit of the expert who drafts the legislative proposal and, if necessary, take part in the work of the draft working group drafting the legislative proposal.

Expert bodies responsible for each of the determined effects[2] participate in the regulatory impact assessment process by considering and giving opinions within its scope.

Legal quality

Several levels and stages of control ensure the legal quality of regulations adopted by the Parliament and by the Government. The Rules of Procedure of the Government of Croatia define the legislative process in three sequential steps: expert task forces, ministerial co-ordination committees and, finally, review by the Inner Government Cabinet[3] prior to the government session. Any draft regulation prior to its adoption must be submitted to the GLO. The GLO is established by the Government Act as an expert legal service, which has the task of reviewing drafts of legislative proposals from the perspectives of constitutionality and coherence with the general principles of law.

Reviews of the quality of legislative proposals are based on the current legal system, the rules of the profession and the multiannual practice created in the work of the GLO.

When the proposal is very complex, the GLO participates in the selection of the most appropriate legal solutions as well as the proper formulation of legal text in the regulations, either individually or as a part of a working group. When obliged by the Government, the GLO in co-operation with the regulatory body makes the appropriate adjustments and corrections in the draft regulation.

The final quality control check and compliance with all the opinions expressed in the drafting process are carried out at weekly meetings of the expert task forces and ministerial co-ordination committees within the Government. Representative of the GLO attends these meetings and, if necessary, provides additional opinions on the legal bases and the correctness of the regulations.

The GLO also reviews the issues of the legal system development and issues of constitutionality and legality of a particular regulation in co-operation with the proposers. The GLO representatives provide professional education and training in regulatory drafting, where civil servants are educated about how to draft constitutional and legally correct regulations.

Ex ante analysis of regulations

The RIA process and methodology apply exclusively to primary legislation that Government proposes to the Croatian Parliament, as stipulated in RIA Law of 2017. This means that legislative proposals from MPs, parliamentary parties and other legitimate proposers are not obliged to follow up with the RIA law. However, parliament only passes about 1% of primary legislation outside of scope of RIA application, notwithstanding the many laws passed under urgent procedure.

The general purpose of RIA in the Croatian legislative framework is to consider regulations or alternatives to encourage the business environment, strengthen the rule of law and reduce the costs of implementing the regulations. At the same time, the RIA law requires that central state administrations ensure the protection of human rights and fundamental freedoms, personal and political freedoms and rights, social and cultural rights.

The specific objectives of RIA process are to ensure openness and transparency of the legislative process, identify obstacles to entrepreneurship and encourage co-operation and inter-departmental co-ordination in the process of legislative drafting. Beyond the RIA regulations, Croatia also has an ongoing strategy to improve RIA in the country.

Central government bodies appear to follow the laws and regulations on RIA closely. All primary laws are posted with a RIA online as part of the consultation process.

It is clear that the RIA programme is well established in Croatia. However, a number of representatives did not believe that RIA was influencing the decision-making process. First, many regulatory decisions are made outside of the legislative planning activities, so once the initial RIA is underway, the decision to

regulate has been made. In addition, certain ministries reported that proposers did not consider their input or feedback on the costs to businesses when designing regulations.

Unfortunately, central government bodies generally only give sparse details on the impacts of proposed laws. For example, assessments of specific impacts are normally limited to a brief statement and a "check box" exercise where those proposing regulations must say if there are negligible, medium, or high impacts. A lack of technical expertise in RIA may result from a combination of factors, including a lack of permanent training on RIA and a lack of competitive wages in the public sector to attract and keep talent.

The situation seems to be unchanged since the reports on RIA from the Government of the Republic of Croatia in 2015 and OECD SIGMA programme in 2014. The authors identified that the institutional framework and the model is mostly established in Croatia for the *ex ante* impact of regulations. However, a key remaining challenge will be to improve the technical quality and usefulness of RIA. Croatia has a strategy to address these shortcomings (see Box 5.3).

Box 5.3. Vision, mission and goals of the RIA strategy for Croatia, 2018 to 2023

The Strategy sets out a vision, mission and three strategic goals for further development of the regulatory impact assessment from 2018 to 2023:

Vision: A modern legislative framework that supports the development of civil society promotes entrepreneurial freedom and ensures the rule of law.

Mission: Ensure the drafting of quality legislative proposals by consistently applying the regulatory impact assessment with the analysis of direct impacts and participation of the public concerned.

Strategic Objectives of Regulatory Impact Assessment:

1. Ensure the implementation of the legislative procedure by drafting legislative proposals in accordance with the applicable regulations in the area of regulatory impact assessment.
2. Ensure the administrative capacity of central administrative bodies to effectively evaluate the regulatory impact assessment when drafting legislative proposals.
3. Ensure the openness and transparency of regulatory impact assessment procedure in advocating public opinion and the public concerned when drafting legislative proposals.

In addition to the vision, mission and objectives, the strategy also outlines what resources will be needed to meet the goals of the strategy.

Source: Government of Croatia, RIA Strategy 2018-2023, Zagreb, December 2017.

As mentioned, the RIA process and strategy does not cover subordinate regulation – an area that may still contain heavy administrative burdens or regulatory impacts – or subnational authorities (see Chapter 8 for more discussion on regulatory policy at the subnational level). However, SIGMA in 2014 noted that "… the RIA Law gives possibility to [the Government of the Republic of Croatia] to require RIA for secondary legislation if the proposed secondary legislation or a draft is likely to bear potential significant impacts on economy, social affairs or on environment. This possibility has not been exercised for the time being" (OECD SIGMA, 2014[2]).

The RIA process in Croatia in detail

The RIA Law and its associated regulation sets out three important aspects of RIA process: annual planning of government legislative activities; implementation of full RIA stage for those legislative activities that have significant directs impacts; and the process for legislative activities submitted outside of the annual plan.

The RIA regulation contains the specific procedures and forms required for RIA in Croatia. According to the RIA Law, the Government shall adopt a Legislative Activity Plan containing all draft legislative proposals that are envisaged to be approved during the proscribed period.

The need to carry out full RIA is established based on the results of the Initial RIA. A full RIA is required in cases when there is:

- a large direct impact and a small number of impacted stakeholders
- a large direct impact and a large number of impacted stakeholders
- a small direct impact and a large number of impacted stakeholders.

The established combinations are reported for each of the direct impacts of the draft legislative proposal in the Initial RIA form.

If a full RIA is required, the state administration body carries out the following:

- determines in detail the outcomes or changes that are to be achieved by the draft regulation
- analyses in detail the direct effects identified in the Initial RIA
- if necessary, it analyses in detail the direct effects of individual and possible alternative normative solutions from the draft legislative proposal
- selects the optimal solution for achieving the determined outcomes, i.e. changes in the area that is regulated by the draft legislative proposal
- if necessary, performs a SME test
- if necessary, applies measurement based on the SCM methodology
- and establishes the timeline and basic criteria for evaluating draft legislative proposals and other related issues.

The head of the state administration body may set up a working group to draw up the full RIA form and a draft legislative proposal. A public presentation and public consultation of the full RIA and a draft law should be conducted for at least 30 days. At the same time as the public consultation, the full RIA form is submitted to the competent authorities and the GLO for an opinion.

The Ministry of Economy, Entrepreneurship and Crafts is obliged to review the results of the SME test and the SCM methodology, if the analysis has been completed. Following consultation, the full RIA form is again submitted to the GLO for approval and the draft legislative act is submitted to the competent authorities, the GLO and to other bodies in accordance with the Rules of Procedure of the Government.

If during a calendar year, a law is required that is not included in the Legislative Activity Plan, the state administration body carries out an initial RIA. The state administration body must carry out consultations for a period of at least 15 days within the framework of the Initial RIA. At the same time as consultation stage, the state administration body submits an initial RIA form to the GLO. The GLO also forwards the initial RIA form to the Ministry of Economy, Entrepreneurship and Crafts for conducting the SME test and the implementation of the SCM methodology. The Ministry of Economy, Entrepreneurship and Crafts submits an opinion to the GLO within five days of receiving it.

The GLO analyses the Initial RIA form and, if necessary, requests a supplement or a modification. The state administration body is bound to agree the initial RIA form with the GLO prior to the adoption of draft legislative proposals at sessions of the Expert Task Groups and Ministerial Coordination Committees within the Government. Depending on the results of the initial RIA, the state administration body proposing the regulation carries out a full RIA process as above.

According to the RIA law, RIA is not required by the government to:

- ratify international treaties

- implement regulations and other binding legal acts of the European Union that are directly implemented in the territory of the Republic of Croatia
- apply the State Budget of the Republic of Croatia; and
- grant authority to the Government to regulate certain issues within the scope of the Croatian Parliament.

The exemption for international treaties may be overruled. In this case, a RIA may be carried out, based on the conclusion of the Croatian Parliament.

Since 2017, the RIA Law requires that government bodies prepare and draft laws alongside a RIA. The goal is to encourage the executive to select an optimal legal solution or undertaking other activities and measures.

Policy makers must analyse the direct effects of draft legislative proposals on many areas of Croatian society, including:

- the small economy (SMEs)
- labour market
- social welfare and pension system
- health
- environmental protection
- human rights protection
- and market competition.

In the RIA process, a full RIA is carried out, depending on the results of the initial RIA stage. Direct effects are analysed, according to the following types:

- **Economic impact assessment:** Assessment of the expected direct impacts on the macroeconomic environment, investment inflows, market functioning and economic competitiveness, small business, administrative barriers to business, research and development and consumer protection
- **Social impact assessment**: An assessment expected direct impacts on demographic trends, social welfare, social inclusion and protection of groups with special interests and needs, access to public services and the right to health care
- **Impact assessment on labour and labour market:** Estimating the expected direct effects on employment and the labour market, standards and rights on the quality of workplace and on the pension system
- **Environmental impact assessment**: Estimating expected direct effects on climate, quality and use of air, water and soil, management of natural resources, use of renewable and non-renewable energy sources, waste management and recycling
- **Impact assessment on human rights protection**: An assessment of the expected direct effects on gender equality, the right to equal treatment and opportunities, the suppression of discrimination, the violation of privacy, the protection of personal data, access to justice, access to information and other rights guaranteed by the Constitution of the Republic of Croatia and,
- **Impact assessment on market competition**: An assessment of the expected direct effects on competition between market participants on non-discriminatory terms.

Direct effects should be analysed in particular when the affect the following stakeholders:

- micro, small, medium and large entrepreneurs, family farms, co-operatives
- citizens

- families and households
- workers and retired people
- service providers in a particular business area and consumers
- Croatian war veterans
- minorities
- social groups with special interests and needs
- associations and foundations
- various other national and subnational bodies or nationalised industries.[4]

Considering risk and performance-based alternatives to regulation

According to the RIA law, government bodies are obligated as part of the RIA process to consider non-regulatory solutions. At this stage, a state administration body considers alternatives to legislation during elaboration of an initial RIA form. Consideration of non-normative solutions include: do nothing option, information and training, self-regulation and co-regulation particular. Other alternatives such as usage of economic instruments (taxation, transfer incentives to nudge particular behaviour of affected population) could be under consideration, but this will be at the end a legislative proposal as taxation or any other form of budget transfer has to be introduced by a primary legislation.

According to some Croatian authorities, government bodies tend to think about alternatives to regulation just to complete the Initial RIA form, i.e. after a decision on a legislative solution has already been made. Thus, considering alternatives to regulation is still uncommon. An often-reported issue – and one certainly not unique to Croatia – is that a head of a government body decides on an ad hoc basis during a year which activities are adopted, before a complete analysis of options (see Chapter 2 on regulatory policy strategy).

Box 5.4. Six types of alternatives to regulation

Performance-based Regulations: Performance-based regulation specifies required outcomes or objectives, rather than the means by which they must be achieved. Firms and individuals are able to choose the process by which they will comply with the law. This allows them to identify processes that are more efficient and lower cost in relation to their circumstances, and also promotes innovation and the adoption of new technology on a broader scale.

Process-based regulations: These regulations are so named because they require businesses to develop processes that ensure a systematic approach to controlling and minimising production risks. They are based on the idea that, given the right incentives, producers are likely to prove more effective in identifying hazards and developing lowest-cost solutions than is a central regulatory authority. They are particularly useful where there are multiple and complex sources of risk, and *ex post* testing of the product is either relatively ineffective or prohibitively expensive.

Co-regulation: Under co-regulation the regulatory role is shared between government and industry. It is usually effected through legislative reference or endorsement of a code of practice. Typically, the industry or a large proportion of industry participants formulate a code of practice in consultation with government, with breaches of the code usually enforceable via sanctions imposed by industry or professional organisations rather than the government directly. This approach allows industry to take the lead in the regulation of its members by setting standards and encouraging greater responsibility for performance. It also exploits the expertise and knowledge held within the industry or professional association.

Economic instruments: At a theoretical level, the use of economic instruments should a priori be the preferred means of achieving policy objectives in a wide range of situations. This is because these tools – taxes, subsidies, tradable permits, vouchers and the like – operate directly through the market, thus harnessing market incentives and avoiding the substantial potential for distorting market incentives inherent in most forms of regulation.

Information and education: The most widely used alternative approach to regulation in OECD member countries is information and education campaigns. These approaches address information asymmetries and empower citizens and consumers to adopt actions or make informed choices that match their preferences and align their sensibility to risks. While many information campaigns simply seek to inform citizens and enhance consumer choice, some information campaigns are more explicit in seeking to change behaviour.

Voluntary approaches: Voluntary approaches are arrangements initiated and undertaken by industry and firms, sometimes formally sanctioned or endorsed by government, in which self-imposed requirements which go beyond or complement the prevailing regulatory requirements. They include voluntary initiatives, voluntary codes, voluntary agreements, and self-regulation and can vary in regard to their enforceability and degree of voluntarism.

Source: (OECD, 2002[31]), *OECD Reviews of Regulatory Reform: Regulatory Policies in OECD Countries*, https://doi.org/10.1787/9789264177437-en.

Policy makers have some guidance available on considering alternatives to regulation. RIA guidance on the process and methodology contains detailed information on how to consider alternatives to legislation and provides examples of such instruments. Alternatives to legislation are also always part of RIA training curriculum, even if they often are not included in proposals.

Public consultation and communication on RIA

Within the impact assessment procedure, government bodies are obliged to conduct consultations on the RIA and draft regulation (law) proposal for at least 30 days with the public. To support the consultation, proposers must include some brief explanatory text. Consultations are conducted via central state portal "e-Consultations" (e-Savjetovanja) (see more on consultations in Chapter 4).

Guidance, resources and training

As a part of the overall RIA legislative framework, the GLO has developed a RIA guidance document. The purpose of the guidance is to provide additional information about RIA methodology and process. The objective of this guidance is to set a structured step-by-step guide for whoever will draft RIA documents in law making process. Part of the guidance is a technical guide on standard analytical methods applicable to assessing costs and benefits of a legislative proposal, and other non-regulatory solutions. It consists of technical aspects of costs and benefits analysis, cost effectiveness analysis, preparatory work on public consultation stage, details on analysis of provided comments from stakeholders, publication of the feedback to the stakeholders, and a part on identifying milestones for monitoring and evaluation of a legislative proposal.

During the implementation of two twinning projects, Croatia held a set of workshops in RIA methodology. These workshops included the complete basics of RIA methodology from identification of a problem to reaching a decision of a preferred option and setting milestones for policy monitoring and evaluation[5] (see the section on RIA twinning projects in Croatia).

During the first twinning project in 2011, the three-day workshop was organised with around 100 participants from government, business representatives and civil society organisations. A “train the trainers” course in RIA methodology was also included, in which 20 civil servants attended with the purpose of building additional layer of sustainability to RIA system. During the second twinning project, a set of one-day workshop was designed so that each impact was covered in details. For instance, a one-day workshop was dedicated to environmental impact assessment and then other similar workshops were designed in other respective areas, including the economy and social care. Participant were free to participate in one or all consecutive workshops.

In total, the twinning projects had more than 400 participants. As for the sustainability of RIA legislative framework, a two-day workshop on the RIA process and methodology with focus on application of SME test and SCM methodology has become a part of the curricula of State School of Public Administration. From October 2017 to June 2018, this program had 70 attendees. RIA and the RIA process in general is currently not a part of the curriculum of the State School of Public Administration.

Despite Croatia’s significant efforts in training staff, a lack of human resources remains a challenge for implementing RIA and regulatory policy more broadly in Croatia. Many representatives noted that wages in the public sector compared to the private sector were quite low. Young people, especially those with skills in economics or cost-benefit analysis, are often attracted to the private sector because of higher wages. Even if some people become trained in RIA, the SME Test and SCM methodology, they may leave the public service and take these newly developed skills with them.

The SCM is relatively well established in Croatia. Government bodies have units for measuring administrative burdens that could serve as the basis for more technical units, which could more thoroughly look at measuring regulatory impacts.

Assessment and recommendations

Croatia scores highly on the iREG indicators for a good reason: all the necessary elements of *ex ante* evaluation exist for primary laws in Croatia. RIA starts relatively early in the process and looks at a wide variety of impacts. The RIA process is completed for all primary laws, which covers some 99% of regulations. Crucially, the GLO – a centre-of-government body – has the authority to review RIAs for primary laws. The RIA process also involves a threshold system that determines if a full RIA needs to be completed. Croatia has also made great strides in providing training and guidance on the ex-ante impact of primary laws, including the SCM methodology.

However, policy makers have not used RIA to its full potential. Although the elements are all there on paper, the actual information provided in RIAs seems to be relatively underdeveloped and could be significantly improved. Overall, the main challenge for Croatia is to turn the theory into practice, building and maintaining the analytical capacities in the government. Not only to ensure that ministries developing new regulations are producing good RIAs, but that it really becomes a part of the decision making process in general.

In addition, interlocutors during the fact-finding mission indicated that *subordinate regulations in Croatia are not under the same framework*, although they are responsible for many of the impacts to Croatian society, particularly administrative burdens.

Croatia could take a less is more approach to RIA. Target RIA and analytical resources to those major legislative initiatives that will have a major impact on Croatian citizens. At first, this could be through pilots of a rigorous process as part of the legislative planning. Overtime, Croatia could develop a triage process or threshold test to have two or three levels of RIAs. Under the current system, full RIAs generally contain little analysis. Croatia could pilot a full cost-benefit analysis to a handful of target regulations that are likely to have significant impacts on society. The targeted reviews could demonstrate to the government

decision-makers the value of having a more robust and in-depth RIA. Following a pilot, a third level of RIA could be introduced as part of legislative planning.

It will be very challenging to support a more in-depth analysis with the necessary human resources in ministries. **Croatia could continue to bolster training efforts and hiring to conduct evaluation**, particularly to support a more detailed impact analysis. In a number of reviews on the state of RIA in Croatia, the authors have noted that building capacity in policy makers to make use of RIA is crucial. Croatia should make sure that GLO itself has the necessary human resources to provide an effective service to support high-quality RIA in Croatia. This could involve hiring experts in cost-benefit analysis or economics. Crucially, training on RIA and cost-benefit analysis should become a key part of the State School of Public Service in Croatia, so that the analytical capacities also exist in ministries themselves as well. The small analytical units in state administrative bodies trained in the SCM could serve as the basis for more advanced units on measuring regulatory costs and benefits (see Chapter 3 for more information on the institutional setup).

Croatia should apply RIA to subordinate regulations with significant impacts. Institutionally, it is unclear who would be the oversight body for such a change. The GLO stated in interviews that it could not provide oversight, because that may conflict with its role as an expert service of the government only and not ministries or state administrative bodies. It may be necessary for the Ministry of Economy, Entrepreneurship and Crafts to review impacts as part of the inter-ministerial co-ordination process for subordinate regulation that requires each ministry to review impacts under its purview.

Alternatives to regulation should be encouraged before the issue is included in the Legislative Action Plan. Ministers who direct the legislative plan could be encouraged to analyse issues and identify the problem rather than deciding on the policy lever before they choose it as the solution. This is especially important for regulations that are not a result of an EU directive.

Croatia could consider requiring monitoring and evaluation plans as part of new regulations that have a very large impact on the country. Government bodies should carefully monitor regulations with high impacts on citizens or business to ensure that the regulation is meeting its objectives. It will be crucial that Croatian government bodies are reviewing any legislation passed under urgent procedure.

RIA twinning projects in Croatia

To improve the implementation of regulatory impact assessment (RIA) methodology into national policy-making process, through capacity building of Government Legislation Office (GLO) and regulatory institutions in the public administration and to ensure awareness of the stakeholders and wider public about the implementation of RIA co-ordination system. This was accomplished through:

1. Further development of impact assessment legal framework,
2. Development of administrative capacity in regulatory impact assessment and
3. Development and implementation of public relations campaign for regulatory impact assessment public awareness raising.

This project was of particular interest to those involved in the implementation of the Regulatory Impact Assessment system, particularly for:

- Government Legislation Office
- Government bodies, primarily the ministries
- Business Community and the NGO's.

The project "Development of Regulatory Impact Assessment (RIA) system in the Republic of Croatia" started in January 2011 and lasted for 18 months. The total value of the project was 1 100 000 EUR. This twinning project was implemented with the assistance of Northern Ireland Co-operation Overseas – NI-CO and the Estonian Ministry of Justice (Member State Twinning Partner).

Through the implementation of this project, Government Legislation Office elaborated and developed the legal framework for impact assessment, strengthened the administrative capacities for the regulatory impact assessment and raised the public awareness on the importance of establishing of RIA system.

This was achieved through the following range of results:

- Developed and adopted Act on Regulatory Impact Assessment and the Regulation on the implementation of the RIA procedure with Guidelines on impact assessment methodology
- Developed Strategy and Action Plan for implementation of RIA in Croatia
- Developed administrative capacities of line ministries through elaborate training programmes and implemented pilot projects
- Two study visits to EU RIA agencies
- Successfully implemented public awareness campaign in line with the developed Communication Strategy.

IPA 2011 Strengthening capacity for implementation of Regulatory Impact Assessment Strategy 2013 – 2015

The overall objective of the project was to increase the quality of primary legislation by using regulatory impact assessment (RIA) thus assisting public administration in becoming an efficient service capable of drafting clear and simple legislation. The project purpose was to strengthen capacities of the Government Legislation Office (GLO) and line ministries in regards to implementation of RIA system into law making process with a special focus on building capacities for analysis of economic, environmental and social impacts in drafting legislation. The project was successfully implemented in 2015.

IPA 2007 Development of regulatory impact assessment (RIA) system

The overall objective of the twinning project was to assist the Croatian public administration in becoming an efficient, modern service, capable for conducting impact assessment tools as a part of development of a modern regulatory system. The project's aims were to improve implementation of regulatory impact assessment (RIA) methodology into national policy making process, through capacity building of the Government Legislation Office and regulatory institutions in public administration and to ensure awareness of stakeholders and wider public about the implementation of RIA co-ordination system. The project consisted of three components: i) Further development of impact assessment legal framework; ii) Development of administrative capacity in regulatory impact assessment; iii) Development and implementation of Public Relations campaign for regulatory impact assessment public awareness rising. The project was successfully implemented in 2012.

The second Twinning light project started on 30 April 2015 and lasted for six months. The total value of the project was 250.000 EUR. This twinning project was implemented with the assistance of Northern Ireland Co-operation Overseas – NI-CO and the UK Department for Business, Innovation & Skills.

This project builds on the twinning project: Development of Regulatory Impact Assessment (RIA) System in Croatia (HR/2007/IB/FI/02) completed in 2012. Its purpose was strengthen GLO capacities of the (GLO) and line ministries in regards to implementation of RIA system into legislation making process with a special focus on building capacities for analysis of economic, environmental and social impacts in drafting legislation. This was accomplished through:

1. Further development of RIA methodological tools
2. Strengthening administrative capacity in regard to RIA implementation and
3. Raising public awareness on RIA benefits in legislative procedure.

Through the implementation of this project, Government Legislation Office has reviewed the RIA methodology tools, strengthened the administrative capacities for the regulatory impact assessment and raised the public awareness of their role in the existing RIA system.

This was achieved through the following range of results:

- Developed RIA methodology to include monitoring tools and updated the Guidelines on impact assessment methodology
- improved administrative capacities of line ministries through elaborate training programmes
- One study visit to EU RIA Agency
- Improved the Communication Strategy to raise public awareness and Stakeholder engagement.

References

OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264209022-en. [1]

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OECD SIGMA (2014), *Review of Policy on RIA and Legislative Drafting Capacities Of Republic of Croatia*, https://zakonodavstvo.gov.hr/UserDocsImages//dokumenti//2014%20SIGMA%20Izcjesce%20o%20RIA%20EN.pdf (accessed on 7 January 2019). [2]

Notes

[1] The same applies to reports, information and similar materials, if they contain suggestions of conclusions that define obligations to state administration bodies or create financial obligations.

[2] The effects may include, the economy, the small economy (SMEs), labour market, social welfare and pension system, health, environmental protection, human rights protection and market competition.

[3] The inner government cabinet includes the prime minister and ministers.

[4] This may include central state administration bodies, other state bodies, judicial bodies, public institutions, local and regional self-government units, legal entities with public authorities, companies owned by the Republic of Croatia and companies owned by local and regional self-government units.

[5] Other modules included, setting the objectives and possible policy solutions (regulatory instruments and consideration of alternatives to regulation), identification of likely significant impacts to various areas (economy, environment, social care) and analysis of their positive and negative aspects to affected groups/population.

6 *Ex post* evaluation of regulation in Croatia

This chapter focuses on how the Croatian government rationalises its existing stock of regulations, including how it undertakes reforms to improve regulation in specific areas or sectors to reduce administrative burdens and other compliance costs associated with regulation or evaluate the overall effectiveness of a regulation.

Ex post evaluation is one the most underdeveloped regulatory policy tools in the OECD. Generally, OECD countries have *ex ante* requirements to look at the impacts of regulations under development, but few do a thorough analysis of regulations once they are in place. In many countries *ex post* reviews only happen effectively during the amendment of regulations or on an *ad hoc* basis. The impetus to modify, update or create new regulations often only happens when an issue suddenly becomes a political priority. Few countries have regular programmes in place to ensure that regulations meet their objectives or look at the package of regulations that affects an entire sector.

Box 6.1. The fifth recommendation the Council on Regulatory Policy and Governance

Conduct systematic programme reviews of the stock of significant regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost-justified, cost-effective and consistent and delivers the intended policy objectives.

5.1. The methods of Regulatory Impact Analysis should be integrated in programmes for the review and revision of existing regulations. These programmes should include an explicit objective to improve the efficiency and effectiveness of the regulations, including better design of regulatory instruments and to lessen regulatory costs for citizens and businesses as part of a policy to promote economic efficiency.

5.2. Reviews should preferably be scheduled to assess all significant regulation systematically over time, enhance consistency and coherence of the regulatory stock, and reduce unnecessary regulatory burdens and ensure that significant potential unintended consequences of regulation are identified. Priority should be given to identifying ineffective regulation and regulation with significant economic impacts on users and/or impact on risk management. The use of a permanent review mechanism should be considered for inclusion in rules, such as through review clauses in primary laws and sunsetting of subordinate legislation.

5.3. Systems for reviews should assess progress toward achieving coherence with economic, social and environmental policies.

5.4. Programmes of administrative simplification should include measurements of the aggregate burdens of regulation where feasible and consider the use of explicit targets as a means to lessen administrative burdens for citizens and businesses. Qualitative methods should complement the quantitative methods to better target efforts.

5.5. Employ the opportunities of information technology and one-stop shops for licences, permits, and other procedural requirements to make service delivery more streamlined and user-focused.

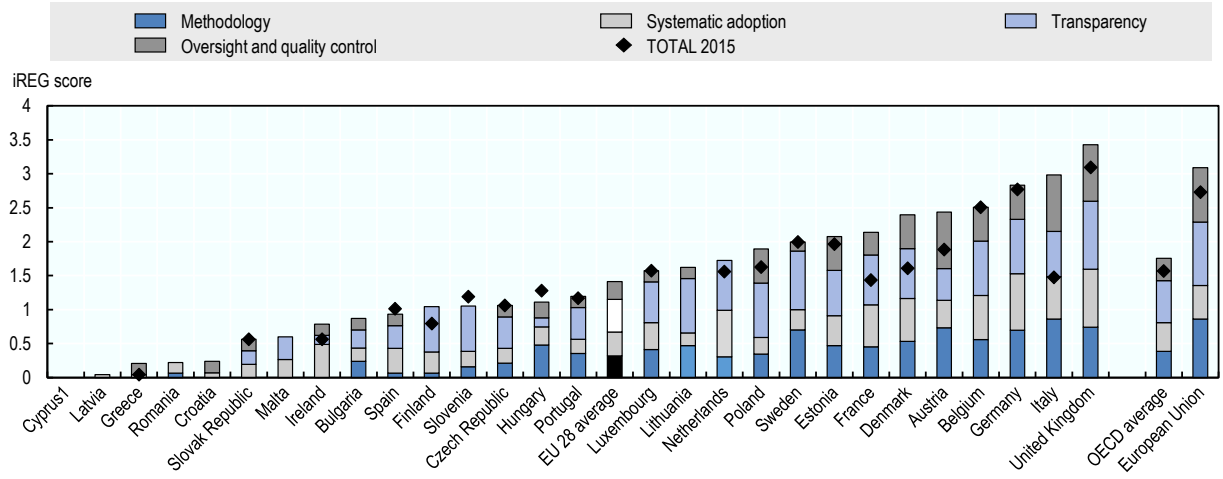
5.6. Review the means by which citizens and businesses are required to interact with government to satisfy regulatory requirements and reduce transaction costs.

Source: (OECD, 2012[1]), *Recommendation of the Council on Regulatory Policy and Governance*, https://dx.doi.org/10.1787/9789264209022-en.

Currently in Croatia, ministries may propose and develop amendments through the working groups described in Chapter 4. In these working groups, members get an opportunity to present ideas that may affect amendments to existing regulations. However, there is no formal system for reviewing the quality of regulations in particular sectors or programmes of work. Croatia has also not undertaken any *ad hoc* reviews of the performance of regulations in any particular sectors.

As a result, Croatia scores quite poorly in the OECD iREG indicators for *ex post* reviews (OECD, 2019[2]). In fact, it is one of the worst performing EU countries, according to a recent study by the OECD (see Figure 6.1).

Figure 6.1. Composite indicators: *Ex post* evaluation of primary laws, 2018



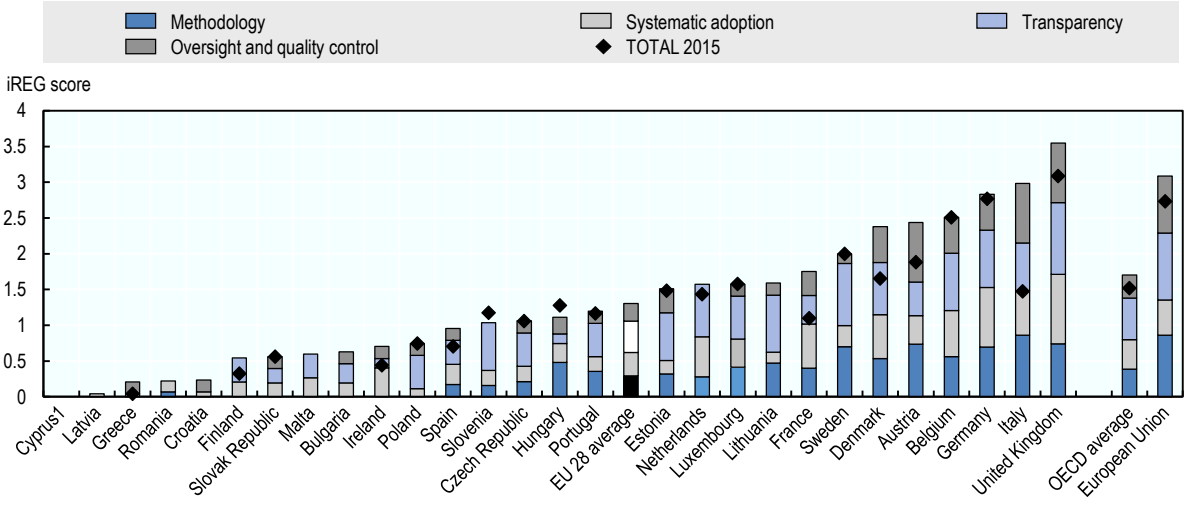
Notes: Data for 2015 is based on the 34 countries that were OECD members in 2014 and the European Union, which included 21 of the current 28 EU Member States. The OECD average is based on the 34 member countries at the time of the survey. Data for 2018 includes the remaining EU Member States of Bulgaria, Croatia, Cyprus,[1] Malta and Romania. The more regulatory practices as advocated in the 2012 Recommendation a country has implemented, the higher its iREG score.

1. Note by Turkey:
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

Note by all the European Union Member States of the OECD and the European Union:
The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, and the extension to all EU Member States, http://oe.cd/ireg.

Figure 6.2. Composite indicators: *Ex post* evaluation of subordinate regulations, 2018



Notes: Data for 2015 is based on the 34 countries that were OECD members in 2014 and the European Union, which included 21 of the current 28 EU Member States. The OECD average is based on the 34 member countries at the time of the survey. Data for 2018 includes the remaining EU Member States of Bulgaria, Croatia, Cyprus,[1] Malta and Romania. The more regulatory practices as advocated in the 2012 Recommendation a country has implemented, the higher its iREG score.

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Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, and the extension to all EU Member States, http://oe.cd/ireg.

Recognising the relative weakness, Croatia already has some changes planned. In 2017, an obligation to conduct an *ex post* RIA process was put into place in certain cases, e.g. when a draft legislative proposal is passed under an urgent procedure. In theory, the government may use an urgent procedure to remove a threat or damage or to protect a particular economic or social interest. In those cases, the state administration body shall subsequently (*ex post*) carry out RIA at the latest within two years from the date of entry into force of the law.

Box 6.2. Approaches to *ex post* evaluation

"Programmed" reviews

- For regulations or laws with potentially important impacts on society or the economy, particularly those containing innovative features or where their effectiveness is uncertain, it is desirable to embed review requirements in the legislative/regulatory framework itself.
- Sunset requirements provide a useful "failsafe" mechanism to ensure the entire stock of subordinate regulation remains fit for purpose over time.
- Post-implementation reviews within a shorter timeframe (1-2 years) are relevant to situations in which an *ex ante* regulatory assessment was deemed inadequate (by an oversight body for example), or a regulation was introduced despite known deficiencies or downside risks.

Ad hoc reviews

- Public "stocktakes" of regulation provide a periodic opportunity to identify current problem areas in specific sectors or the economy as a whole.
- Stocktake-type reviews can also employ a screening criterion or principle to focus on specific performance issues or impacts of concern.
- "In depth" public reviews are appropriate for major regulatory regimes that involve significant complexities or interactions, or that are highly contentious, or both.
- 'Benchmarking' of regulation can be a useful mechanism for identifying improvements based on comparisons with jurisdictions having similar policy frameworks and objectives.

Ongoing stock management

- There need to be mechanisms in place that enable "on the ground" learnings within enforcement bodies about a regulation's performance to be conveyed as a matter of course to areas of government with policy responsibility.
- Regulatory offset rules (such as one-in one-out) and Burden Reduction Targets or quotas need to include a requirement that regulations slated for removal if still "active", first undergo some form of assessment as to their worth.
- Review methods should themselves be reviewed periodically to ensure that they too remain fit for purpose.

Source: (OECD, Forthcoming[3]), *OECD Best Practice Principles for Regulatory Policy: Reviewing the Stock of Regulation*, Paris.

The first set of laws that must undergo the *ex post* RIA procedure, which are related to tax reform, entered into force on 1 January 2017. The Ministry of Finance has prepared the *ex post* RIA for each of the laws under this requirement. The Government has plans to monitor *ex post* RIAs.

Croatia has undertaken an extensive administrative burden reduction program for businesses and for the public sector called the Action Plan for Administrative Burden Reduction. According to the results of the Action Plan for Administrative Burden Reduction 2018, the total measured costs of all areas covered was HRK 5.1 billion. The Ministry of Economy, Entrepreneurship and Crafts estimates that implementing all the measures would save the economy HRK 625.9 million – an administrative burden reduction of 12%. The goal for administrative reduction until the end of 2021 is 21%.

For Croatia, the key challenges during the simplification process of regulation and burden reduction were; short deadlines, large number of regulations, resistance of the institutions, small number of employees within Ministry of Economy, Entrepreneurship and Crafts/Independent Business Environment Improving Service – in charge for the Action Plan co-ordination.

Reviews of the stock of regulation and formalities

During the mid-2000s, administrative burden reduction programs were a hot topic in regulatory policy. Almost all countries in Europe had targets to reduce administrative burdens on businesses, and sometimes citizens and the public administration too. Although Croatia started a bit later, it has a well-developed plan for reducing administrative burdens, even if it does not yet do systematic reviews of areas for improvement.

The Ministry of Economy Entrepreneurship and Crafts has implemented the Standard Cost Model (SCM) methodology and SME Test to help support businesses in Croatia, which face steeper burdens and procedures than in many comparable countries (see Chapter 1).

The Action Plan for Administrative Burden Reduction on the Economy is part of the broader reform package from the National Reform Plan within the European Semester. The purpose is to create an improved investment climate, simpler business conditions and to provide easier access to market services through the full implementation of the Internal Market Services Directive of the EU.

Regulations significantly burden the business sector and make it difficult for free access to market services. Therefore, the main objective of Action Plan and its several iterations was to administratively unburden the economy.

This Action Plan builds on the 34 measures of administrative reduction that have already been implemented in 2016, which included improvements in public procurement, work safety, crafts, trade, real estate brokerage, tax consultancy and accounting.

In 2019, Croatia also has two new initiatives related to the *ex post* evaluation of regulation. The first project will aim to identify the 10 most problematic procedures and areas on businesses and citizens. The second project, funded by the Structural Reform Support Service of the EC, will focus on new methodologies to review regulations other than SCM. *Ex post* evaluations have so far in Croatia focused exclusively on administrative burdens, so developing new ways to review regulations will be a critical to improving the regulatory environment (see Table 6.1 for examples of other types of *ex post* evaluation).

Administrative simplification initiatives

The Government determined the measures for administrative reduction through inter-departmental co-ordination with public administration bodies and through numerous consultations with business associations.

Table 6.1. Sum of administrative costs and reduction – Action Plan for Administrative Burden Reduction on Economy 2018

Competent authority	Legislative area	Total measured administrative cost per area (HRK) *ex post*	Amount of administrative reduction (HRK) *ex ante*	Estimated amount of administrative reduction (%) *ex ante*
Croatian Bureau of Statistics	Noble metals	1 134 651.13	87 740.06	7.73%
Croatian Bureau of Statistics	Metrology	22 429 954.42	5 764 520.84	25.70%
Croatian Bureau of Statistics	Homologation	1 947 584.18	0.00	0.00%
Ministry of Finance – Tax Authority	Taxes	4 858 814 699.84	577 024 891.45	11.88%
Ministry of Finance –Customs Administration	Customs, excise and special taxes	39 802 610.58	1 251 013.49	3.14%
Ministry of the Interior	Private protection	3 145 522.57	94 236.56	3.00%
Ministry of the Interior	Private detectives	82 453.46	4 258.30	5.16%
Ministry of the Interior	Protection of money institutions	2 712 670.21	189 779.32	7.00%
Ministry of Tourism	Tourism and catering	109 023 452.26	23 902 096.45	21.92%
Croatian Bureau of Statistics	Official statistics	48 572 693.06	7 116 070.93	14.65%
Ministry of Agriculture	Aquaculture	158 475.54	109 821.58	69.30%
Ministry of Agriculture	Fresh-water fisheries	695 464.43	627 875.99	90.28%
Ministry of Agriculture	Phytosanitary policy	1 089 458.03	521 453.74	47.86%
Ministry of Construction and Physical Planning – State Geodetic Directorate	Geodetic and cadastral jobs	13 681 713.66	9 292 072.95	67.92%
	TOTAL	**5 103 291 403.37**	**625 985 831.66**	**12.27%**

Source: Information provided by the Ministry of Economy.

One of the additional outputs from the Action Plan for Administrative Burden Reduction on Economy was the online tool, the "SCM Calculator". The ministries are using this tool in the process of SCM measurement of their regulations.[1]

Citizens can report detected burdens by e-mail. Also, all parafiscal levies can be reported on the Registry for Parafiscal Levies.[2] At this moment, there is an on-line form on the Ministry of Economy, Entrepreneurship and Crafts website as part of Registry for Parafiscal Levies that automatically forwards all queries to responsible institutions. In 2020, a project is planned for the implementation of a portal that will integrate all applications in a user-friendly way.

The use of ICTs to streamline processes in Croatia

In addition to looking at how regulations could be streamlined for businesses, Croatia has undertaken extensive measures to digitalise public administration procedures, perhaps more than in many OECD countries. The main task of public administration is to serve citizens, which Croatia hopes to achieve through improving electronic public services.

In June 2015, the Croatian Parliament adopted The Public Administration Development Strategy for the period from 2015 to 2020, which represents a strategic framework for improving administrative capacity and better public administration.

In December 2016, the Government of the Republic of Croatia also agreed to the Action Plan for Implementation of the Public Administration Development Strategy for the period 2017-2020.

The Government's policy is focused on meeting specific objectives:

- Building effective public administration
- Depoliticising and effectively managing human resources in the public sector
- Digitalisation of public services.

Among all the main and specific objectives of the Action Plan, the ones that are ICT related are:

- **Main objective 6**: Improving the delivery of services by electronic means; specific objective: facilitation the communication between public service and users of electronic services
- **Main objective 7**: Rational use of ICT resources; specific objective: rationalisation of resources, creating standards for e-Business and digitalisation.

To achieve the objectives above, Croatia is in the process of preparing numerous projects to reduce administrative burdens on public administration. (These projects are presented in detail in Annex 6.A).

The ultimate objective of the above is to establish common platforms and appropriate digital services for public administration bodies, which will improve service delivery and reduce the regulatory and administrative burdens on citizens and businesses.

Assessment and recommendations

Up until now, *ex post review in Croatia has focused almost exclusively on reducing administrative burdens to business, government and citizens.* There has been a strong focus on digitalisation of services. Generally, these reviews have brought improvements to the procedures internal to government. Many OECD countries have had a focus on administrative burdens, but this focus neglects whether laws and regulations are really meeting their objectives in an efficacious way. Every regulation is in effect an experiment. A ministry develops new rules for the market in the hopes that the market will have a better outcome on Croatian citizens. It is crucial that Croatia takes steps to ensuring that regulations are meeting the policy objectives of the government without undue costs to society.

Targeted *ex post* reviews focusing on performance of regulations ("fitness checks") or particular sectors should be used to improve the quality of regulations in high-impact sectors. Croatia could follow up the project this year on new methodologies in *ex post* evaluation with a few reviews in target sectors.

Priority areas or sectors for those reviews must be identified in co-operation with stakeholders. **Croatia could establish a permanent business forum to target areas of reform and to continuously search for areas to reduce administrative burdens**, e.g. like the Danish Business Forum (see Chapter 4 for more details).

During the design phase, **Croatian ministries could develop plans to track the success for proposed major regulations or at least identify some objectives of success.** What is measured is improved. It will be difficult for Croatia to review the impact of regulations without a plan to evaluate their efficacy, so Croatia should plan how to evaluate new regulations during the design phase. This could include mentioning one or two indicators of relevance for any new major draft regulation. The first *ex post* RIAs required in 2019 could be a good opportunity to see if the regulations met their proposed objectives.

Like for *ex ante* evaluation, a key challenge for Croatia will be building the necessary expertise on *ex post* evaluation. **Croatia should develop or reinforce institutions for oversight and expertise on *ex post* evaluations and *ex post* RIAs.** This unit could possibly be combined with the functions within a centre-of-government body, like the GLO, or could continue within the Ministry of Economy, Entrepreneurship and Crafts, who already has expertise on the Standard Cost Methodology. Rather than reviewing all *ex post* reviews, the GLO with the co-operation from the Ministry of Economy, Entrepreneurship and Crafts could provide oversight of the first *ex post* reviews based on methodologies other than the SCM.

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OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264209022-en. [1]

OECD (Forthcoming), *OECD Best Practice Principles for Regulatory Policy: Reviewing the Stock of Regulation*, OECD Publishing, Paris. [3]

Notes

[1] https://scm.mingo.hr.

[2] https://nameti.mingo.hr.

Annex 6.A. Seven public administration digitalisation projects under way in Croatia

1. Shared Service Centre which will unify the state information infrastructure and will enable the sharing of ICT resources and the same application solutions with a view to their rationalisation. All public sector bodies will be able to use a common, reliable and scalable ICT infrastructure according to the "clouds" paradigm. During 2018, it is planned to prepare a report on the ERDF, sign the Grant Agreement and begin implementation of the three-year project for the Establishment of Shared Services Centre. The amount of funds will be HRK 305 million, of which up to 85% of the funds from the ERDF fund.
2. e-Business which will provide a unique approach to e-business services, in the same way as the e-Citizens System is set up for individuals. The project will also establish a sub-system of e-Authorisation and access rights management. We are planning to prepare applications for ESF (European Social Fund), sign the Grant Agreement and begin the implementation of a three-year project on Establishing a Common e-Business Platform. For the establishment of the system and the three-year project, HRK 45.5 million is provided, of which 85% is the grant from the ESF fund.
3. e-Fees, which represents a common horizontal component in the development of complex e-services that will enable electronic payment of administrative and other fees. By the end of 2018, we will enable the card payments in the State offices around the Republic of Croatia. At later stages, payment of other types of fees (court, notary, tourist ...) will be provided. For the establishment of the system and the three-year project, HRK 45.7 million is provided, out of which 85% is non-refundable from the ESF fund.
4. e/m-Signature and e-Stamp is a project that will significantly facilitate the business in public administration. Citizens or business entities will no longer have to submit signed bills in order to use the services of public bodies. We are planning to prepare applications for the ESF, sign the Grant Agreement and begin the implementation of a three-year project establishing a Common System of e-Signature, m-Signature and e-Stamp with appropriate services that will be able to used by all public administration bodies, citizens and business entities for electronic signing and / or stamping of electronic documents as well as for their validation. For the establishment of the system and the three-year project, HRK 12 million is foreseen, of which 85% is non-refundable from the ESF fund.
5. Single Administrative Site represents a project whose establishment will facilitate access to public administration. Computerised services will be used by citizens and entrepreneurs through the e-Citizens Platform or through the e-Business Platform, and citizens who do not use digital technologies will be able to realise their rights by entering a single administrative site where a public servant will assist them in doing so. Out of the ESF funds, HRK 113.8 million are foreseen, of which 85% are non-refundable funds from the ESF fund.
6. e-Enrolment project will facilitate the process of enrolment in educational institutions from nursery schools through primary and secondary school to admission to higher education institutions, by digitalizing the whole process. Citizens will be able to report a child without a paper through the e-Citizens System or electronically in a selected institution. Also, the tracking of one's child through the whole education path will be enabled.

7. e-Newborn project Croatia has also established the first complexed e-service in a form of e-Newborn child. It is an integrated service that in one place allows: enrolment of a child into a birth register; enrolment in the register of citizenship; regulating the residence of the child to the parents' address; regulation of the health insurance of the child; and applying for a one-time cash support for a new born child from the Croatian Institute for Health Insurance.

7 Regulatory compliance, enforcement and inspections

This chapter reviews Croatia's strategy for regulatory compliance, enforcement and inspections, including the appeals process. It points to the opportunities and challenges for the implementation of the new law on the State Inspectorate. Finally, the chapter makes recommendations for how Croatia could improve its enforcement and compliance regime.

Compliance with regulations

Regulations cannot be effective unless the regulated subjects and actors comply with those regulations. Some ministries and inspection bodies (e.g. the Sanitary Inspection, Agricultural Inspection) regularly monitor compliance rates in Croatia. The overall compliance rates seem to be standard and there are no major issues compared to most of the OECD countries. However, Croatia has the 3rd largest grey economy among 31 European countries (IMF, 2018[1]) but, according to the data of the Labour Inspectorate, reports on conducted labour inspections indicate a gradual decrease of cases of undeclared work in Croatia (Bejaković, 2015[2]).

In those cases where data on the level of compliance are being collected, reasons for non-compliance are also regularly analysed. The use of this information as inputs for the review of the legislation is, however, less frequent, also given the limited experience with systematic reviews of regulations in Croatia. For example, the Labour Inspectorate participates in working groups dealing with legislative changes in the areas the Inspectorate covers, using the information from the inspection process.

For most regulated subjects, it is generally difficult to understand what they need to do to be in compliance with applicable regulations. Providing information and assistance to regulated subjects with the aim of increasing compliance should be a part of the work of enforcement and inspection authorities.

In Croatia, these activities are not yet systematically embedded in the daily work of all inspectorates. This does not mean that individual inspections do not promote compliance, on the contrary. For example, regarding regulations of fisheries, the Ministry of Agriculture organises workshops for fishermen, traders and carriers in all major cities on the coast. These workshops include presenting regulations in place and obligations stemming from them. The ministry also publishes relevant information, contact details and where to direct queries related to fishing, sale, transport documents etc. on their website.

In the tax administration area, large taxpayers obtain a special status and extended services provides through the Large Taxpayers Office. The Sanitary Inspection provides instructions, guidelines and trainings developed in co-operation with relevant stakeholders, such as the Chamber of Commerce, Chamber of Crafts, etc.

Regulatory enforcement and inspections

Ensuring effective compliance with rules and regulations is an important factor in creating a well-functioning society and trust in government. If not properly enforced, regulations cannot effectively achieve the goals intended by the governments. Regulatory enforcement is therefore a major element in safeguarding health and safety, protecting the environment, securing stable state revenues and delivering other essential public goals. Inspections are the most visible and important among regulatory enforcement activities. For more information on the OECD's view on the issue of regulatory enforcement and inspections, see the OECD Best Practice Principles for Regulatory Enforcement and Inspections see (OECD, 2014[3]) and (OECD, 2018[4]).

Box 7.1. The OECD Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections

1. Evidence based enforcement. Regulatory enforcement and inspections should be evidence-based and measurement-based: deciding what to inspect and how should be grounded on data and evidence, and results should be evaluated regularly.
2. Selectivity. Promoting compliance and enforcing rules should be left to market forces, private sector and civil society actions wherever possible: inspections and enforcement cannot be everywhere and address everything, and there are many other ways to achieve regulations' objectives.
3. Risk focus and proportionality. Enforcement needs to be risk-based and proportionate: the frequency of inspections and the resources employed should be proportional to the level of risk and enforcement actions should be aiming at reducing the actual risk posed by infractions.
4. Responsive regulation. Enforcement should be based on "responsive regulation" principles: inspection enforcement actions should be modulated depending on the profile and behaviour of specific businesses.
5. Long term vision. Governments should adopt policies on regulatory enforcement and inspections: clear objectives should be set and institutional mechanisms set up with clear objectives and a long-term road-map.
6. Co-ordination and consolidation. Inspection functions should be co-ordinated and, where needed, consolidated: less duplication and overlaps will ensure better use of public resources, minimise burden on regulated subjects, and maximise effectiveness.
7. Transparent governance. Governance structures and human resources policies for regulatory enforcement should support transparency, professionalism, and results-oriented management. Execution of regulatory enforcement should be independent from political influence, and compliance promotion efforts should be rewarded.
8. Information integration. Information and communication technologies should be used to maximise risk-focus, co-ordination and information-sharing – as well as optimal use of resources.
9. Clear and fair process. Governments should ensure clarity of rules and process for enforcement and inspections: coherent legislation to organise inspections and enforcement needs to be adopted and published, and clearly articulate rights and obligations of officials and of businesses.
10. Compliance promotion. Transparency and compliance should be promoted through the use of appropriate instruments such as guidance, toolkits and checklists.
11. Professionalism. Inspectors should be trained and managed to ensure professionalism, integrity, consistency and transparency: this requires substantial training focusing not only on technical but also on generic inspection skills, and official guidelines for inspectors to help ensure consistency and fairness.

Source: (OECD, 2014[3]) *Regulatory Enforcement and Inspections*, OECD Best Practice Principles for Regulatory Policy, Paris, http://dx.doi.org/10.1787/9789264208117-en.

The state of play of regulatory enforcement and inspections before 1 April 2019

Croatia was one of the first countries which decided to consolidate most of the inspection functions "under one roof" and create the State Inspectorate in 1997 competences of which were strengthened by a special law in 1999. The State Inspectorate assumed the former responsibilities of 12 various inspectorates (labour and workers safety and protection; trade and market surveillance; power, mining and equipment) that had been split between four ministries. Croatia reduced the number of inspections bodies from about 25 to less than 20 (for the 12 inspections moved to the Central Inspectorate, 4 inspectorates were established; but subsequently few inspections have been added) and the number of inspection units (representing different branches and departments in Croatia) from 100 to 49. This significantly reduced the number of inspections needed for an effective level of compliance, and has permitted the sharing of the reform's benefits between the state administration and the business community.

The State Inspectorate was abolished on 1st January 2014 and currently, the inspection activities are regulated by several laws, such as the Law on Inspections in the Economy, the Tourist Inspection, the Labour Inspectorate, the Customs Service, the Law on Sanitary Inspection, as well as other laws regulating individual administrative areas and conducting inspection activities in that area. The inspections are carried out by several inspection authorities, such as the Tax Administration of the Ministry of Finance, Sanitary Inspection of the Ministry of Health, Market Inspection of the Ministry of Economy, Entrepreneurship and Crafts, Labour Inspectorate of the Ministry of Labour and Pension System, Agricultural Inspection, Fisheries Inspection and Veterinary Inspection of the Ministry of Agriculture, etc.

This created a need for horizontal, cross-sectoral co-operation between inspection bodies. Mechanisms for such co-ordination exist, such as various committees for co-operation between inspection authorities. For example in the area of non-food (technical) products, a co-ordination committee was established between the inspection authorities responsible for monitoring of the safety of products placed on the market, its work is co-ordinated by the Ministry of Economy, Entrepreneurship and Crafts. However, more co-ordination would be needed to ensure joint planning of inspections and exchange of information on inspection results to make risk analysis and targeting of inspections more effective.

Most of the inspections are planned, however, inspection authorities have to react and act upon complaints received from consumers and other stakeholders, in case they indicate potential violations. The Market Inspection develops annual inspection plans, based on indicators such as past inspections results, laboratory test results of products sampled from the market, inputs received from consumers, as well as information received through the RAPEX[1] and ICSMS[2] systems. The Labour Inspectorate adopts a strategic plan for a period of three years, which is revised annually. The Ministry of Agriculture and the Ministry of Health, the authorities involved in securing food safety, animal feed, animal health and welfare and plant health, jointly prepared the "The "Multi-annual national plan of official controls of the Republic of Croatia for the period from 1 July 2015 to 30 June 2020".[3] The plan is regularly updated in relation to the new legislation and the division of responsibilities and updates are published on the web page of Veterinary and Food Safety Directorate.[4]

Each Annual Work Report of the Labor Inspectorate is scrutinised with the representatives of employers' association and representatives of trade unions as well as the National Labor Protection Council.

In some areas, regulatory enforcement based on the risk-based approach and sanctions. This is however still not a common practice. Risk-based approach is used for the planning of the frequency and of the objectives of the supervision, for example, in the area of food safety. The elements on which the risk-based approach is built on are: the size of the facility, activity of the facility, the size of the product market, previous checks that include the number and type of identified non-compliances. In case of the Veterinary Inspection, the frequency of on-site inspections is based on "high", "medium" or "low" risk assessment. The parameters for the assessment as well as the algorithm for calculating the risk for different types of businesses/establishments are included in the annual plan.

Electronic tools for reporting on inspections are used only by some inspections. The “e-INSPECTOR” is an expert system developed as a generic solution for increasing efficiency and effectiveness of inspection functions. It improves inspector performance, and supports synchronised activities of different government bodies. It is used by the Ministries of Agriculture, Health and by Customs Inspection. It covers all phase of inspection work: Planning; Methodology and document standardisation; Risk Management; Registers of: subjects, objects, regulations; Operations; Inspector case preparation; On-field work (including on-line document creation and issuing); Post-inspection work; Document management, digital archive, digital signature; Controlling, escalations, alerts; Analysis and reporting, business activity monitoring; Internet based communication with clients.

In case of the Fisheries Inspection, all inspection reports are filled in an electronically form in the “e-INSPECTOR” module. The module monitors each infringement in control list and provides a percentage of non-compliance of each part of fisheries control. In case of infringements with high percentage of cases, more frequent controls are conducted.

New law on the State Inspectorate

The National Reform Programme for 2018 envisages measures for the unification of inspection services, and a plan to re-establish the State Inspectorate as an inspection body that will unify related inspection works in the economy. This should eliminate excessive differences within the competencies of different inspections, an issue that was identified by the European Commission as one of the limiting factors in the efficient implementation of EU legislation. Therefore, the new Law on the State Inspectorate (*Zakon o Državnom inspektoratu*) was developed by the government and approved by the Parliament in December 2018. It will enter into force on 1 April 2019.

The State Inspectorate takes over the inspection of pressure equipment and the inspection of the management of poisonous chemicals from the Ministry of Economy, Entrepreneurship and Crafts, the sanitary inspection from the Ministry of Health, veterinary, agricultural, hunting, forestry and phytosanitary inspection from the Ministry of Agriculture, tourist inspection by the Ministry of Tourism, energy inspection, environmental inspection, inspection of nature protection and water inspection from the Ministry of Environmental Protection and Energy, Labour Inspectorate from the Ministry of Labour and the Pension System, and construction inspection from the Ministry of Construction and Physical Planning. The State Inspectorate is established as an independent inspection body (a state administration body that will report directly to the Government). The central office will be based in Zagreb with five to six regional offices and departments across the country.

Concentration of inspection activities is, of course, not the only goal of the establishment of the State Inspectorate. According to the analysis in the explanatory memorandum to the draft law, the internal organisation of inspections will be regulated in a unique way, common provisions regulating the duties and powers of all inspectors with the aim of uniform handling of inspection inspections is provided, inspections will be better co-ordinated which will result in the avoidance of unnecessary repetition of inspections by different inspection authorities, thereby reducing administrative burdens.

In addition, the application of the “principle of opportunity” in the work of the inspectors of the State Inspectorate is introduced. By applying this principle, inspectors will not apply corrective measures for minor offenses if the supervised legal or physical persons eliminate the irregularities during the inspection supervision, or until the decision is taken, if they act upon the adopted decision or if they undertake to eliminate the irregularities within a certain period. This will help to support regulated subjects in complying with regulations rather than focusing on punishment and deterrence and, in the long term, should support economic growth.

Planning of inspections will be improved through systematic alignment of inspection plans, planning of joint inspections and development of common guidelines for inspections. In some cases, inspections will be announced to the inspected subjects in advance of the inspections.

Appeals

The right of appeal against individual legal decisions made in first-instance proceedings by courts or other authorised bodies is guaranteed by the Croatian Constitution. This right of appeal may be denied in exceptional cases specified by law if other legal protections are ensured. Individual acts of state administration and bodies with public authority must be based on the law. Judicial control of the legality of individual acts of administrative authorities and bodies with public authority is also ensured by the Constitution.

The rules of procedure in the field of administrative law are regulated by the Law of Administrative Disputes.[5] The administrative dispute is initiated by a lawsuit which is filed within 30 days of delivery of the disputed individual decision or decision on objection to disputed proceedings.

Administrative disputes are solved by the administrative courts and the High Administrative Court of the Republic of Croatia. The court decides on the lawsuit ruling on the main and subsidiary claims. The verdict is issued and published on behalf of the Republic of Croatia.

The first instance verdict of the administrative court of a party may be appealed and the High Administrative Court examines the first instance verdict in the part in which it has been challenged by the appeal and within the limits of the reasons set out in the appeal.

Assessment and recommendations

The inspection framework in Croatia is going through a substantive reform in 2019 relating to the creation of the State Inspectorate. While there is no OECD recommendation on how to organise inspection authorities, the OECD Best Practice Principles on Regulatory Enforcement and Inspections certainly recommend that "inspection functions should be co-ordinated and, where needed, consolidated: less duplication and overlaps will ensure better use of public resources, minimise burden on regulated subjects, and maximise effectiveness." (OECD, 2014[3]) In this context, *the ongoing reforms in Croatia seem to be a move in the right direction.*

It is also positive that consolidation is not the only goal of the reform. The new framework should enable better planning of inspections and therefore reducing burdens stemming from inspections for the inspected subjects. The administration also wants to make enforcement and inspections more responsive, creating opportunities for assisting inspected subjects in complying with regulations rather than strict focus on deterrence.

Croatia should focus on successfully implementing the inspection reform in the following years. However, the reform should not stop there. **The use of risk-based approaches to enforcement should be bolstered**. A unified risk assessment system should be developed enabling better targeting of inspections. Also, the use of ICTs should be strengthened in conducting and reporting on inspections. **A central information system to share information between inspections should be developed** and the use of the "e-INSPECTOR" tool broadened. Last but not least, **inspectorates should focus more on providing advice, issuing guidance and inspection checklists to promote compliance** with regulations. Consolidating inspections in the new State Inspectorate should create the necessary conditions for moving this reform agenda forward.

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OECD (2018), *OECD Regulatory Enforcement and Inspections Toolkit*, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264303959-en. [4]

OECD (2014), *Regulatory Enforcement and Inspections*, OECD Best Practice Principles for Regulatory Policy, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264208117-en. [3]

Notes

[1] The Rapid Exchange of Information System (RAPEX) is the EU rapid alert system for unsafe consumer products and consumer protection.

[2] The internet-supported information and communication system for the pan-European market surveillance.

[3] http://www.veterinarstvo.hr/default.aspx?id=1255.

[4] www.veterinarstvo.hr.

[5] Official Gazette 20/10, 143/12, 152/14, 94/16, 29/17.

8 Multilevel Governance: The interface between the national and the sub-national level

This chapter looks at the interface between the national and the sub-national level of government in Croatia. It explains the organisation of regulatory attributions and the oversight mechanisms in place for regulation at the sub-national level and points to challenges and opportunities for regulatory policy in Croatia's municipalities, counties and cities. Finally, it gives recommendations for improvement of the multilevel regulatory governance set-up.

The importance of sub-national regulatory policy

In most OECD countries, different levels of government have the authority to make regulations. In Croatia, central government bodies function alongside regional and local governments, which have their own set of rules and mandates. The different layers of government have the capacity to design, implement, and enforce regulation.

The 2012 *OECD Recommendation of the Council on Regulatory Policy and Governance* addresses multi-level regulatory governance in two sections regarding coherence and co-ordination, and regulatory management capacities. Achieving co-ordinated reform across multiple levels of government is certainly a case where the whole is greater than the sum of its parts.

This multi-level regulatory framework poses a serious challenge. According to a report from the *Conseil d'État* in France (Marcou and Musa, 2017[1]), decentralisation of regulatory powers can create serious economic frictions because businesses and citizens have to manage an extra level bureaucratic process. Multi-level regulation affects the relationships of public administration with citizens and businesses and, if poorly managed, may negatively influence economic growth, productivity, and competitiveness.

Among others, multi-level regulatory governance should include avoiding duplicated or overlapping rules, low quality regulation, and uneven enforcement.

Box 8.1. The eleventh recommendation of the council on regulatory policy and governance

Foster the development of regulatory management capacity and performance at sub national levels of government.

11.1 Governments should support the implementation of regulatory policy and programmes at the sub-national level to reduce regulatory costs and barriers at the local or regional level, which limit competition and impede investment, business growth and job creation.

11.2 Promote the implementation of programmes to assess and reduce the cost of the compliance with regulation at the sub-national level;

11.3 Promote procedures at the sub-national level to assess areas for which regulatory reform and simplification is most urgent to avoid legal vacuum, inconsistencies, duplication and overlap;

11.4 Promote efficient administration, regulatory charges should be set according to cost recovery principles, not to yield additional revenue;

11.5 Support capacity-building for regulatory management at sub-national level through the promotion of e government and administrative simplification when appropriate, and relevant human resources management policies;

11.6 Use appropriate incentives to foster the use by sub-national governments of Regulatory Impact Assessments to consider the impacts of new and amending regulations, including identifying and avoiding barriers to the seamless operation of new and emerging national markets;

11.7 Develop incentives to foster horizontal co-ordination across jurisdictions to eliminate barriers to the seamless operation of internal markets and limit the risk of race-to-the bottom practices, develop adequate mechanisms for resolving disputes across local jurisdictions;

11.8 Prevent conflict of interest through clear separation of the roles of sub-national governments as regulators and service providers.

Source: (OECD, 2012[2]), *Recommendation of the Council on Regulatory Policy and Governance*, https://doi.org/10.1787/9789264209022-en.

The OECD has found that poor regulatory quality at one level may undermine high-quality policies and practices at other levels. In order to ensure regulatory quality across levels of government, governments at the national level need to have plan to ensure regulatory quality at lower levels of government that goes beyond merely enforcing the constitutionality or legal quality of sub-national regulations. National government should put in place clear definitions and effective implementation of the mechanisms to achieve good co-ordination, coherence, and harmonisation in making and enforcing regulation. Finally, measures to avoid and eliminate overlapping responsibilities are also critical.

There is no single ideal form for regulatory co-operation between national and local governments. Which level of government has the authority to regulate and in what manner is dependent on many internal and external factors, including the overall economic performance of the given country.

The OECD has developed a framework to analyse key issues of multi-level regulatory governance (Rodrigo, Allio and Andres-Amo, 2009[3]). It sets out that an analytical framework for multi-level regulatory governance should address a number of issues, including regulatory policies and strategies, institutions, and policy tools. On regulatory policies and strategies, issues related to harmonisation of regulatory policy and vertical co-ordination for regulatory quality must be addressed. The definition of roles and responsibilities of institutions responsible for regulatory policy is also an important element in this context, with the aim to strengthen institutional capacities. Finally, a set of regulatory policies and instruments that should be applied at lower levels of government, such as the introduction and use of regulatory impact assessment, transparency, reduction of administrative burdens, as well as tools to improve compliance and enforcement of regulation, are included in the agenda of a multilevel regulatory governance framework.

The organisation of regulatory attributions in Croatia

National law-making powers in the Croatian constitution

Croatia is a unitary state so much of the regulatory power rests with the national government. Since independence, Croatia has devolved significant duties to local authorities in part due to political pressure to ensure that local communities – which may have significant minorities – are able to operate independently (Korpic, 2003[4]). The Constitution of the Republic of Croatia stipulates in Article 129a that affairs falling within the purview of local and regional self-government are regulated by law.

More generally, the Constitution of the Republic of Croatia stipulates the principles of separation of powers into the legislative, executive and judicial branches. It includes the constitutionally guaranteed rights and limits to local and regional governments. Separations of powers encompassed in the Constitution include forms of co-operation and reciprocal checks and balances between the different levels of government.

Powers of local and regional governments to adopt regulations and general acts

The Constitution guarantees citizens the right to local and regional self-government, which is exercised through local or regional representative bodies, composed of members elected in free elections by secret ballot on the grounds of direct, equal and general suffrage. Citizens may also directly participate in the administration of local affairs, through meetings, referenda and other forms of direct decision-making, in compliance with the law and local statutes. The above rights are also exercised by EU citizens in compliance with the law and EU acquis communautaire. Furthermore, in Croatia the Constitution states that local government units are:

- municipalities and towns/cities
- territories of which are to be determined in the manner stipulated by law
- and other units of local self-government that may be established by law.

The Constitution states that regional governments are counties. The territory of a county is to be determined in the manner stipulated by law. In addition, the capital city of Zagreb has been accorded the status of a county.

Local and regional governments adopt general acts and regulations in all areas of their scope as defined by law (specified below). They have the authority to implement regulations adopted at the state level as defined by the LRSGA and special regulations.

Local and regional governments are responsible for the provision of services in all areas included in their scope, as well as services in other areas when authorised by special regulations. For instance, waste management and healthcare services are in their scope.

Local and regional governments also maintain important administrative matters related to services and regulations. They issue permits and approvals and issue plans in their administrative areas. For instance, counties and large towns issue location and construction permits and other acts related to construction and implementation of planning documents.

Ultimately, local governments are responsible for the quality of the regulations they adopt. The national government supervises the regulations and acts for the purpose of protecting constitutionality, citizens' rights and legality. However, the national government does not monitor their quality. The final review of the quality of local government regulations may only be given by the High Administrative Court of the Republic of Croatia through the review procedure to their general acts.

According to the Constitution of the Republic of Croatia, affairs which fall within the competence of local or regional self-governments are related to:

- housing, zoning and urban planning
- public utilities
- child care
- social welfare
- primary healthcare services
- pre-school and primary education
- culture
- physical education and sports
- technical culture
- consumer protection
- environmental protection and improvement
- fire prevention and civil defence.

Regional governments additionally administer affairs in key economic areas related to economic development, transportation and the development of the network of educational, health, social and cultural institutions.

The authority for local and regional governments to manage these areas are regulated by law. When devolving such matters, the national government should give priority to the bodies that are closest to the citizen. When determining these areas, the scope and nature of affairs and the requirements of efficiency and economy should be taken into account.

Local and regional governments are entitled to their own revenues and to spend them freely for areas under their purview. The revenues of local and regional governments must be proportional to their powers as envisaged by the Constitution and law. The national government is obligated to provide financial assistance to weaker units of local and regional governments in compliance with the law.

Under Article 33 of the Act on the Government of the Republic of Croatia, the Government resolves any conflicts of jurisdiction between government bodies. Any conflicts of jurisdiction between the bodies of the legislature, the executive and the judiciary are to be resolved by the Constitutional Court of the Republic of Croatia, in accordance with Articles 81 and 82 of the Constitutional Act on the Constitutional Court of the Republic of Croatia (Official Gazette No. 99/99, 29/02 and 49/02).

Oversight of regulation at the sub-national level

In Croatia, supervision of local and regional governments is largely limited to their legality (constitutionality and conformance with other relevant laws and regulations) and the supervision of some financial and administrative matters. A number of representatives mentioned that corruption remains an issue in Croatia at the local level, particularly with respect to administrative matters like construction permits and procurement, which often go to preferred agents. See for example (Bejaković, 2014[5]) and (GAN Integrity, n.d.[6]).

The national government conducts supervision of the legality of work and legal acts of local and regional governments to protect constitutionality, legality and citizens' rights. The local or regional government's representative body and the Ministry of Finance (or other authority stipulated by law) supervises the legality of material and financial management of a local or regional government.

The Local and Regional Self-Government Act stipulates that supervision of the legality of work of the representative body of a local or regional government is conducted by the central state administration body competent for local and regional government. Once irregularities are detected in the work of the local or regional body, the central government body will issue a decision declaring the relevant sitting of the local or regional body or part thereof unlawful, and the legal acts adopted at the sitting null and void. An appeal against the above decision is not admissible, but an administrative dispute may be brought before the High Administrative Court of the Republic of Croatia.

In the procedure of supervision of the legality of general acts, if the head of the state administration office in the county finds that a general act is in violation of the Constitution and the law, or that there were irregularities, he or she will issue a decision suspending the application of the act. However, the decision on suspension of a general act from application may also be issued directly by central government bodies within their scope. The proceedings for the review of the legality of a general act may, depending on the phase of the proceedings, also involve the High Administrative Court of the Republic of Croatia, the Government of the Republic of Croatia and the Constitutional Court of the Republic of Croatia.

When it comes to supervision over the performance of transferred state administration tasks, the ministry competent for the performance of the state administration tasks may issue instructions. The Government may deprive local and regional governments of the authority to perform tasks if they fail to proceed as instructed.

Administrative appeals on local governments may be submitted to the responsible body in the county. For acts adopted by the administrative bodies of counties and large towns, an appeal can be lodged to the competent ministry, unless otherwise stipulated by a special law. Furthermore, an administrative dispute may be initiated under the provisions of the Administrative Disputes Act.

No appeal is admissible against individual legal acts adopted by the representative body or municipal prefect, mayor or county prefect, which address the rights, obligations and legal interests of natural and legal persons. However, an administrative dispute can be initiated, unless otherwise stipulated by a special law.

No appeal is admissible, unless otherwise stipulated by a special law, against individual legal acts issued by a representative body or a mayor or county executive, which address the rights, obligations and legal interests of natural and legal persons. However, an administrative dispute may be initiated.

Multilevel co-ordination

The Regulatory Impact Assessment Act and the Rules of Procedure of the Government of the Republic of Croatia define co-ordination mechanisms between the national and subnational level. Local governments are regularly consulted, although only on an *ad hoc* basis, through their national associations as part of working groups. They are not a formal part of the civil society groups consulted through the established working groups.

When giving opinions on the proposals of laws and other regulations concerning local and regional governments, the Ministry of Public Administration refers all bodies to the provisions of the European Charter of Local Self-Government. The Charter stipulates that local authorities shall be consulted, insofar as possible, in due time and in an appropriate way in the planning and decision-making processes for all matters which concern them. Despite this, some local and regional govern representatives mentioned that they were often consulted too late in the process for regulations. Often, they only learned of new laws when the draft was available on the e-Consultation portal. Local and regional governments were often times not involved appropriately during the working groups set up during the development of regulations. On the other hand, the Associations also said that they often had limited resources themselves to conduct their own internal consultations to get the opinion of members.

Ministries that are drafting proposals of laws and other regulations often send their drafts and proposals to the associations of local and regional with a request for their opinions.

National associations of municipalities, towns/cities and counties are themselves a kind of co-ordination mechanisms. Local and regional self-government units use them to assume a common position in policy-making processes, although this can be a challenge with so many local and regional governments.

Croatia does not have a central co-ordinating mechanism for developing or reviewing regulations. Each ministry is in charge of contacting relevant local authorities in a primarily *ad hoc* approach when co-ordinating with the subnational government. This might lead to excessive bureaucracy because of duplicate consultations.

Box 8.2. Co-ordination between central and local governments in Denmark and Sweden

In Denmark, the local association of municipalities (LGDK) participates in a Steering Group for Cross-national Initiatives (STS). This has actively involved municipalities in the discussion of methods and results in areas such as e-government initiatives and the De bureaucratisation Programme. An example of policy based on co-operation between central and local government is the creation of a common citizens' portal. Following an annual agreement of 2007, the government has developed a portal, in co-operation with municipalities and regions. The portal provides a single guide to information regarding the public sector, and a common access for citizens to digital self-service solutions and access to own data across authority structures and levels. LGDK is also usually involved at a very early stage in the process of making rules, in an informal way.

In Sweden, the Swedish Agency for Economic and Regional Development – Tillväxtverket, a central government agency, has mapped the problems experienced by enterprises in their contacts with regional authorities and municipalities and possible solutions, in close co-operation with the Swedish Association of Local Government (SALAR). SALAR has also been active in identifying dysfunctional or

unnecessary regulations created at the national level which impact on the local level. SALAR has also encouraged the standardisation of often diverging municipal approaches to the interpretation and enforcement of regulations.

Source: (OECD, 2010[7]), *Better Regulation in Europe: Denmark 2010*, http://dx.doi.org/10.1787/9789264084551-en; (OECD, 2010[8]), *Better Regulation in Europe: Sweden 2010*, Paris, http://dx.doi.org/10.1787/9789264087828-en.

Challenges and opportunities for regulatory policy in Croatia's municipalities, counties, and cities

Croatia has a total population of 4.3 million, but over 500 different units of local and regional government. More than half of municipalities have fewer than 3 000 inhabitants.[1] As noted in Marcou and Musa, the capacity for regulatory policy is often significantly more limited in sub-national governments, particularly when they are relatively small. According to the associations of local governments in Croatia, many small local governments adopt regulations that appear to work in larger, more populous areas, because they lack the resources or capacities to develop their own policies. Given these limitations, it is likely best then to focus efforts to implement RIA, *ex post* evaluation and consultation on Croatia's larger cities and counties and to use simpler tools, compared to the national level.

Use of regulatory management tools at the local and regional level

Overall, use of regulatory policy tools in municipalities remains sparse. However, Croatian local and regional governments conduct some consultations and the situation is improving. The information commissioner of Croatia reported that just over 1 100 local consultations took place in Croatia in 2016, 1 721 in 2017 and 3 303 in 2018. Most consultations focus on environmental matters, urban planning, and sustainable waste management. This situation is also set to improve even more. There are currently plans to adapt the national level e-consultations portal for the local and regional level in Croatia (see Box 8.3).

Box 8.3. Adapting the national level e-consultations portal for the local and regional level in Croatia

Development of e-consultations portal for local and regional level in Croatia is planned within the Action Plan for the Implementation of the Open Government Initiative in the Republic of Croatia up to 2020. Local e-consultations will be integrated in the existing e-Consultations portal where local and regional units will be able to publish their own consultations, so in future, it is expected that all on-line consultation at all levels will be available to citizens in one place. This activity will be implemented by the Government Office for Co-operation with NGOs, Information Commissioner, Croatian County Association, Association of Cities in the Republic of Croatia and Association of Municipalities in the Republic of Croatia.

Local and regional development strategies also provide an opportunity to introduce regulatory management tools, such as RIA and *ex post* evaluation. Many counties and the capital city of Zagreb already use or plan to use certain regulatory policy tools. In Zagreb, for example, the City Office for Strategic Planning and Development used consultation during the production of the City of Zagreb Development Strategy for the period up to 2020 (see Box 8.4 for a summary of the strategy). Furthermore, the Development Strategy presents a good opportunity for Zagreb to use tools like the SCM when looking for ways to make the local economy more competitive.

RIA could also be a complement to Zagreb's priority to protect and preserve the local environment. Environmental assessments, for example, are already going to be a part of the process to protect the environment. Many other cities and regions in Croatia have experience forming development strategies that include economic and environmental goals.

Box 8.4. Zagreb Development Strategy

In The City of Zagreb Development Strategy for the period leading up to 2020, the City of Zagreb outlines the basic framework for all project initiatives and proposals at the level of the City that must be co-ordinated with the strategic document.

The development strategy was developed with stakeholders from many fields, including business, academia, NGOs, and private citizens. It outlines six key goals for the strategy:

1. A competitive economy
2. Development of human resources
3. Environmental protection and sustainable management of natural resources and energy
4. Improving urban quality and city functions
5. Improving the quality of life
6. Improving the development management system.

Each goal has a set of priorities and measures. Special emphasis in the implementation of the Development Strategy, along with the financial and institutional framework, was placed on strategic projects. The document focuses on and encourages further efficient realisation of 15 key strategic projects for the development of the City in the period ahead.

A number of the goals could also benefit from the implementation of regulatory policy tools. For example, the goal on environmental protection could be an entry point for a regulatory impact analysis that focuses on benefits to the environment.

Source: (City of Zagreb, 2017[9]), The City of Zagreb Development Strategy for the period leading up to 2020, City office for strategic planning and development of the city, https://www.zagreb.hr/userdocsimages/gu%20za%20strategijsko%20planiranje/rszg%202020%20_%20eng_digital.pdf.

Opportunities for learning from each other

In a 2018 report, the World Bank found significant differences between the ease of doing business between 25 municipalities across Europe, including five in Croatia.[2] The researchers found that Croatia had the widest variance in practices across cities. Entrepreneurs faced very different obstacles depending on the city.

Based on this, Croatia's cities certainly have a lot to learn from each other about how to reduce administrative costs to business for policies like dealing with construction permits or enforcing contracts. Additionally, the wide number of practices is likely a serious challenge to expanding a business in Croatia beyond the borders of the city in which the business started. The World Bank acknowledged that if Zagreb adopted the best practices of all the communities, Croatia's ranking would improve 11 places in the World Bank Doing Business Index.

Across the OECD, there have been a number of attempts to improve co-ordination and co-operation on regulatory policy between the different levels of government. For example, in Canada the Federal-Provincial-Territorial Committee on regulatory Governance and Reform (OECD, 2015[10]) is a group that

shares ideas and good practices in regulatory reform across provinces. The committee brings together policymakers from federal and sub-national governments to share best practices and to develop a common framework.

In Italy, amendments to the Constitution in 2001 gave significant powers to the regions. A number of co-ordination forums were established to encourage regulatory co-operation between sub-national and national governments (see Box 8.5).

Box 8.5. Regulatory co-ordination and co-operation in Italy

In Italy, the amendments introduced to the Constitution in 2001 established the transfer of legislative and regulatory competences from the State to the regions. In general, regions have gained legislative powers due to the increase of matters of concurrent competence. They have also reinforced their competence in issues that are no longer an attribution of the State. In the new constitutional balance of power among different levels of government, co-ordination mechanisms play a fundamental role. The main mechanism in Italy is the so called "Conference System", based on three co-ordination bodies:

- The Conference of State-Regions: It was established in 1988 to allow regional governments to play a key role in the process of institutional innovation, particularly regarding the transfer of attributions from the centre to the regional and local authorities. Its composition includes the Prime Minister or the Minister of Regional Affairs as President of the Conference, the presidents of the regions, and other ministers according to the competences of the issues under discussion.
- The Conference of State – Municipalities and Other Local Authorities: It was established in 1996 and its functions include co-ordinating the relations between states and local authorities, as well as analysing and serving as a forum for discussion of issues of interest for local authorities. Its composition involves the Prime Minister as President of the Conference, the ministers of the Interior, Regional Affairs, Treasury, Finance, Public Works, Health, the President of the Association of Italian Provinces, the President of the Association of Italian Mountain Communities, 14 mayors, and 6 presidents of provinces.
- The Unified Conference of State – Regions – Municipalities and Local Authorities: It was established in 1997 as the institutional mechanism to co-ordinate the relationships among the central government, regions, and local authorities. Its composition includes all the members of the previous two conferences. It served as the forum for an agreement on administrative simplification between the Italian regions and the national government in 2007. The signed document defines common principles for quality and transparency of the normative system in order to harmonise legislative techniques. In particular, it engages the State, regions, and local authorities to apply ex ante instruments, such as impact analysis and feasibility studies, and *ex post* evaluation.

Source: (García Villarreal, 2010[11]), "Successful Practices and Policies to Promote Regulatory Reform and Entrepreneurship at the Sub-national Level", *OECD Working Papers on Public Governance*, No. 18, https://dx.doi.org/10.1787/5kmh2r7qpstj-en.

Assessment and recommendation

Croatia's local and regional governments have significant authorities to develop their own regulations, particularly with respect to key economic areas like construction and environmental permits. The relative high degree of autonomy has led to significant differences in the quality of administration and regulation between subnational governments. Many of the smaller local governments lack the human resources or experience to effectively implement regulatory policy.

The *expansion of the e-Consultations portal in Croatia is a welcome development because it will extend a key regulatory policy tool to local and regional governments* at little cost. At the same time, many of the regional governments' development plans offer a good opportunity to introduce regulatory policy tools at the subnational level.

Based on previous studies, *sharing best practices in Croatia's local and regional governments could lead to significant improvements in administrative burdens* with the help of the national government.

The national government could encourage openness and transparency for economically important regulations and procedures at the sub-national level through the planned e-consultation portal. This portal could also be an opportunity for local governments to introduce a simplified RIA, which would serve as a launching pad for discussions about proposed regulations or decisions. This would be particularly important for economically significant regulations related to constitution permits, urban planning, environmental sustainability and waste management.

The national government could also find ways to encourage and help reduce administrative burdens at sub-national levels. To achieve this, **Croatia could develop a platform to share and easily access relevant licensing, urban planning regulations in local governments**. Often, a large economic barrier is the administrative and planning barriers for businesses. Improving the access to information of business and citizens across local governments will make it easier for them to make good economic decisions. It may also enhance knowledge transfer and competition between local governments to become more efficient.

To encourage rational regulations and policy at the local level, **the national government should help local governments use data and evidence-based policy at the local level for the most significant economic areas under the authority of local and regional governments**. A point of entry for such policies could be the development programs adopted by major cities and counties such as Zagreb and Rijeka.

Croatia should make local governments and their representative groups (e.g. Association of Municipalities) key social partners in working groups, the proposed business forum, and any high-level committees on regulatory policy (see Chapter 4 for more info). Many regulations and laws have serious effects on the revenues or operations at the local level and their continued co-operation in developing national laws is paramount. Including local and regional governments in the business forum could support administrative burden reductions at the local level.

More broadly**, Croatia could support administrative simplification efforts at the subnational level by taking advantage of economies of scale.** One way to do this would be for the Croatian government to target a simplification measure to a common bureaucratic procedure handled by local and regional governments (e.g. filing construction permits or environmental assessments). Targeting a specific set of procedures common to all local governments would have broader impacts across the economy. It would also take advantage of economies of scale of simplification, enabling easy wins for administrative burden reduction.

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Notes

[1] An up-to-date count of local and regional governments is available at: https://udruga-opcina.hr/en/about-us/localself-government-in-croatia-73

[2] The cities included Osijek, Rijeka, Split, Varazdin, and Zagreb in Croatia; Brno, Liberec, Olomouc, Ostrava, Plzen, Prague, and Usti and Labem in the Czech Republic; Braga, Coimbra, Evora, Faro, Funchal, Lisbon, Ponta Delgada, and Porto in Portugal; and Bratislava, Kosice, Presov, Trnava, and Zilina in Slovakia.

9 Multilevel governance: The interface between the national level and the European Union

Chapter 9 assesses the interface between the EU and the national level of government in Croatia, which is a core element of effective regulatory management in all EU countries. The chapter describes and evaluates the processes in place for negotiating the national position, transposing EU directives into national law and ensuring consistency with national legislation in Croatia. The chapter also briefly addresses the mechanisms in place to prevent gold-plating. Finally, it gives recommendations for improvement of the multilevel regulatory governance set-up.

The 2019 *Better Regulation Practices across the EU* report (OECD, 2019[1]) highlights that the complexity of today's environment means that governments cannot address regulatory challenges at the domestic level alone. The quality of laws and regulations in the EU also depends on the quality of the regulatory management systems, both in member states and in EU institutions. The benefits of European legislation can significantly be reduced if countries' practices of negotiating and transposing EU directives into national law are not well designed and implemented. The regulatory management systems of the EU institutions and the EU Member States therefore need to be mutually reinforcing in order to be effective (OECD, 2019[1]). As the EU's latest member, aligning national- and EU-level legislative processes is particularly important for Croatia.

Croatia in the European Union

When Croatia joined the European Union in 2013, the national co-ordination of EU affairs was established with the Ministry of Foreign and European Affairs (MFEA) appointed as the national co-ordinative body. The Croatian government set the legal framework and procedures for the national co-ordination of EU-affairs (OG 43/16) by adopting the Decision on the Establishment of the Inter-ministerial Working Group for European Affairs.

The MFEA is the national co-ordinative body for the transposition and implementation of the EU *acquis* and manages the EU-affairs database (*IKOS EU Affairs*) that enables automatic distribution of documents received from EU institutions and online co-operation among state institutions involved in the transposition process. The ministry also co-ordinates the drafting of the Annual Government Program on implementation and transposition of the EU *acquis* into Croatian law. The MFEA regularly reports on the implementation of the EU *acquis* to the permanent working bodies of the Government. As central contact point, the MFEA is responsible for notifying the EC on the progress of the transposition process via the electronic EC database.

Negotiation of the national position

The process for developing the national position of Croatia at the EU negotiation stage is co-ordinated by the MFEA.

An inter-ministerial EU-affairs working group is set up to discuss and approve the national position on items on the COREPER I and COREPER II agenda. The working group can also discuss other horizontal issues related to EU affairs. OG 43/16 stipulates that the working group consists of representatives of all ministries and governmental bodies and is set up and chaired by the MFEA. The inter-ministerial EU-affairs working group meets weekly.

The national framework positions on new legislative proposals as well as national positions for EU council meetings are discussed and approved by the government's permanent working body on the Co-ordination of Foreign and European Policies and Human Rights, which is chaired by the MFEA. The working body is made up of EU co-ordinators or their deputies in the central government bodies responsible for the subject area. National positions for the EU Council meetings are in a last step adopted by the government. Competences and responsibilities of government bodies for the participation in the work of the Council Working Groups are laid out in the *Conclusions of the Government of the Republic of Croatia.* The MFEA decides in case of disputes over competences.

The working body can decide to include other competent authorities and key stakeholders to ensure stakeholder engagement in the decision-making process, however there is no requirement in place to do so. Stakeholders are also not systematically informed of the various opportunities to provide feedback on legislative proposals at the early stage of their development directly to the EC (see Box 9.1), as no single body is responsible for informing the general public.

Box 9.1. Stakeholder engagement throughout the policy cycle at the European Commission

The European Commission uses a range of different tools to engage with stakeholders at different points in the policy process:

- Timelines make it easy to track an initiative and to anticipate upcoming opportunities to provide input.
- Through roadmaps and inception impact assessments (IIA), the public has the possibility to provide feedback on the Commission's policy plans at the initial stage of policy development.
- A 12-week public consultation is conducted through the "Have your say" portal allowing stakeholders to express their views on key aspects of the proposal and main elements of the impact assessment under preparation.
- Stakeholders can provide feedback to the Commission during an eight-week consultation period on its proposals and their accompanying final impact assessments once they are adopted by the College.
- At the end of the consultation work, an overall synopsis report should be drawn up covering the results of the different consultation activities that took place.
- The Commission also consults stakeholders as part of the ex post evaluation of existing EU regulation. Stakeholders can provide their views on existing EU regulation at any time on the "Have your say" website.

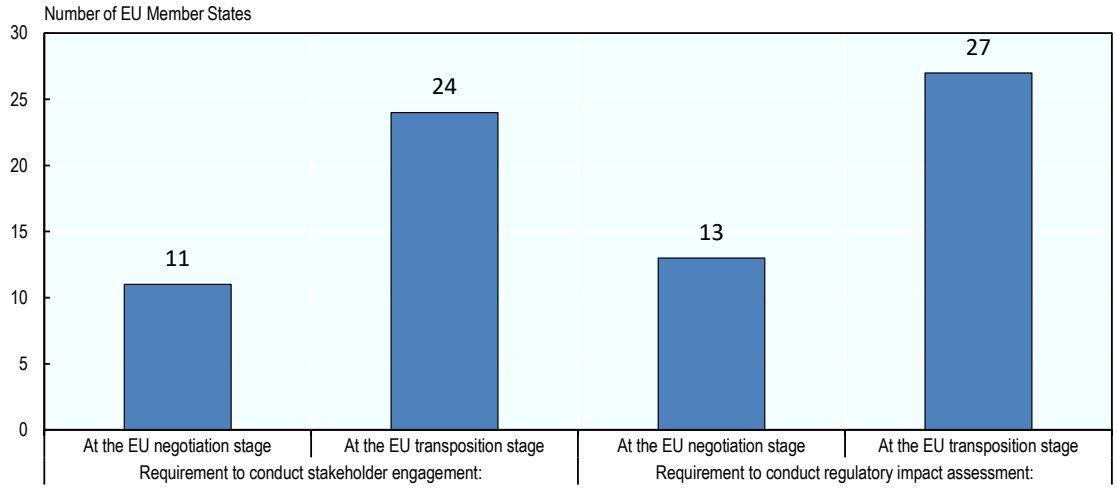
Sources: OECD (forthcoming): OECD Best Practice Principles on Stakeholder Engagement in Regulatory Policy, OECD Publishing, Paris; OECD Pilot database on stakeholder engagement practices in regulatory policy. http://www.oecd.org/gov/regulatory-policy/pilot-database-on-stakeholder-engagement-practices.htm. As cited in (OECD, 2019[1]), *Better Regulation Practices across the EU*, https://doi.org/10.1787/9789264311732-en.

According to the Law governing the Co-operation between the Parliament and Government in EU affairs (OG 81/13), the national framework positions on new EU legislative proposals are presented in the Parliamentary Committee for EU-affairs. Art. 7 stipulates that the Committee could ask for a full RIA (including public consultation on the initial RIA) to be conducted on draft EU documents to inform the national position, however in practice this has not happened yet.

In just more than half of OECD countries that are members of the EU, including in Croatia, there is no requirement to conduct an impact assessment at the EU negotiation stage (see Figure 9.1) even though this phase presents a strong opportunity for countries to directly amend the EU legislative proposal. There is, however, an obligation for administrative bodies responsible for drafting the national framework position in Croatia to indicate if the EU proposal will have an impact on the state budget and if amendments to the national legislation will be necessary.

While European Council and Parliament committed themselves to carry out impact assessments of substantial amendments to the Commission's proposals, the impacts of these amendments on individual member states may not be adequately determined (OECD, 2019[1]). Assessing the impacts of EU legislative proposals at the negotiation stage could therefore prevent unnecessary regulatory burdens for Croatia and there are options available that require less resources than a full RIA. For example in Lithuania, policymakers are required to complete a "basic impact assessment" in reaching its negotiation position. Basic impact assessments examine objectives and options for implementation of draft legislation, including quantitative data whenever possible (Government of Lithuania, 2008[2]).

Figure 9.1. EU Member States' requirements to conduct stakeholder engagement and RIA on EU-made laws



Note: Data is based on 28 EU Member States.
Source: Indicators of Regulatory Policy and Governance Survey 2017, http://oe.cd/ireg.

Transposition into national law

The process of transposition and implementation of EU directives in Croatia is standard and similar to many OECD countries that are members of the EU.

Regulations which transpose EU legislation into national law are drafted by the central government bodies according to their competences set out in the Act on Organisation and Scope of Ministries and other Central State Bodies (OG 93/16, 104/16) and Act on the State Administration System (OG 93/16, 104/16). Other agencies (with public authority) may participate in the drafting process if the content of the regulation relates to their competences. In case of disputes over competences, the decision is being made by the Government based on the recommendation of Ministry of Foreign and European Affairs, which is the national body responsible for the transposition and implementation of the EU *acquis*.

The body responsible for drafting the legislation is required to conduct a regulatory impact assessment at the transposition stage. The same requirements and processes apply as for regulations originating domestically. This is the case in most OECD countries (see Figure 9.1 right panel).

When drafting the legislation that transposes the EU directive, the competent body is obliged to consult all key stakeholders (NGOs, general public, business sector). Through the central government platform *e-Savjetovanja* stakeholders can submit their comments on the draft legislation in open public consultations.

The transposition of EU directives into national law can be challenging and limited guidance is available in Croatia. In the UK, the government published elaborate transposition guidance describing the steps to follow in order to effectively transpose EU directives into national law. The results are summarised in a so-called transposition checklist composed of 20 elements (Table 9.1) (Department of Business, Energy & Industrial Strategy (UK), 2018[3]).

Table 9.1. UK Transposition Guidance

Transposition checklist as published by the Department of Business, Energy & Industrial Strategy

Pre-transposition	• Consider at the earliest possible stage how a proposal will be implemented and enforced in the UK, including by the devolved administrations. • Commit appropriate resources to handling the transposition. • Discuss the Directive with the negotiating team and lawyers to ensure an adequate link between negotiation and transposition. Any issues that may impact on transposition should be reflected in the transposition project plan. • Consider how to transpose in a manner which avoids going beyond the minimum requirements of the Directive. • Any issues that may impact on transposition should be reflected in your transposition project plan. • Make use of project management techniques to ensure timely implementation and effective stakeholder engagement at key stages.
Initial RRC notification	• Write to the Reducing Regulation Committee (RRC) (for information only) within 2 weeks of the legislation appearing in the Official Journal of the EU, including a covering letter, transposition project plan and transposition table if you include one. • Ensure that your covering letter discusses how the proposed approach to implementation addresses the Guiding Principles – Cabinet Office has issued a template which should be followed when drafting this covering letter.
Initial RRC notification	• Prepare an impact assessment (IA). • For significant measures (with net annual business impacts greater than +/- £5 million) seek an opinion from the Regulatory Policy Committee (RPC) on your IA. Ensure you allow sufficient time in your project plan to re-work your impact assessment should you receive a negative opinion from the RPC. • Seek RRC (and relevant domestic policy Cabinet committee(s)) clearance to consult, addressing how the Guiding Principles have been applied. The Cabinet Office template which should be followed when drafting this covering letter. Ensure you attach the consultation document, a consultation stage IA and any relevant RPC opinion.
Final clearance	• Allow time to seek RRC (and relevant domestic Cabinet committee(s)) clearance of the final proposed legal text – in case this is required. Address in your clearance letter the Guiding Principles. For significant measures, ensure you attach a final IA with a positive RPC opinion and updated transposition table. • Produce guidance which sets out for those affected exactly what their legal obligations are, at least 12 weeks before the legislation takes effect. • Notify the Commission of implementation. • Produce a Transposition Note for the UK Parliament.
Review	• Review the impact of the legislation implementing a Directive every 5 years, drawing on, and incorporating, the post-implementation review process.

Source: (Department of Business, Energy & Industrial Strategy (UK), 2018[3]), "Transposition guidance: how to implement European directives effectively", https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/682752/eu-transposition-guidance.pdf.

The issue of gold-plating

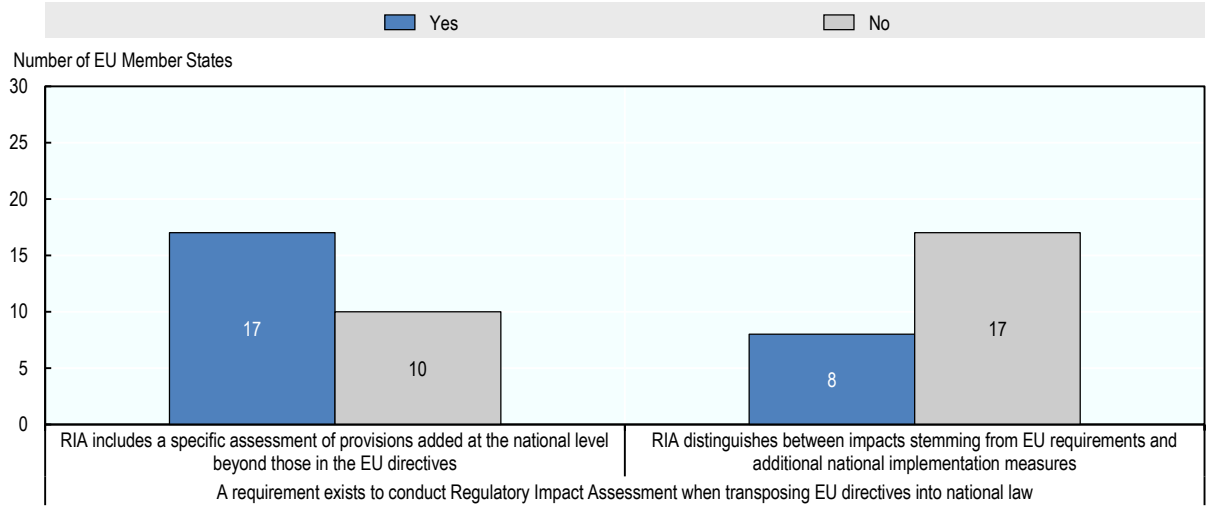
The majority of EU member states include a specific assessment of provisions added at the national level which go beyond those established in the EU directive (Figure 9.2, left pane), so called "gold plating" (Box 9.2). By doing so, countries assess the total regulatory impacts of the legislation imposed by both the EU and the member state (at national level).

Box 9.2. Gold plating of EU directives

Gold plating is a term specifically used in the EU context and describes over-implementation of an EC Directive through the imposition of national requirements going beyond the actual requirements of the Directive. Directives allow Member States to choose how to meet the objectives set out in the Directive, adapting their approach to their own institutional and administrative cultures. Moreover, many directives are minimum directives allowing Member States to go beyond their requirements. It is therefore often at this stage that additional details and refinements, not directly prescribed by the Directive, are introduced. These can go well beyond the requirements set out in the Directive, resulting in extra costs and burdens (OECD, 2009[4]).

Source: (OECD, 2019[1]), *Better Regulation Practices across the EU*, https://doi.org/10.1787/9789264311732-en.

Figure 9.2. Requirements to assess gold plating and national additional implementation measures



Note: Data is based on 28 EU Member States.
Source: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, and the extension to all EU Member States, http://oe.cd/ireg.

In Croatia, a specific assessment of gold plating is not included in the RIA that is conducted at the transposition stage. A specific assessment of these impacts during the RIA conducted at the transposition stage helps to identify and avoid unnecessary regulatory burdens. Considering the high level of burdens for businesses in Croatia, this could be particularly relevant. Lithuania's European Law Department laid out a series of steps that can be taken to prevent gold-plating (see Box 9.3).

Box 9.3. Recommendations for preventing gold-plating – Lithuania

During the negotiation phase at EU-level, the responsible national institutions should:

- Clarify the objectives of the draft EU legislation; evaluate subsidiarity of the initiative; conduct impact assessment and describe the data provided to the European Commission for the EU level impact assessment; compare the data of the EU level and national level impact assessments; identify potential issues and raise these issues during the negotiation process.
- Start preparations for the transposition stage; identify necessary measures for the transposition of the draft EU legislation and consult on them with relevant stakeholders.

During the transposition stage, responsible national institutions should:

- Always start from the position that over-implementation must be avoided; evaluate the stock of existing regulations first, to avoid the flow of new regulations wherever possible; use derogations or alternative 'lighter regimes' wherever possible; conduct comparative linguistic analysis of the EU law; use technology based measures; use better regulations principles to choose smart and least burdensome implementing solution;
- If necessary, perform additional impact assessment to complement the existing one. Consult with end-users of the legislation.

At the post-transposition stage, the responsible institutions should:

- Include a statutory duty/clause for an ex post review or enter the duty into the legislation review plan.

Source: The European Law Department, Lithuania in (OECD, 2015[5]).

Ensuring consistency of national legislation with EC Regulations

The procedure ensuring compliance of national legislation with the *acquis communautaire* is laid out in the Decision on the Instruments for Alignment of the Legislation of the Republic of Croatia with the *acquis* (OG 44/2017). The decision obliges the competent authorities (i.e. those responsible for drafting the legislation) to ensure the alignment of domestic legislation with the *acquis* during the preparation of the draft legislation and sets forth the appropriate instruments.

Competent authorities, when preparing the draft legislation, are required to prepare the instruments for alignment of legislation (the "Table of Concordance of the Provisions of the EU Acts with the Draft Legislation" and the "Statement of Compatibility of the Draft Legislation with the *acquis*") and submit them to the MFEA for approval via the IKOS – EU affairs online platform. After the Ministry of Foreign and European Affairs approves both instruments for alignment of the legislation, the competent authority submits the draft legislation together with a Statement of Compatibility to the MFEA for official verification and confirmation of alignment. In case the act is adopted under regular legislative procedure, a second reading will have to be conducted following the same procedure. The MFEA then determines if the draft legislation has been aligned with the *acquis*.

The MFEA can return the draft legislation to the competent authority for revision in the following cases:

1. the competent authority did not prepare the instruments for alignment of the legislation;
2. the instruments for alignment of the legislation were not prepared correctly;
3. the information in the instruments for alignment of the legislation are contradictory to the draft legislation;
4. the Ministry of Foreign and European Affairs determined that the draft legislation has not been aligned with the *acquis*.

Once all instruments have been prepared correctly and the MFEA determines that the draft legislation is in line with the *acquis*, the competent authority submits the draft legislation to the Government (no later than four months before the deadline for notification of national transposition measures determined by the EU directive with which the draft legislation is being aligned).

The MFEA as national co-ordinative body is responsible for monitoring the process and reports on the progress to the Government annually, proposing measures for advancement of its implementation.

Assessment and recommendations

Croatia has successfully put in place a government structure for co-ordinating the interface between EU- and national level. The MFEA as national co-ordinative body oversees the process of negotiating and transposing EU directives and individual line ministries are responsible for drafting positions in their areas of competence. For the purpose of enabling distribution of documents received from EU institutions and co-operation among state institutions involved in the transposition process the *IKOS EU Affairs* database has been set up.

While the institutional set-up works well, Croatia focuses its efforts on the later stage of the EU legislative process and rarely uses regulatory management tools to inform the national position during the negotiation phase. The negotiation phase presents a strong opportunity for Member States to directly amend European Commission proposals (as introduced to Council and the European Parliament) before they become EU legislative acts. It is therefore important that the relevant stakeholders get an opportunity to express their views on the EU legislative proposal and that its impacts for Croatia are adequately assessed at this stage. Like in many other EU countries, there is no requirement in Croatia to consult relevant stakeholders and assess impacts of the draft legislation when developing the national position on the EU draft legislation and in practice this rarely happens.

The public is not systematically informed of opportunities to provide their input at EU-level. The Commission uses a range of different tools to engage with stakeholders at various points during policy development. These present opportunities for EU countries and their citizens to participate, provide evidence, and improve EU laws including at early stages of their development. Currently, Croatia does not systematically inform stakeholders of the opportunity to provide input in order to facilitate the early engagement of its citizens to get engaged on EU level early in the legislation making process. This represents a lost opportunity for affected parties to have their views heard directly at EU level.

Croatia should ensure that a proportionate analysis of impacts is carried out and relevant stakeholders are involved in the process of preparing national positions to draft EU legislation. Criteria for when such assessment is necessary should be set by a Government resolution. In addition to applying regulatory management tools on national level when negotiating the national position and transposing EU directives into national law, Croatia should use the results of regulatory management tools (e.g. RIA) conducted at EU level to inform the process. While the European Council and Parliament carry out impact assessments for substantial amendments to the Commission's regulatory proposals, the impacts of these amendments may not adequately assessed by individual member states, which could cause unnecessary burdens for individual countries. The impact assessments conducted on both EU- and national level should therefore inform the development of the national position for the negotiation phase in EU council.

When assessing the impacts of legislation, an assessment of "gold-plating" should be included. Provisions added at the national level that go beyond those in the EU directives can add significant costs and burdens to businesses and citizens. A specific assessment of these impacts during the RIA conducted at the transposition stage helps to identify and avoid unnecessary regulatory burdens. In addition, there are several other steps that can be undertaken to avoid gold-plating (see Box 9.3).

Croatia could consider centralizing the responsibility for raising awareness of consultations happening on EU-level. The responsibility to inform the general public of consultations conducted on EU-level currently lies with line ministries. It could be considered to centralise the responsibility for awareness raising for EU-consultations in the MFEA to ensure the public is informed systematically. The MFEA would notify the public of upcoming consultations on EU-level by posting on the e-consultation portal.

References

Department of Business, Energy & Industrial Strategy (UK) (2018), "Transposition guidance: how to implement EU Directives into UK law effectively", https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/682752/eu-transposition-guidance.pdf (accessed on 11 December 2018). [3]

Government of Lithuania (2008), *Resolution No.21 of 9 January 2004 Official Translation 22 July 2008*, http://www.oecd.org/gov/regulatory-policy/46272075.pdf. [2]

OECD (2019), *Better Regulation Practices across the European Union*, OECD Publishing, Paris, https://doi.org/10.1787/9789264311732-en (accessed on 13 March 2019). [1]

OECD (2015), *Regulatory Policy in Lithuania: Focusing on the Delivery Side*, OECD Reviews of Regulatory Reform, OECD Publishing, Paris, https://dx.doi.org/10.1787/9789264239340-en. [5]

OECD (2009), *Better Regulation in Europe: An OECD Assessment of Regulatory Capacity in the 15 Original Member States of the EU. Project Glossary*, http://www.oecd.org/dataoecd/32/54/34227698.pdf (accessed on 22 November 2018). [4]

10 SME Taxation in Croatia

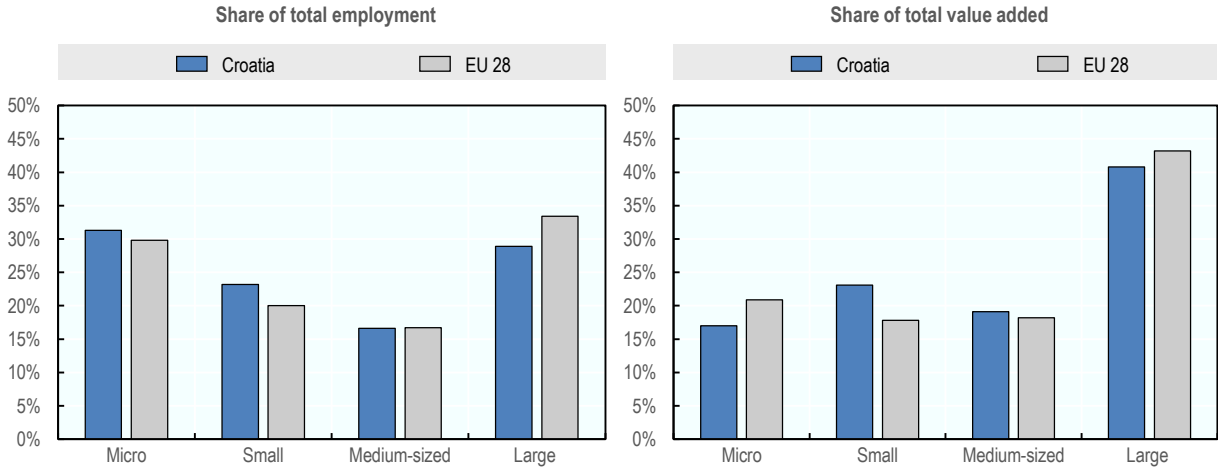
This chapter looks at the taxation of small and medium-sized enterprises (SMEs) in Croatia. It starts by providing some background on the SME sector and the tax system in Croatia and discusses conceptual issues in the taxation of SMEs, including the use of special tax rules for small businesses. The chapter then assesses the tax treatment of SMEs in Croatia – including both self-employed sole traders and incorporated small businesses.

Brief description of the SME sector in Croatia

There is no internationally agreed definition of SMEs and definitions vary across and within countries. The indicators used to categorise SMEs generally include the number of employees, annual turnover and/or net assets. The commonly used European Commission (EC) classification defines micro, small and medium-sized enterprises based on their number of employees and either turnover or balance sheet total. According to this classification, SMEs are enterprises that employ fewer than 250 persons and have an annual turnover below EUR 50 million and/or an annual balance sheet total below EUR 43 million.[1]

Based on the EC's definition, SMEs account for the vast majority of companies, employment and value added in Croatia. SMEs account for 99.7% of the total number of firms in Croatia, a share that is very close to the EU-28 average of 99.8% (European Commission, 2017[1]). Large firms, on the other hand, represent a very small fraction of the total number of businesses, with only around 390 large companies registered in Croatia in 2016. Figure 10.1 also shows that Croatian SMEs account for over 70% of total employment (left panel) and generate almost 60% of overall value added (right panel). Croatian SMEs' contributions to both value added and employment are slightly higher than in the EU-28 on average.

Figure 10.1. Share of total employment and value added by company size in 2016: Croatia and EU average



Note: Firm sizes are based on the EC classification.
Source: (European Commission, 2017[1]), *2017 SBA Fact Sheet-Croatia*, http://dx.doi.org/file:///C:/Users/Perret_S/Downloads/Croatia%20-%20SBA%20Fact%20Sheet%202018.pdf.

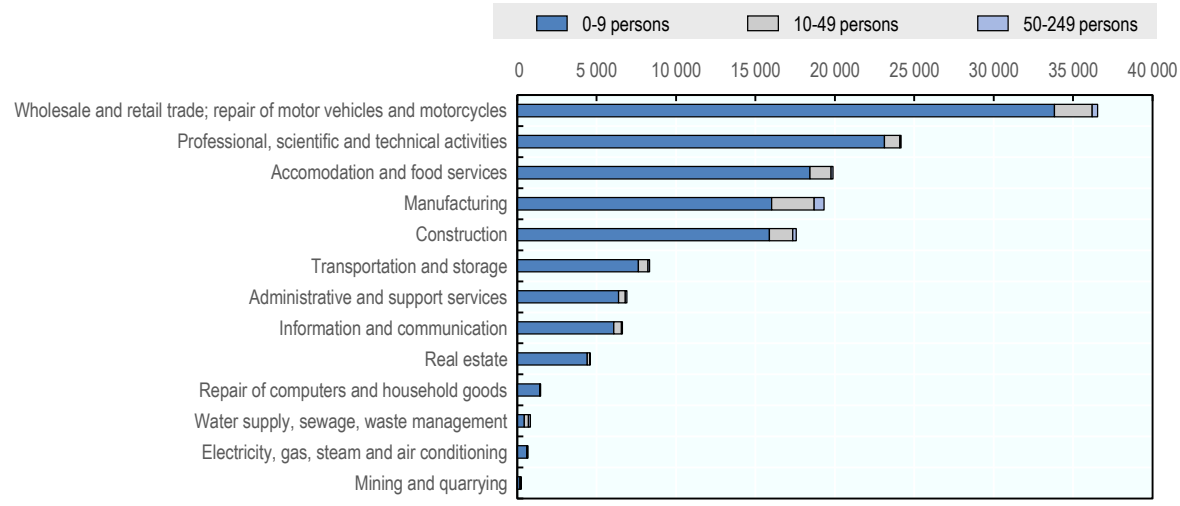
The profile of Croatian SMEs varies widely. Micro companies represent more than 90% of the total number of businesses in Croatia, while small and medium-sized businesses account for the remaining 10%. Micro companies are a significant contributor to employment, as they account for almost one third of all jobs, but play a more limited role in the generation of value added (Figure 10.1). This reflects the typically lower levels of labour productivity in micro-businesses. Small and medium-sized companies account for large and roughly similar shares of employment (40%) and value added (42%). In comparison, in the EU on average, micro-companies account for 93% of the total number of businesses and generate about 30% of employment and 21% of value added; while small and medium-sized companies account for around 36% of both employment and value added.

SMEs operate in different sectors. The predominant sectors include wholesale and retail trade; professional, scientific and technical activities; accommodation and food services; manufacturing; and construction (Figure 10.2). SMEs also vary in terms of their growth and innovation potential. Only a minority of firms qualify as high-growth companies (European Commission, 2017[1]). In addition, while some SMEs

are innovative, studies generally point to the comparatively lower levels of innovation in the Croatian SME sector (Božić and Rajh, 2016[2]).

Figure 10.2. Breakdown of the SME population in non-financial sectors in Croatia

Number of enterprises registered in 2016 (legal entities and natural persons)



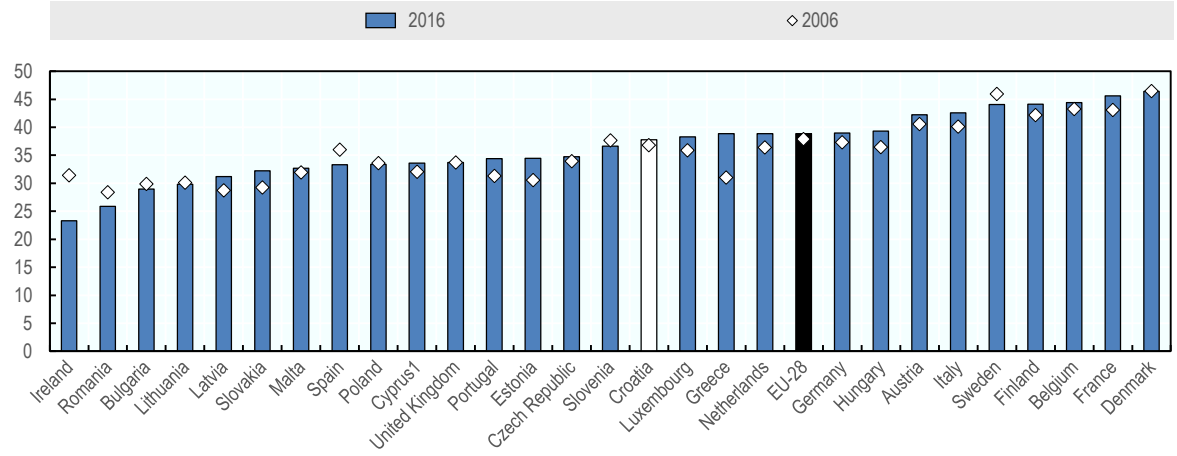
Source: Structural Business Statistics, Croatian Bureau of Statistics.

Overview of the Croatian tax system

Main features of Croatia's tax system

Croatia collects a relatively high overall level of tax revenues. Its total tax revenues amounted to 37.8% of GDP in 2016 (Figure 10.3) – a level that was slightly below the EU average of 38.9%, but above the OECD average of 34.0% of GDP (OECD, 2018[3]). Between 2006 and 2016, Croatia experienced a one percentage point increase in its tax-to-GDP ratio, an evolution that was similar to the increase in the EU average tax-to-GDP ratio during the same period.

Figure 10.3. Tax revenues as a share of GDP in 2006 and 2016 in EU countries

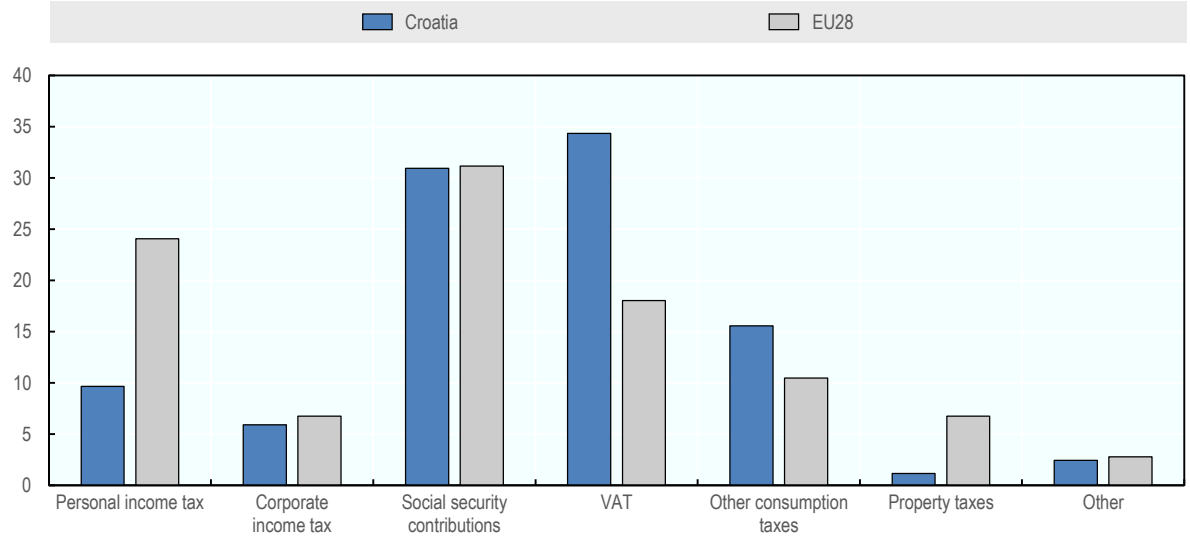


1. Note by Turkey:
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".
Note by all the European Union Member States of the OECD and the European Union:
The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.
Source: (European Commission, 2017[4]), DG Taxation and Customs Union, based on Eurostat data, https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en (accessed 15 April 2019).

Consumption taxes, in particular value-added tax (VAT), account for a very large share of Croatia's tax revenues. In 2016, VAT was Croatia's largest source of tax revenues, accounting for more than a third (34.3%) of its total tax revenues (Figure 10.4). In comparison, VAT accounted on average for 18% of total tax revenues in EU countries. Croatia's significant revenues from VAT are partly explained by its standard VAT rate of 25% – the second highest in the EU after Hungary – and efficient VAT enforcement. In 2016, Croatia was the EU country with the third lowest VAT gap, which measures the difference between the expected VAT revenues and the amount of VAT actually collected (European Commission, 2018[5]). In addition to VAT, other consumption taxes, which predominantly include excise duties, represent close to 16% of Croatia's total tax revenues.

Figure 10.4. Composition of total tax revenues in 2016 – Croatia and EU-28 average

Tax revenues expressed as a share of total taxation



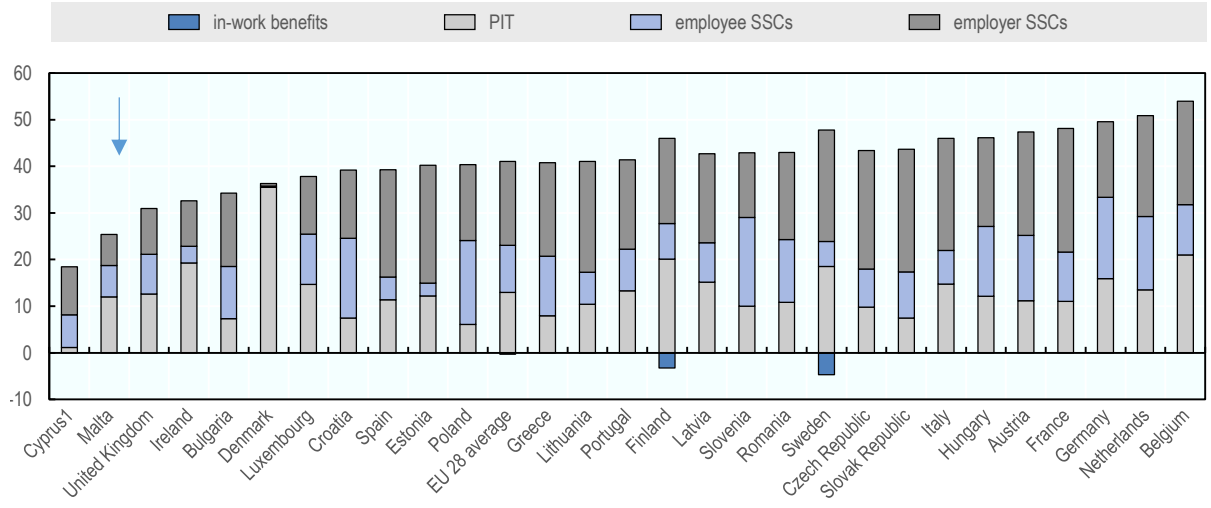
Source: European Commission, DG Taxation and Customs Union, based on Eurostat data, https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en (accessed 15 April 2019).

Another significant feature of Croatia's tax system is its high reliance on social security contributions (SSCs). SSCs accounted for 30.9% of total revenues in Croatia in 2016. This share was slightly below the EU average share of 31.1%, but above the OECD average share of 25.8% of total tax revenues (OECD, 2017[6]). High shares of SSCs are a common feature across many EU countries, in particular in Central and Eastern Europe. Regarding the composition of SSCs in Croatia, employer SSCs accounted for 53% of total SSCs while employee SSCs made up the remaining 47%, a split that is roughly similar to the EU average (56% of total SSCs from employer SSCs and 44% from employee SSCs).

High SSCs result in relatively high overall tax burdens on labour income, especially at low income levels. Figure 10.5 shows tax wedges – i.e. the sum of personal income tax (PIT) and SSCs paid by the employee and the employer (including payroll taxes) net of family benefits, expressed as a percentage of total labour costs – for single workers earning the average wage. Croatia's tax wedge predominantly consists of employer and employee SSCs, whereas PIT accounts for a limited share of the total tax burden on labour income. While Croatia's tax wedge for a worker earning the average wage is below the EU average (39.2% in Croatia compared to 40.8% in the EU on average), its tax wedge for workers at lower income levels is higher than the EU average. For instance, Figure 10.6 shows the tax wedge for single workers earning half of the average wage across EU countries. In 2016, Croatia's tax wedge was 32.9%, slightly above the EU average of 32.5%.

Figure 10.5. Tax wedge for single workers earning the average wage across EU countries in 2017

Tax wedges expressed as a share of total labour costs



1. Note by Turkey:
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Note by all the European Union Member States of the OECD and the European Union:
The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.
Source: OECD Tax-Benefit Models.

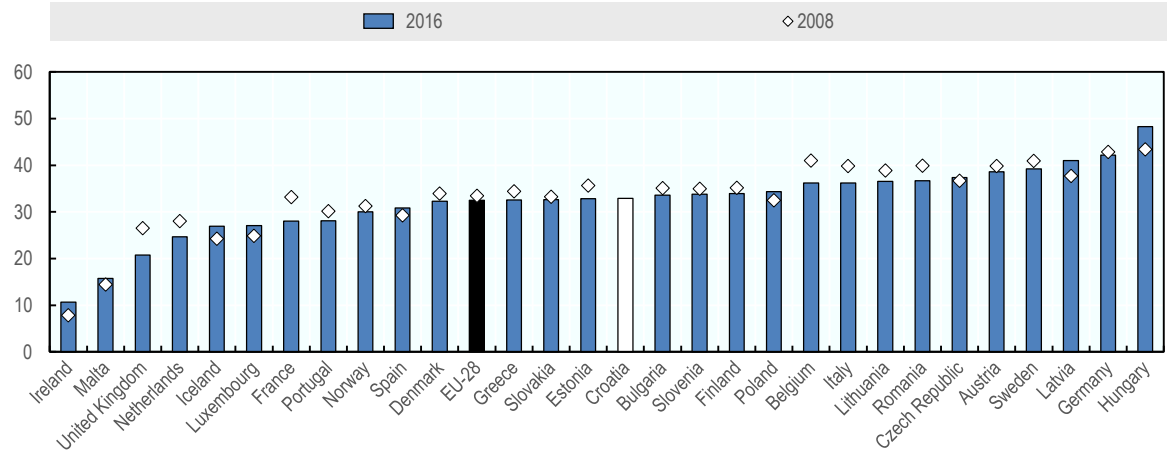
High tax wedges on labour income can discourage workforce participation and reduce incentives for employers to hire workers. High tax wedges can discourage workforce participation by reducing workers' after-tax earnings. In general, empirical evidence highlights the higher responsiveness of low-income workers to these types of work disincentives. High employer SSCs also increase the cost of employing workers and can therefore negatively affect labour demand. Looking at Croatia, Deskar-Škrbić (Deskar-Škrbić, Drezgić and Šimović, 2018[7]) found that increases in the tax wedge have a statistically significant negative effect on employment.

High labour taxes in the formal sector also increase incentives for employers and workers to operate in the informal economy, especially at low income levels. The larger the difference between total labour costs and the return on labour after taxes are deducted, the greater the incentive for both

employers and employees to avoid taxes by operating informally. High levels of informality may in turn negatively affect productivity, growth and trust in government institutions. In Croatia, informality is a persistent issue, with estimations of undeclared work varying between less than 10 % to more than 30 % of GDP (European Commission, 2017[8]). "Envelope wages" remain a common practice, with employers declaring the mandatory minimum wage as the taxable wage and providing the rest of their employees' wages in cash to minimise SSC and PIT liabilities (Williams et al., 2017[7]).

Figure 10.6. Tax wedges for single workers earning 50% of the average wage across EU countries in 2008 and 2016

Tax wedges expressed as a share of total labour costs



Source: European Commission tax and benefits indicator database based on OECD Tax-Benefit Models.

The Croatian tax system is also characterised by low revenues from direct taxes, in particular from PIT. PIT revenues accounted for only 9.7% of total tax revenues in Croatia in 2016, a share that is very small in comparison to the EU average of 24.1%. The low revenues from PIT reflect in large part the high PIT exemption threshold relative to current wage levels. The standard monthly tax-free allowance is set at HRK 3 800 (EUR 507), which amounts to more than 60% of the average wage. In practice, more than 50% of individuals do not pay any PIT. The low revenues from PIT limit the progressivity of the tax system. Corporate income tax (CIT) also accounts for a small share of total tax revenues – around 5.9% of total taxation, but this share is relatively close to the EU average of 6.8%.

The high level of SSCs and the comparatively limited role of PIT suggests that there could be room to shift part of the tax mix – and the financing of social benefits – from SSCs to PIT. Heavy SSC burdens weigh particularly heavily on low-income workers, reducing incentives for them to work and for employers to hire them. Efforts to shift part of the financing of social benefits from SSCs to PIT could reduce those disincentives as well as enhance progressivity. The case for expanding the financing of social benefits beyond SSCs is strongest when the benefits received by taxpayers are only weakly linked to the amount of SSCs paid, as is the case with health insurance and family allowances for instance. On the other hand, benefits for retirement, disability and unemployment, which tend to be more strongly related to wage earnings, could continue to be financed in large part through SSCs.

Finally, property tax revenues are very low, mainly because Croatia does not levy a recurrent tax on immovable property. The introduction of a recurrent tax on immovable property was legislated and expected to come into force in 2018 but has been postponed since then with no indication of whether and when it may become effective (European Commission, 2018[9]). OECD research has found that recurrent

taxes on immovable property are an efficient form of taxation, causing more limited distortions to long-run growth in GDP per capita than other taxes including CIT, PIT and VAT (Johansson et al., 2008[10]).

Croatia's 2017 tax reform aimed at supporting SMEs and entrepreneurship

In 2017, Croatia introduced a comprehensive tax reform, involving significant changes to CIT, PIT and VAT. The standard CIT rate was reduced from 20% to 18%. The PIT rate schedule was revised, with a reduction in the number of tax brackets and rates from three to two. The reform package also included a decrease in the standard VAT rate from 25% to 24% as of January 2018, but the VAT rate decrease has been postponed. Box 10.1 describes in more detail the most important measures included in the 2017 tax reform.

A number of the measures included in this comprehensive tax reform specifically aimed at supporting entrepreneurship and SMEs. Croatia's tax system currently has two thresholds at which special tax treatments apply to small businesses. A reduced CIT rate of 12% was introduced for SMEs with a turnover below HRK 3 million (approximately EUR 400 000). Businesses below the HRK 3 million threshold, which were already eligible for VAT cash accounting, were granted the possibility to use cash accounting for CIT purposes. For smaller businesses, the VAT registration threshold, or threshold above which VAT registration becomes compulsory, was raised from HRK 230 000 to HRK 300 000. Overall, the key tax support measures that are currently available to small businesses in Croatia are summarised in Table 10.1:

Table 10.1. Key tax support measures for SMEs in Croatia

	Small businesses with a turnover below HRK 300 000 (EUR 40 000)	Small businesses with a turnover below HRK 3 million (EUR 400 000)
Income tax	• **Lump-sum tax**: Unincorporated businesses can get a derogation from regular income tax and pay a fixed amount of tax. The amount of tax depends on their level of turnover. Bookkeeping requirements are also reduced.	• **Reduced CIT rate**: A reduced CIT rate of 12% applies, instead of the normal 18% CIT rate. • **CIT cash accounting**: SMEs have the option to use cash accounting for CIT purposes. Under cash accounting, income tax is paid on revenues only when cash is received and input costs are claimed only when cash is paid out. This differs from accrual accounting, which requires businesses to recognise revenues and expenditures at the time when the transaction occurs, rather than when the cash payment is received or made.
VAT	• **VAT exemption threshold**: Businesses are not required to register for VAT but may elect to do so. Businesses that are not registered for VAT are not required to charge and collect VAT and are consequently not entitled to deduct the input VAT incurred on their purchases of goods and services.	• **VAT cash accounting**: SMEs have the option to use cash accounting for VAT purposes. Under cash accounting, VAT is paid on sales only when the cash is received and, similarly, input tax credits are claimed only when cash is paid on a purchase. • **Quarterly VAT reporting**: Below HRK 800 000 of turnover, businesses are eligible for quarterly instead of monthly VAT reporting.

Source: OECD Questionnaire on SME Taxation and IBFD.

Box 10.1. Main measures of the 2017 tax reform

Corporate income tax

- The standard CIT rate was reduced from 20% to 18%.
- A reduced rate of 12% was introduced for small enterprises (i.e. enterprises with annual revenues below HRK 3 million).

- The CIT base was broadened by abolishing the tax incentive for reinvested profits. Accordingly, profits reinvested in long-term assets used in business activities are no longer exempt from CIT.
- CIT cash accounting was introduced for small businesses that fall within the scope of the VAT cash accounting scheme (turnover below HRK 3 million), allowing small businesses to pay CIT on a cash basis rather than on an accrual basis.
- The share of tax-deductible entertainment expenses was raised from 30% to 50%.

Personal income tax

- The number of progressive tax rates was reduced from three (12%, 25% and 40%) to two; as a result, a 24% rate applied to monthly income up to HRK 17 500 (approx. EUR 2 300) and income above HRK 17 500 was taxed at a 36% rate. From 1 January 2019, the 24 % rate applies to monthly income up to HRK 30 000 (approximately EUR 4 000) and income above HRK 30 000 is taxed at the rate of 36%.
- The standard monthly tax-free allowance was raised from HRK 2 600 to HRK 3 800 for all taxpayers.
- The SSC exemption for author and artist income, as well as retiree casual work and other income, was abolished and SSCs on these earnings are now levied at reduced rates.

Value-added tax

- The mandatory period for remaining in the VAT system once registered was reduced from five to three years.
- The VAT registration threshold was raised from HRK 230 000 to HRK 300 000 as of 1 January 2018.
- The standard VAT rate was supposed to be lowered from 25% to 24% as of 1 January 2018 but the reform has been postponed.

Overview of the arguments for and against special tax provisions for SMEs

This section briefly reviews the arguments for and against special tax provisions for SMEs. In assessing the need for special tax provisions for SMEs, the case in favour is generally based on arguments related to market failures and the positive externalities associated with SMEs. A second category of arguments for intervention claims that tax systems inherently penalise SMEs and that, in the absence of intervention, they will unfairly disadvantage them against their larger competitors. The case against granting special tax provisions to SMEs, on the other hand, considers the revenue and efficiency costs of doing so, including the risk of generating further distortions and complexity.

Special tax provisions for SMEs can take various forms. Tax preferences may lower the amount of tax payable by the SME, through special tax regimes, reduced tax rates, or additional deductions, credits and exemptions. Tax preferences may also reduce the tax payable by an investor or owner of an SME. Special provisions in the form of simplified tax obligations may also be introduced with the aim of reducing SMEs' tax compliance costs. Table 10.2 provides a typology of common tax provisions for SMEs in OECD and EU countries.

Table 10.2. Typology of special tax provisions for SMEs

Categories of measures		Examples
Tax reductions	Business level	Tax allowances (e.g. accelerated depreciation; immediate expensing; R&D tax allowance; etc.)
		Tax credits (for investment, R&D, employment, etc.)

Categories of measures		Examples
		Reduced CIT rate for small business profits
	Investor level	Incentives for investments in SMEs or investments in venture capital funds
		Capital gains tax preferences
		Inheritance and gift tax preferences
Tax simplification	Income tax	Presumptive taxation
		Simplified accounting (e.g. cash accounting)
		Reduced tax filing requirements
		Less frequent advance tax payments
	VAT	Exemption (registration/collection) threshold
		Simplified input tax credit calculation schemes
		Cash accounting
		Reduced tax filing requirements
	Other taxes	Simplified calculation and remittance of SSCs and payroll deductions

Source: Based on (OECD, 2015[11]), *Taxation of SMEs in OECD and G20 Countries*, OECD Tax Policy Studies, No. 23, https://dx.doi.org/10.1787/9789264243507-en and (European Commission, 2007[12]), *Simplified Tax Compliance Procedures for SMEs Final Report of the Expert Group*, http://ec.europa.eu/enterprise/entrepreneurship/support_measures/.

Reasons for considering special tax provisions for SMEs

There are two main lines of argument in support of special tax provisions for SMEs. The first set of arguments focuses on the market failures that affect SMEs due to their small size. The second major justification is that tax systems tend to have a disproportionate adverse impact on SMEs (OECD, 2015[11]).

Market failure arguments

The first line of argument in favour of SME-specific tax provisions is related to market failures, centred on assumptions of positive spill-over benefits and financing constraints resulting from asymmetric information.

Positive spillovers generated by SMEs

One of the arguments in favour of special tax provisions for SMEs is that small businesses generate benefits over and above those accruing privately to investors. The benefits may include innovations that can be applied elsewhere and positively affect economic growth. Other potential benefits include labour training and the upgrading of skills that can be applied subsequently in other businesses. In choosing the amount of investment to be undertaken, SME investors can be expected to consider only the private benefits and costs of their investment. By ignoring the social benefits that spill over to the rest of the economy, the expected outcome is under-investment in and by SMEs, relative to a socially optimally level. According to this view, tax incentives targeted at SMEs could encourage investment levels that would be closer to a social optimum.

However, a large proportion of SMEs are not significant job or innovation creators. There is a lack of empirical analysis showing that SMEs have a greater tendency to innovate or upskill than large companies, which suggests that externalities are not linked to company size. Although some self-employed individuals and SMEs display traits that characterise entrepreneurship – flexibility, speed, risk taking and innovation – the nature of the businesses which most small companies and self-employed persons operate in suggests that the majority have limited growth potential (Chen, Lee and Mintz, 2002[13]). In fact, in Croatia, only a small fraction of SMEs qualify as “high-growth” and the innovation performance of small businesses appears to be comparatively low (see *Brief description of the SME sector in Croatia*). In this context, granting favourable tax treatment to all small companies could be inefficient.

Financing constraints

Another market failure argument for providing special tax treatment to SMEs is that they generally face higher financing constraints. The limited information about the growth prospects of small firms can make it more difficult for them to obtain access to credit (Mirrlees et al., 2011[8]). However, except where information asymmetries affect access to finance, the more restricted access to credit, or higher risk premium, faced by SMEs may not be due to market failures, but to the inherently riskier and less profitable nature of some SMEs.

Tax concessions might not be the most efficient policy response to SMEs' financing constraints. Non-tax measures may be a more efficient way of enhancing small businesses' access to finance. For example, if on account of asymmetric information, capital markets are denying financing to SMEs in cases where funds would be provided under symmetric information, governments could seek to enhance transparency by increasing financial reporting requirements. Where governments choose to use tax measures, these should be targeted at supporting investment by small businesses (e.g. enhanced investment tax credits or allowances) as opposed to providing "blanket support" to all small businesses in the form of preferential tax rates for all small businesses, regardless of whether they invest or not (Mirrlees et al., 2011[8]).

Disproportionate impact of tax systems on SMEs

The second line of argument in support of special tax provisions for SMEs is that tax systems can be inherently disadvantageous for SMEs. The features of tax systems that may have a disproportionate negative effect on SMEs include the tax treatment of losses, the favourable tax treatment of debt finance, tax compliance costs and the international tax planning opportunities typically available to multinational enterprises (MNEs).

Tax treatment of losses and debt bias

The asymmetric treatment of profits and losses is one of the disadvantages that SMEs face in tax systems. Profits are taxed when they occur, while losses are typically not refunded when they occur, but carried forward and used against future income (or sometimes carried back and used against past profits). In many countries, however, losses can only be carried forward (or back) for a limited number of years, and there is generally no compensation for the time delay when losses are carried forward. This may disproportionately affect SMEs, which are more likely to record losses in their early stages of development. For firms that do not recover and generate income within the carry-forward period (which may be the case for younger enterprises in particular), the deferred loss cannot be utilised. These arguments have been used to justify more flexible carry-forward provisions for SMEs, the ability to refund losses at the time they occur, or the possibility to use losses to offset other income.

Another tax disadvantage faced by SMEs is related to their greater reliance on equity finance. Corporate tax systems generally provide interest deductions for the cost of debt finance but no deductions for the cost of equity. To the extent that SMEs have more limited access to credit and rely more heavily on equity finance, they tend to be penalised compared to large businesses. While an allowance for corporate equity can be provided to reduce the distortion between debt and equity finance, as with debt interest deductions, the allowance will not be of immediate benefit to firms in a loss position.

Compliance costs

While total business tax compliance costs tend to be higher for large companies, the compliance burden tends to be regressive relative to firm size. Tax compliance costs involve recording transactions, maintaining financial and tax accounts, calculating tax liabilities, making tax payments to the government, etc. Since compliance costs have a significant fixed component, they impose a relatively

higher burden on smaller firms as a percentage of turnover or profit, or per employee. An EC study found that on average, a company with fewer than ten employees faces a regulatory burden that is roughly twice as high as the burden of a company with ten to 20 employees and about three times the burden of companies with 20 to 50 employees. For bigger companies, the burden per employee is only one fifth or one tenth of that of small enterprises (European Commission, 2007[12]). In certain cases, high compliance costs may discourage SME creation and growth. Tax compliance costs may also affect SME owners and operators' decisions of whether to become self-employed, to employ other people or to operate in the formal economy.

In addition, SMEs often rely on external professionals, which increases their tax compliance costs. Larger companies are more efficient in dealing with tax requirements, and often have internal specialists. SMEs, on the other hand, generally lack internal tax experts, which means that they often hire outside professionals to deal with tax issues. The high cost of outside professionals increases the tax compliance burden of SMEs.

Tax avoidance by MNEs

Another inherent tax disadvantage that SMEs face is that certain MNEs have greater opportunities to engage in cross-border tax planning. Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies by MNEs that exploit gaps and mismatches in tax rules to artificially shift their profits to low or no-tax jurisdictions where they have no or little real economic activity. While most of these strategies are legal, they undermine the fairness and integrity of tax systems because businesses that operate across borders can use BEPS strategies to gain a competitive advantage over enterprises, typically SMEs, which only operate domestically.

However, this issue should be addressed directly rather than indirectly by providing tax preferences to SMEs. The most significant global initiative to fight against tax avoidance by MNEs has been the OECD/G20 BEPS project, which led in 2015 to the delivery of a package of measures to equip governments with instruments to address BEPS. The OECD/G20 BEPS package contains 15 actions including new minimum standards, the revision of existing standards, common approaches that will facilitate the convergence of national practices, and guidance drawing on best practices. To ensure the consistent application of the BEPS package across countries, the Inclusive Framework on BEPS was created in 2016 and now brings together over 125 countries, including Croatia.

Caution in using special tax provisions for SMEs

Revenue loss

Tax preferences that reduce small businesses' tax burdens, as with any other type of tax incentive, generate a loss in potential tax revenues, at least in the short run. Revenue losses will be particularly significant in the case of reduced tax rates and other tax preferences that are available to all SMEs. Revenue losses can be expected to be even greater when tax avoidance is prevalent or when the tax administration is weak, as businesses initially not intended to benefit from preferential tax measures might easily find ways to reorganise their affairs (e.g. by artificially splitting their business activity) to be eligible for SME tax preferences.

However, certain types of SME-specific tax provisions can be provided without leading to any revenue losses. Tax simplification measures aimed at lowering small businesses' compliance burdens do not lead to losses in tax revenues. Moreover, in a context where informality is high, tax simplification measures may actually have a positive effect on revenue collection by incentivising small businesses operating in the informal economy to formalise their activities.

Challenges of targeting special tax provisions for SMEs

Many tax provisions targeted at SMEs may not achieve their intended objective. For instance, a number of small firms may not benefit from profit-based tax incentives because they need to be profitable before they can make use of the tax preferences. This is particularly problematic for small firms in their start-up phase when up-front costs are high relative to revenues. Similarly, while investment tax credits and tax allowances are more targeted, they may also be of limited use to companies making investments with delayed returns if carry-forward provisions (i.e. the possibility to offset future taxable income or tax liabilities with unused tax benefits) are inadequate.

More generally, size alone does not necessarily warrant intervention. Many of the market failure arguments discussed above do not apply to all SMEs, but to subsets of the SME population. For example, only a subset of SMEs tends to innovate, which means that tax preferences aimed at supporting innovation should be targeted to the SMEs most responsive to innovation incentives and that are likely to generate spillover benefits. Similarly, younger SMEs may be more specifically targeted as they are more likely to be affected by the asymmetric treatment of profits and losses in tax systems (OECD, 2015[11]).

Disincentives to firm growth

Generous tax preferences for SMEs can limit their incentives to grow. Tax preferences for SMEs, particularly those that significantly reduce their tax burdens, can encourage small businesses to keep their reported income or turnover below small business eligibility thresholds to continue taking advantage of the preferential tax treatment. In fact, many countries have found evidence of individual taxpayers and companies "bunching" below points of discontinuity (kinks or notches) in tax systems (Boonzaaier et al., 2017[14]) (Kleven, 2016[15]).

A critical consideration in designing tax incentives for SMEs is to avoid "cliff edge" effects. The disincentives to firm growth and the risks of bunching below thresholds depend on how sharp the increase in the tax burden is when transitioning from the SME to the regular tax regime. Tax incentives should therefore be designed in a way that smooths cliff edge effects when businesses transition from SME status (e.g. avoiding excessive tax burden differentials between SME and regular tax regimes, putting transitional measures in place).

Increased complexity and opportunities for tax arbitrage

The introduction of special tax measures targeted at SMEs can add complexity by requiring additional record-keeping, monitoring, or registration processes. Complexity is even greater when multiple tax preferences with different thresholds are available. Over time, there is also a risk that special tax provisions that are initially only targeted at SMEs may give rise to pressure for such provisions to be extended to all businesses, particularly if there is no clear rationale for limiting them to SMEs (see Alt, Preston and Sibieta, 2010[14] for an example of how the R&D tax incentive for small businesses was extended to large firms in the United Kingdom).

In addition, SME tax preferences create opportunities for tax arbitrage. Caution must be exercised to ensure that taxpayers not intended to benefit from a tax preference, particularly a tax reduction, are not able to reorganise their affairs in such a way as to benefit from the provision. For example, a non-qualifying firm may reorganise itself into two or more new business entities to access tax relief conditional on firm size, determined on the basis of turnover, profit and/or capital. Tax preferences may also affect a small business' decision to incorporate. In countries where incorporated SMEs are granted a reduced CIT rate and the taxation of distributed dividends is low, the tax system may encourage the incorporation of profitable firms. Ultimately, the potential tax saving from converting wages into distributed profits can encourage a shift away from employment within large firms and towards contracting between large firms and small owner-managed businesses (Mirrlees et al., 2011[8]).

Concluding remarks on the use of special tax provisions for SMEs

Overall, this review of the arguments for and against special tax provisions for SMEs highlights the need to exercise caution when considering such measures. Many of the arguments in favour of special tax provisions for SMEs have clear limitations, while some of the risks associated with SME tax preferences have been confirmed empirically. A number of policy conclusions can be drawn from the assessment of the pros and cons of special tax provisions for SMEs:

- **The taxation of SMEs needs to be assessed within the context of the overall tax system.** A simple, efficient tax system that is conducive to business growth is of great advantage to SMEs and reforming the general tax system to make it more business-friendly is typically preferable to special tax provisions for SMEs. Tax preferences for SMEs should not be used to compensate for weaknesses in the tax system that should be addressed directly, such as a high standard CIT rate. In this case, the most efficient approach is to lower the standard CIT rate rather than to introduce a reduced CIT rate for SMEs.
- **The benefits of SME tax incentives should be carefully weighed against their potential negative effects**: If tax preferences – in particular tax reductions – are provided, they should be considered against the revenue and efficiency costs of doing so, including the risk of creating further distortions or barriers to growth, and increasing complexity.
- **Alternatives to tax preferences should be considered first**: The use of special tax provisions – in particular tax reductions – to correct perceived market failures or size disadvantages should be carefully considered against other options. Generally, the first-best approach is to consider whether and how issues can be addressed directly and avoid relying on tax preferences to address obstacles to SME growth that arise outside of the tax system.
- **Where special tax provisions are introduced, they should be specifically targeted to ensure the attainment of the policy objective**: Size is often used as a proxy for other features that governments may wish to address through the tax system (e.g. spillovers, financing, start-ups). If the goal is to support specific activities undertaken by some types of small businesses, tax measures should be targeted at supporting those activities and/or specific types of SMEs. For instance, instead of granting preferential tax rates to all small businesses, tax advantages could be provided for verifiable expenditures that are closely related to the activities that governments want to promote (Mirrlees, 2011[16]). Targeting should be done carefully, however, to make sure that it reaches the intended audience but also minimises complexity and distortions (e.g. lack of incentives to outgrow targets).
- The area where there is a strong rationale for special tax treatment based solely on company size is compliance costs. As discussed, tax compliance costs are clearly regressive relative to firm size. Freedman (2009) concludes that assistance with compliance costs is the only intervention that "is clearly justified on a size basis as opposed to some other test" (cited in (OECD, 2015[11])). In addition, tax simplification measures have the added advantage of generally not leading to any revenue losses.

Assessment and recommendations for the taxation of SMEs

This section assesses the taxation of SMEs in Croatia and provides a number of recommendations to improve small business taxation. This section reviews the income taxation and SSC rules that are applicable to small unincorporated and incorporated businesses. Unincorporated businesses are businesses that are not established as separate legal entities from their owners, while incorporated businesses are businesses where the company is a separate legal entity from its owners. Their tax treatment typically differs. This section also covers issues related to the VAT registration threshold, tax administration and tax compliance costs.

The taxation of unincorporated small businesses

This section looks at unincorporated small businesses and focuses on physical persons carrying out self-employment activities including crafts and trades, free professions, and agriculture and forestry. These businesses are subject to specific income tax and SSC rules. This section presents and assesses these tax provisions.

The taxation of unincorporated businesses is complex and gives room for tax arbitrage

Small unincorporated businesses can opt to be taxed under a simple lump-sum tax regime. Unincorporated businesses carrying independent activities of crafts, agriculture and forestry with an annual turnover below HRK 300 000 (approximately EUR 40 000) can opt to be taxed under a lump-sum tax, which replaces regular income taxation. The lump-sum tax liability is based on small businesses' total turnover, with different lump-sum amounts depending on different turnover brackets (Table 10.3). The level of the tax liability in each bracket is determined so that small businesses at the bottom of each turnover bracket are taxed at around 2.8% of their turnover while businesses at the top of each turnover bracket are taxed at around 2.1% of their turnover (Figure 1.7). A key advantage of the lump-sum tax is its simplicity. In addition to paying a fixed amount of tax, small businesses that opt for lump-sum taxation are not subject to any bookkeeping requirements (but they keep records of turnover).

Table 10.3. Lump-sum tax for small businesses

Tax base and tax liability calculations for 2018

Total revenue	Annual tax base	Annual tax liability	Monthly tax liability	Monthly tax liability including the 18% to city of Zagreb
From 0 to 85 000	12 750	1 530.	127.50	150.45
From 85 000 to 115 000	17 250	2 070	172.50	203.55
From 115 000 to 149 500	22 425	2 691	224.25	264.62
From 149 500 to 230 000	34 500	4 140	345	407.10
From 230 000 to 300 000	45 000	5 400	450	531.00

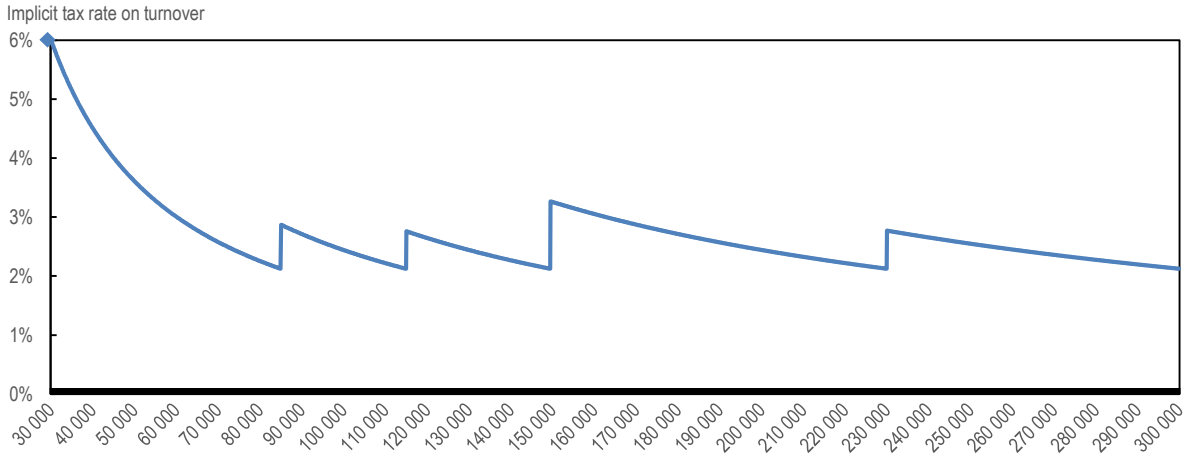
The Zagreb municipal surtax is levied on the central tax liability at a rate of 18%.
Source: Ministry of Finance.

The lump-sum tax has a regressive design and weighs more heavily on businesses with lower levels of profitability. Figure 10.7 shows how the implicit tax rate on turnover evolves when business turnover increases (up to HRK 300 000) under the lump-sum tax. Because the lump-sum tax is not linked to actual earnings but levied as a fixed amount for businesses in the same turnover bracket, it is regressive as a share of turnover in each bracket. In addition, a tax based on turnover imposes a higher tax burden on businesses with lower profit margins. Figure 10.8 shows how the lump-sum tax liability measured as a share of profits increases for a business with a turnover of HRK 300 000 when it becomes less profitable (i.e. when its costs increase). Similarly, the lump-sum tax imposes a relatively high effective tax rate on profits during downturns in business activity when profits are low or negative, which can generate cash-flow difficulties for small businesses. It should be mentioned, however, that the lump-sum tax is optional, which mitigates its regressive impact.

Overall, however, the lump-sum tax is low, which creates incentives for small businesses to remain under the HRK 300 000 threshold. As the amount of the lump-sum tax is low, the increase in the tax burden when small businesses reach the HRK 300 000 threshold and move into the regular income taxation system is significant. This may discourage small business growth and/or encourage small businesses to rearrange their affairs to continue being taxed under the lump-sum tax (e.g. split their activities into two businesses). Figure 10.8 compares the effective tax rates on profits that unincorporated businesses with a turnover of

HRK 300 000 pay when they are subject to the lump-sum tax and when they are subject to regular PIT. It shows how these effective tax rates vary when business costs increase, i.e. when business profitability decreases. At high profitability levels (i.e. when business costs are low), moving from the lump-sum tax to PIT generates a significant jump in the effective tax rate on profits. At lower profitability levels (i.e. when business costs are high), the gap narrows and eventually shifts. This implies that the increase in the effective tax burden from moving from the lump-sum tax to the regular income tax regime is particularly large for high profitability businesses.

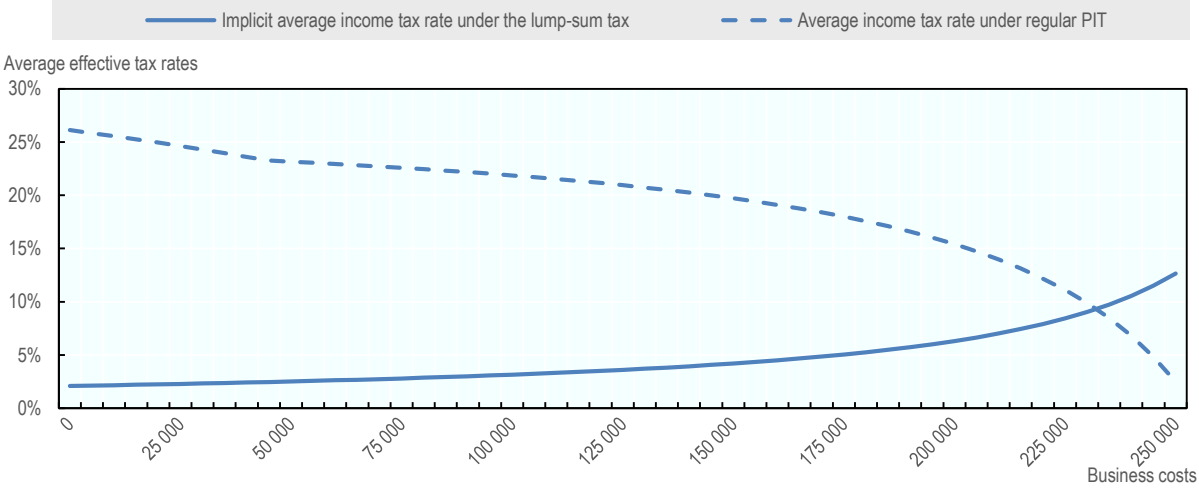
Figure 10.7. Small businesses' average tax rate on turnover under the lump-sum tax



Note: The implicit tax rate includes the 18% Zagreb surtax.
Source: Authors' calculations.

Figure 10.8. Average effective tax rates on profits under the lump-sum tax and the personal income tax when business costs increase

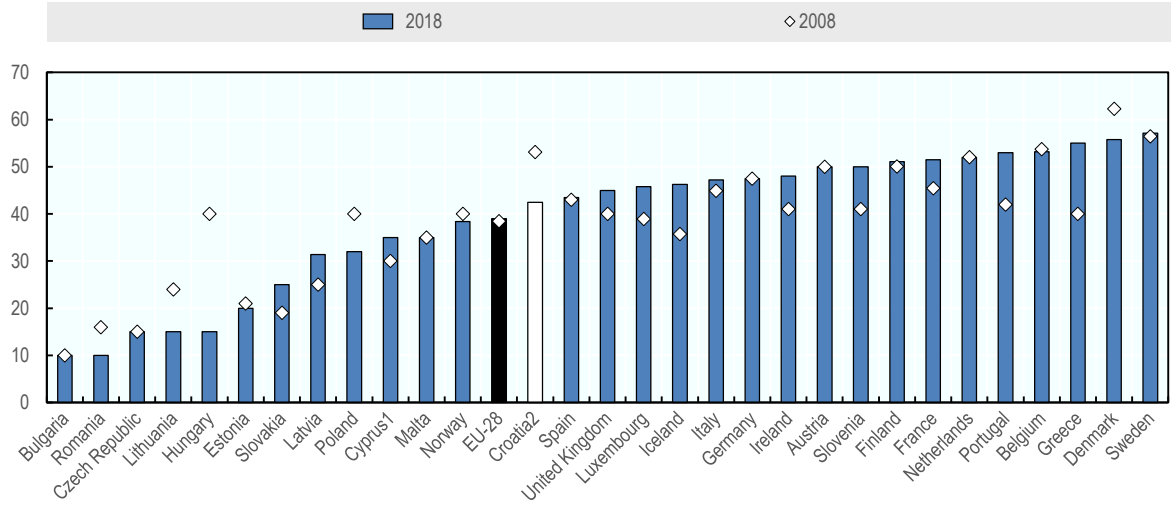
Tax rates for an unincorporated business with a turnover of HRK 300 000



Notes: Average effective tax rates correspond to the total tax liability due by businesses as a share of their income. The calculations are based on the 2018 central government PIT rates: 24% tax rate on monthly income up to HRK 17 500 (approx. EUR 2 300) and 36% tax rate for income above HRK 17 500. The tax rates include the 18% Zagreb surtax.
Source: Authors' calculations.

Unincorporated businesses above the HRK 300 000 turnover threshold are subject to regular income tax. Under the PIT, self-employment taxable income is calculated as the difference between gross receipts and expenditures incurred during the tax period. Business expenses as well as up to 50% of business entertainment expenses (e.g. expenses for gifts, holidays, sporting activities) are deductible from taxable income. Income is taxed by the central government at the rates of 24% on monthly income up to HRK 30 000 (approx. EUR 4 000) and 36% for income above HRK 30 000. In addition to central government tax rates, municipalities can impose surtaxes,[2] which currently range from 0% to 18%. Figure 10.9 shows that Croatia's top marginal PIT rate (including the 18% Zagreb surtax[3]) is slightly above the EU28 average but has seen one of the strongest decreases in the last ten years.

Figure 10.9. Top statutory personal income tax rates (including surcharges) in 2008 and 2018 in EU countries (in %)



1. Note by Turkey:
The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".
Note by all the European Union Member States of the OECD and the European Union:
The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.
2. For Croatia, the tax rates include the average crisis tax (2009-2011) and the surtax for Zagreb (maximum local surtax rate of 18%).
Source: European Commission, DG Taxation and Customs Union.

A specificity of the Croatian tax system is that unincorporated businesses can opt to be taxed under CIT, which increases complexity and leaves room for tax arbitrage. Self-employed businesses have the option to be taxed under PIT or CIT if they remain below a certain threshold.[4] If they are above the threshold,[5] they are automatically subject to CIT. This differs from standard practice in OECD countries where small businesses are usually taxed either under PIT if they are self-employed sole traders or under CIT if they are incorporated firms, although there are exceptions.[6] The issue with giving unincorporated businesses the possibility to be taxed under CIT is that, in addition to making the tax system more complex, it enables them to minimise their tax burden. Figure 10.11 compares the tax burden on income depending on whether small businesses are taxed under PIT or CIT and depending on whether they distribute profits or not. It shows that the current system gives small businesses an incentive to opt for CIT and retain their earnings to lower their tax burdens, although opting for CIT increases compliance costs as businesses are required to maintain double-entry bookkeeping. Incentives to be taxed under CIT instead of PIT exist in other

countries, but being taxed under CIT typically requires small businesses to incorporate, which implies legal changes and often additional reporting and accounting requirements.

The SSC system for the self-employed is regressive

As opposed to regular employees, SSCs for self-employed workers are not linked to actual earnings. For regular employees, the SSC base is equal to gross employment earnings. Employee SSCs include old-age pension contributions of 20%. In 2018, employer SSCs included a 15% general health contribution, a 0.5% occupational health contribution, and a 1.7% unemployment contribution. In 2019, the unemployment contribution and the occupational health contribution were abolished, while the general health contribution was raised from 15% to 16.5%; implying a decrease in total SSC rates from 37.2% to 36.5%. For the self-employed, the SSC rates are the same as for employees but the SSC base is not related to actual earnings. The SSC base is a lump-sum obtained as the product of the average national monthly wage from January to August of the preceding year (HRK 8 020 in 2018) and an occupation-specific coefficient (e.g. 0.65 for traders; 0.55 for farmers and 1.1 for professionals).

This system is distortive and regressive. This type of system may have some merit in a country where the tax administration has a limited capacity to check whether self-employed workers accurately report their earnings. It ensures that at least a minimum level of SSCs is collected. However, determining fixed amounts of SSCs is regressive, with the self-employed workers earning more contributing less as a share of their earnings. The way the contribution base is determined also means that in practice some self-employed businesses pay very low SSCs, which may in turn give some employees incentives to become self-employed.

Special independent activities benefit from special tax regimes

The income earned by journalists, artists and sportsmen falls under the category of "other income", which is subject to a PIT withholding. In some cases, special tax allowances apply. A 30% lump-sum deduction is allowed for the incomes of journalists, athletes and artists. An additional exemption equal to 25% of the taxable base is granted for the income earned by artists, under certain conditions. Until 2017, author and artist income also benefitted from an SSC exemption. The exemption was abolished and these earnings are now taxed at reduced SSC rates.

Additional tax regimes exist for specific activities. Special rules apply to family farms. In particular, family farms are not subject to PIT if they have a total annual income of less than HRK 80 500. A special lump-sum tax also exists for the income earned by homeowners renting rooms and flats to travellers (up to 20 beds). The tax liability is determined based on the number of beds. This regime is particularly generous as the lump-sum tax is low, SSCs are not levied and renters are not subject to "fiscalisation" requirements (i.e. no obligation to issue receipts through electronic cash registers – see below for more details).

Recommendations

Overall, the assessment of the taxation of small unincorporated businesses could be better aligned with economic reality. First, the lump-sum tax could be transformed into a real turnover tax levied as a share of turnover to remove its regressive effects. However, a fixed turnover tax rate would still impose a relatively high effective tax rate on businesses with lower profit margins. To address this issue, some countries apply reduced tax rates on turnover in sectors where profit rates are on average lower or use different eligibility thresholds for different sectors, although this creates additional complexity. Alternatively, the presumptive tax could be progressive (i.e. the tax rates would increase with turnover). While this would also introduce more complexity, it would reduce "cliff edge" effects, as businesses with a high turnover would be subject to higher presumptive tax rates and the move from presumptive to regular taxation would not generate a significant increase in businesses' tax liabilities. Progressive presumptive tax rates would

also mean that lower tax rates could be levied on businesses with very low levels of turnover to encourage them to formalise their activities.

Additional reforms are necessary to simplify the taxation of small unincorporated businesses and limit tax arbitrage opportunities. The possibility for unincorporated businesses to be taxed under CIT could be removed to reduce complexity and tax minimisation incentives. In the longer run, Croatia could also consider levying self-employed SSCs based on actual earnings. Self-employed businesses with a turnover above HRK 300 000, which are taxed under the regular PIT or CIT, should pay SSCs on the income they report. This would require enhancing the exchange of information between the social security and tax administrations. For small self-employed businesses with a turnover below HRK 300 000, which are subject to the lump-sum tax, the lump-sum SSC payments could be kept, although they would continue to have regressive effects. Importantly, changes to the way self-employment SSCs are levied would need to be accompanied by a reform in self-employed workers' social benefit entitlements.

Box 10.2. Presumptive tax regimes

A presumptive tax presumes a different tax base than income in the calculation of small businesses' tax liabilities. Presumptive taxes may replace either only income tax or all the taxes that have to be paid by small businesses and may be accompanied by reduced bookkeeping or tax filing obligations. Presumptive taxes vary across countries but generally fall under one of three categories:

- A lump-sum tax: a flat charge levied on firms below a certain threshold. Lump-sum schemes are often used for very small firms and the self-employed, where compliance costs are likely to be the highest and revenue considerations are minimal. This approach is common in Central and Eastern European countries.
- An indicator-based tax: a tax based on indicators of firm size other than turnover or income. Examples of such indicators include the total number of employees, floor space, inventory values, electricity consumption and other variables that may be correlated with income. Indicator-based taxes are often used to target specific types of business activities (e.g. shipping or transport).
- Turnover tax: unlike a lump-sum tax or an indicator-based tax, a turnover tax is levied on gross revenues.

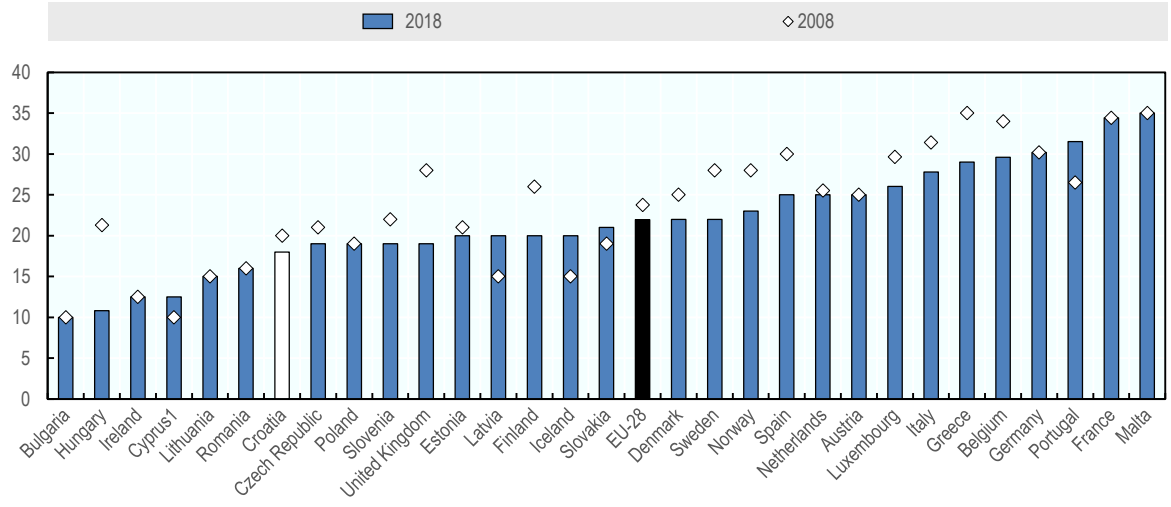
The taxation of incorporated SMEs

Incorporated SMEs are small businesses where the business is carried on through a separate entity for tax purposes. Incorporated SMEs are taxed first at the entity level under CIT and then at the personal level when income is received by individuals. The taxation at the personal level depends on the form in which the income is received (e.g. dividends, capital gains or salary).

Incorporated SMEs benefit from a generous tax treatment

At the corporate level, small businesses are taxed at the preferential CIT rate of 12%, as opposed to the regular CIT rate of 18%. As mentioned above, in 2017, Croatia lowered its regular CIT rate from 20% to 18% and introduced a reduced rate of 12% for SMEs with a turnover below HRK 3 million. A number of countries provide reduced CIT rates for SMEs, although the design of these reduced tax rates varies significantly (OECD, 2015[11]). Overall, it should be noted that Croatia's regular CIT rate was below the EU average of 21.9% in 2018 (Figure 10.10) and that its reduced CIT rate for SMEs is also relatively low compared to other countries that have similar preferential regimes for SMEs in the OECD (Figure 10.11).

Figure 10.10. Top statutory corporate income tax rates (including surcharges) in EU countries in 2008 and 2018 (in %)



1. Note by Turkey:
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Note by all the European Union Member States of the OECD and the European Union:
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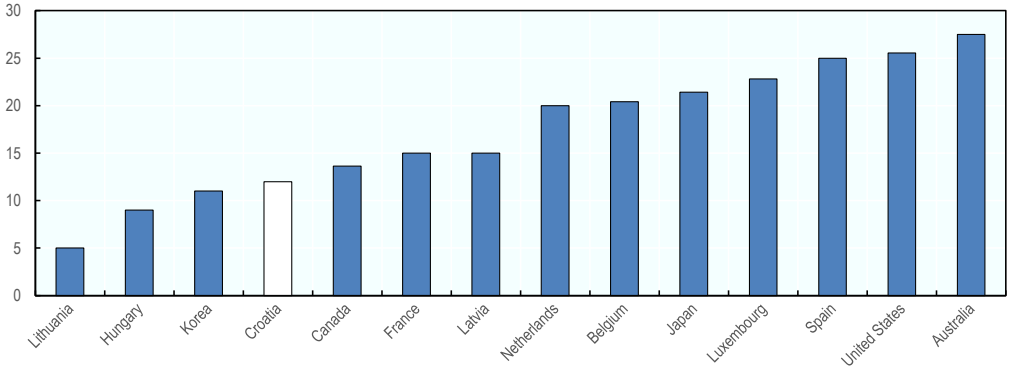
Source: Eurostat.

Figure 10.11. Small business corporate income tax rates in Croatia and OECD countries in 2018

Combined (central and sub-central) corporate income tax rates



Source: OECD Tax Database.

SMEs are also eligible for a number of corporate tax incentives. Table 10.4 gives an overview of these tax incentives. The types of tax incentives vary. They include reduced CIT rates as well as tax deductions (which reduce businesses' taxable income). Some are available to all companies (e.g. accelerated depreciation, R&D tax allowance), while others provide more generous benefits or restrict eligibility criteria to SMEs (e.g. reduced CIT rate for investment; tax allowance for educational expenses).

Table 10.4. Corporate tax incentives available to SMEs in Croatia

	Tax measures	Description	Specific rules for SMEs
CIT rate reduction	Investment incentives	CIT rate reductions conditional upon investment and job creation	Yes: For micro-entrepreneurs (less than 10 employees): 50% CIT rate reduction over five years if minimum investment of EUR 50 000 and at least 3 jobs created
	Regional tax incentives	CIT rate reductions for investments in certain regions	No
Tax allowances	Accelerated depreciation	Doubling of regular depreciation rates	No
	R&D tax incentives	Tax allowances for qualifying R&D expenses for R&D projects that include fundamental research, industrial research, experimental development and feasibility studies.	No
	Tax incentives for investment in education	Tax base reduction by a percentage of expenses incurred on the general education and special education of employees	Yes: SMEs can reduce their taxable base by 70% of eligible costs for the general education and training of employees, and by 35% of eligible costs for the special education of employees.

Source: OECD SME Taxation Questionnaire and IBFD.

Overall, the system of corporate tax incentives is relatively difficult to navigate for small businesses. Different tax incentives pile up on top of each other. Besides, the definition of SMEs varies across tax concessions. A single definition of SMEs and standardised eligibility criteria for all small business tax concessions could be used to make the tax system easier to comply with and to administer.

Corporate tax incentives are generous, but not always well targeted. For instance, under the investment tax incentive, taxpayers may be taxable at a reduced CIT rate or exempt altogether, depending on their level of investment and job creation. For micro-entrepreneurs (less than ten employees), investment tax incentives are granted in the form of a 50% CIT rate reduction over five years if a minimum of EUR 50 000 is invested and at least three jobs are created. This means that the CIT rate is reduced from 12% (rate that applies to businesses below HRK 3 million) to 6% on all of their profits. For small, medium and large enterprises, investment tax incentives can be obtained for a period of ten years under the conditions described in Table 10.5. These tax incentives are generous but they may be of limited benefit for some new businesses, which might not generate profits in their first few years of operation.

Table 10.5. Investment tax incentives: eligibility criteria and CIT rate reductions

Investment amount (EUR)	Number of newly employed persons	CIT rate reduction (%)
150 000 to 1 000 000	5	50
1 000 000 to 3 000 000	10	75
Over 3 000 000	15	100

Source: Ministry of Finance.

In general, expenditure-based tax incentives should be preferred to income-based tax incentives. Tax incentives based on investment expenditures, such as accelerated or enhanced depreciation, immediate expensing of some proportion of capital costs and investment tax credits, provide a larger investment response for each unit of tax revenue foregone, compared to a CIT rate reduction, even if the one provided by Croatia is tied to a minimum level of investment and job creation.

As in most corporate tax systems, the treatment of profits and losses in Croatia is asymmetric. As already mentioned in this chapter, profits are taxed when they occur, while losses are carried forward and used to offset future profits for a limited number of years. In Croatia, tax losses can be carried forward and

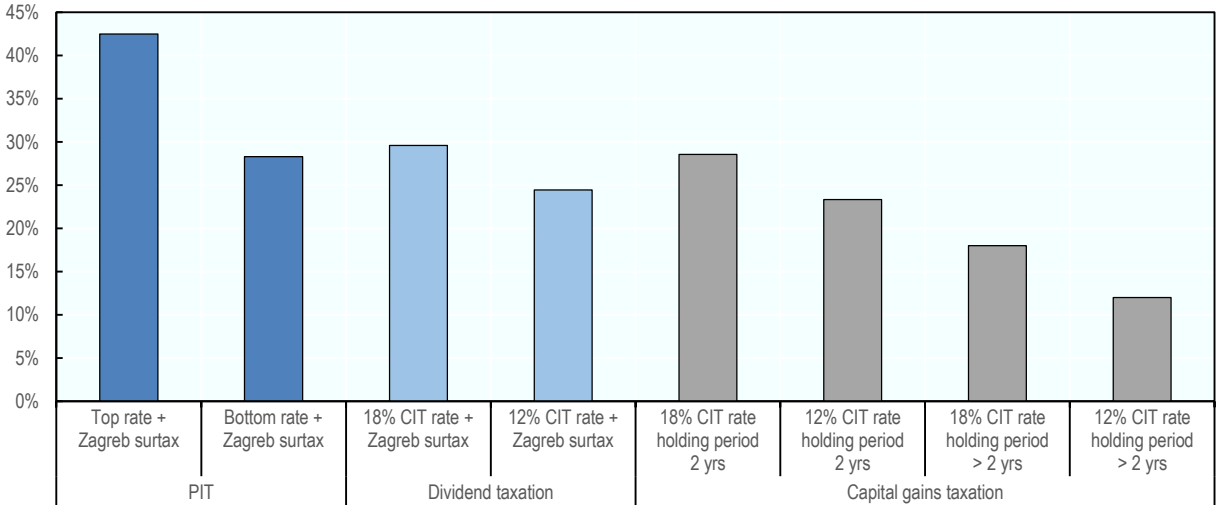
used to offset profits within five years following the year in which the losses were incurred and must be utilised in the order in which they occurred. Tax losses cannot be carried back. The asymmetric treatment of operating losses in the corporate tax system may put start-ups at a disadvantage relative to established businesses as it may take years before they become profitable.

The tax system encourages businesses to incorporate and retain their earnings

After taxation at the corporate level, the income from incorporated SMEs is subject to a second level of taxation at the individual level. Taxation at the personal level depends on the form in which the income is received. If the company distributes profits to shareholders who are individuals, this distribution is subject to a final 12% dividend tax and the municipal surtax (if applicable). If profits are retained and reinvested, on the other hand, they will be subject to capital gains taxation when the company shares are sold. The capital gains tax, which was introduced in 2016, is levied at a rate of 12% (increased if a municipal tax is applicable) and applicable only for holding periods of less than two years. Finally, if the income is distributed as a wage, the salary of the owner for the hours worked in the business is subject to PIT (but deductible for CIT purposes).

The current system provides incentives for businesses to incorporate and retain their earnings. Figure 10.12 compares the marginal tax rates on income depending on whether businesses incorporate or not and whether profits are distributed or not. If business income is taxed as self-employment, the top marginal PIT rate on income can go up to 42.5% (including the Zagreb surtax). The overall tax burden on dividend distributions (which takes into account CIT and PIT) is lower, amounting to either 29.6% or 24.5% depending on whether the 18% or the 12% CIT rate applies. This may encourage businesses to incorporate and to distribute SME income as dividends rather than as labour income. Retaining earnings and eventually receiving income in the form of capital gains upon the disposal of company shares is the most tax-favoured option, particularly if shares are held for more than two years, in which case capital gains are not taxed at the individual level. It also encourages them to incorporate and to move away from receiving SME income as labour income, as the combined impact of the dividend tax at 12% will be lower than PIT.

Figure 10.12. Marginal tax rates on self-employment income, dividend distributions and capital gains



Notes: For the combined tax rates on dividends, the dividend tax at the shareholder level is levied at a rate of 12%. Municipalities apply different surtax rates. The Zagreb municipal surtax is levied on the central tax liability at a rate of 18%. The combined tax rate on dividends is calculated as follows: 18%+(1-18%)*12%*(1+18%). For the combined ETRs on capital gains, the calculations are based on the methodology of the OECD (2018) Taxation of Household Savings, assuming no inflation and an interest rate of 5%.
Source: Authors' calculations.

Owner-managers of companies have been able to minimise their SSCs

The SSC system for the owner-managers of limited liability companies has allowed them to minimise their SSC burdens. The owner-managers of companies often declare working for a very small number of hours within their company and pay SSCs on that very small base of declared working hours. This has allowed owner-managers of companies to significantly reduce their SSC liabilities and ultimately made the system regressive as wealthy owner-managers have been able to minimise their SSCs while regular employees and self-employed businesses have not. As of 1 January 2019, however, minimum SSCs will be introduced: owner-managers will be required to pay SSCs on the same minimum base as crafts, i.e. the average national wage multiplied by 0.65.

Recommendations

Overall, the taxation of incorporated SMEs could be improved in a number of ways. Croatia could adopt a single SME definition for tax and non-tax purposes and standardise the eligibility criteria for small business tax concessions. Croatia could also consider turning the investment tax incentive into an investment tax credit or tax allowance, which would be more directly linked to the amount of investment rather than through a reduced CIT rate as is currently the case. The take-up of corporate tax incentives by small businesses should also be closely evaluated. More generally, the corporate tax allowances available to all businesses could be turned into tax credits as the value of tax allowances depends on the tax rate borne by the taxpayer. Indeed, the higher (lower) the CIT rate, the higher (lower) the amount of tax relief on a given amount of investment allowance claimed, meaning that large companies paying a higher CIT rate end up receiving a higher tax benefit. Croatia could also assess whether more flexible loss offset provisions targeted at small businesses could be helpful.

Additional reforms could be envisaged to limit tax arbitrage. Croatia could consider levying the capital gains tax upon the disposal of shares held for over two years, which would limit businesses' incentives to retain their earnings and ultimately remunerate themselves through capital gains (although there would still be an incentive to receive profits as capital gains as it would defer taxation). The owner-managers of closely held businesses could also be required to pay themselves a minimum salary to prevent tax arbitrage (i.e. small business owners paying themselves a small salary but buying a car, house, telephone, etc. through their business and distributing themselves lower-taxed dividends when they need cash). This minimum salary could also serve as the minimum base on which to levy SSCs for owner-managers.

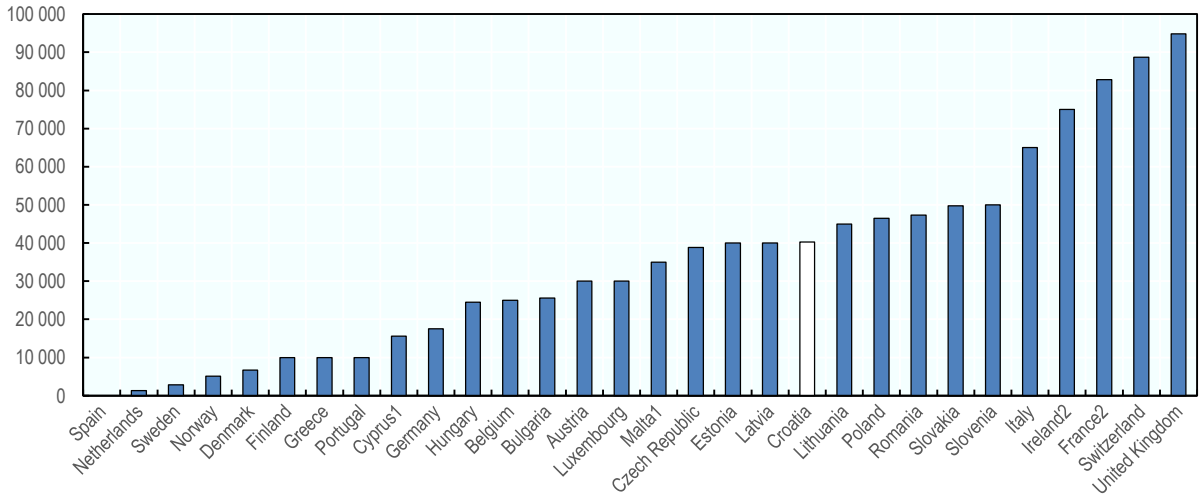
The VAT registration threshold is relatively high

The level of the VAT registration threshold in Croatia is comparatively high. VAT registration thresholds vary widely across countries. In the EU, VAT registration thresholds range between EUR 0 in Spain where there is no VAT registration threshold to close to EUR 95 000 in the United Kingdom. With a VAT registration threshold of HRK 300 000 (approximately EUR 40 000), Croatia has a comparatively high thresholds, but Croatia's threshold is similar to those of comparable Central and Eastern European countries (Figure 10.13).

One of the explanations for Croatia's high VAT registration threshold is its high standard VAT rate. Croatia's high standard VAT rate encourages small businesses to stay or "bunch" below the VAT registration threshold to avoid charging VAT and remain competitive. This is especially true for businesses or sectors with lower levels of inputs relative to supplies to consumers such as labour-intensive businesses and businesses operated by sole proprietors. For these businesses, the amount of VAT paid on their inputs tends to be low and the advantage of being able to deduct input VAT if they register for VAT is limited. Having a high VAT threshold therefore helps these businesses remain competitive in a context where the standard VAT rate is high.

In general, setting the level of the VAT registration threshold at an adequate level is a complex task. The main reason for excluding small businesses from the VAT system is that compliance costs for small businesses may be disproportionate compared to their turnover, and that the costs for the tax administration of having very small businesses pay VAT may be disproportionate compared to potential VAT revenues. On the other hand, a VAT registration threshold introduces competitive distortions between small businesses under and above the threshold. The VAT registration threshold should minimise competitive distortions and be set so that the revenues collected are higher than the administrative costs of ensuring that small businesses properly collect and remit VAT. In countries where the tax administration is weaker, a higher threshold tends to be more appropriate, which is partially confirmed by Figure 10.13.

Figure 10.13. VAT registration/collection thresholds in EU countries in 2018 (in EUR)



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2. Conversions based on exchange rates on 1 September 2018. 1These countries have a lower VAT registration/collection threshold for services.
Source: OECD Tax Database and IBFD.

An issue with a high VAT registration threshold is that it limits the "formalising" role of VAT. VAT theoretically creates positive "chain" effects incentivising economic agents to become formal. VAT can create positive incentives for informal sector firms with actual or prospective dealings with formal sector firms to enter the formal tax system in order to be able to claim tax credits and recover their input VAT. A recent study of small firms in Brazil shows that an individual firm is more likely to register for VAT if its suppliers and/or customers are registered (de Paula and Scheinkman, 2010[17]).

Croatia could consider revising the level of its VAT registration threshold in the future. Generally, tax administration improvements in Croatia have lowered the administrative costs of ensuring that small businesses adequately collect and remit VAT. As the tax administration's enforcement capacity continues to be reinforced, Croatia could consider lowering its VAT registration threshold. In addition, with the rise of the sharing economy and the possible increase in the number of small operators below the VAT registration threshold, the revenue loss and distortions caused by a relatively high VAT threshold might become more problematic. However, the effects of an increase in the VAT registration threshold should be carefully assessed *ex ante*.

Tax compliance costs weigh heavily on small businesses

Tax compliance costs weigh heavily on SMEs in Croatia. Tax accounting, tax return filing and tax payment obligations are numerous and complex. In addition to being regressive relative to firm size, the costs involved in understanding tax rules, maintaining records and filing tax returns have generally required Croatian small businesses to rely on external accounting services because they lack the internal capacity to comply with all their tax obligations compared to large businesses, which have internal accounting services.

Croatia has a number of tax simplification measures targeted at SMEs. As mentioned previously, businesses with a turnover below HRK 300 000 are not required to register for VAT and are eligible for lump-sum taxation. Businesses with a turnover below HRK 800 000 have the possibility to report VAT on a quarterly instead of a monthly basis. This is in line with practices in other OECD and EU countries where SMEs are often allowed to file VAT returns on a less frequent basis. Businesses with an annual turnover below HRK 3 million can also opt for cash accounting for VAT and CIT purposes. Cash accounting minimises cash flow difficulties for small businesses as tax is payable when cash is received, as opposed to accrual accounting, which requires businesses to recognise revenues and expenditures at the time when the transaction occurs. Cash accounting is also simpler than accrual accounting, which requires accounting for expenses related to long-term assets (e.g. depreciation), inventory and pension liabilities on an accrual basis.

However, SMEs continue to face tax compliance difficulties, in particular in relation to advance tax payments. In Croatia, CIT, PIT and the lump-sum tax involve monthly advance payments that are calculated based on the tax owed in previous years. An option to reduce compliance costs, while at the same time easing firms' cash flow constraints, would be to allow small firms to make less frequent advance tax payment instalments. This is common practice in many countries where, for instance, large firms are required to pay advance CIT instalments on a quarterly or a monthly basis, while small firms are allowed to remit CIT less frequently. In Croatia, advance tax payments could shift from a monthly to a quarterly basis for SMEs.

Regarding income reporting obligations, significant progress has been achieved but efforts should continue. Since 2014, employers have been subject to the obligation to submit a unified form (JOPPD form) to the tax administration to report employment income and SSCs. The form is also used by natural and legal persons to report other types of income, including property income, capital income, and insurance income. Overall, the JOPPD form replaced six different forms used before 2014. This initiative represents good progress, however, further simplification is needed. The form proved more burdensome than expected, due to its complicated codes and very short submission deadlines (Kovač, Đulabić and Čičin-Šain, 2017[18]). Generally, the form has to be filled on the day the payments are made. In addition, the information collected through this form has so far only been used by the tax administration, so similar reports continue to be submitted several times (e.g. online registration of workers for tax purposes and paper registration of workers for healthcare). Efforts to exchange this type of information between different public administrations should be pursued.

Complexity and heavy compliance burdens also come from the numerous parafiscal fees that businesses are required to pay. There are about 250 parafiscal fees in Croatia, which apply to both self-employed and incorporated businesses, depending on their location and industry sector. Examples of such fees include fees for forest management, fire protection, water sanitation, the preservation of monuments, membership to the chamber of commerce, etc. They are calculated differently: some are based on turnover, while others are levied as fixed amounts or based on usage or services provided. These parafiscal fees are managed in an unco-ordinated way by different institutions. Overall, these parafiscal charges account for around 2.5% of GDP (Ministry of Economy).

Generally, there is scope for further reducing small businesses' tax accounting, tax return filing and tax payment obligations. Regarding tax accounting, small businesses should be made more aware of the possibility to use cash accounting for CIT, as very few businesses have taken advantage of it so far. Regarding tax filing and reporting, there should be further efforts to streamline taxpayer obligations by sharing the information collected through forms by one public administration with other public bodies. Third-party information should also increasingly be used to pre-fill tax returns. Regarding tax payment obligations, Croatia should consider introducing less frequent advance payments for CIT, PIT and the lump-sum tax under a certain level of tax owed or under a certain turnover threshold. Finally, parafiscal fees should be reviewed and scaled back. The remaining parafiscal charges could be consolidated into a smaller number of payments.

Fiscalisation is a marked improvement but involves compliance costs for businesses

In Croatia, "fiscalisation" has been a major initiative to fight against the informal economy and VAT evasion. Since 2013, all businesses that accept cash payments are required to purchase and use a fiscalisation software that automatically reports every cash transaction to the government in real time through cash registers that are directly connected to the tax administration. The tax administration then checks if the receipts contain all the required elements and have been signed with a correct digital signature. Once these elements are validated, the tax administration attributes a unique receipt identification (JIR) to the receipt. This exchange is done within a few seconds and enables the printing of a receipt approved by the tax administration with a JIR. If there is an issue (e.g. no internet connection), the re-authorisation of receipts has to be performed within 48 hours.

While fiscalisation is a positive development, the burden imposed on smaller businesses could be minimised. Fiscalisation is particularly problematic for small businesses in remote areas (e.g. countryside, islands), where the internet connection is often absent or limited. The time limit for the fiscalisation of receipts could be extended to lower the compliance burden and risks of penalties for these businesses. Training support and special assistance to SMEs could also be provided more widely. Finally, the effects of fiscalisation on tax revenues and the performance of different sectors should be closely evaluated.

The tax penalty system might discourage new businesses

Businesses in Croatia are subject to the same penalties as large firms if their tax returns contain errors or are submitted late. This is in line with practices in most countries, where the size of enterprises usually does not have a direct influence on the level of penalties or fines (European Commission, 2007[12]).

The penalty system could take greater account of businesses' past compliance in the application of penalties. While firm size is usually not taken into consideration, a past record of good behaviour is often taken into account to reduce the severity of penalties (European Commission, 2007[12]). In the United Kingdom, for instance, a points-based penalty system similar to that used with driving licenses is being established to address late or missing tax returns. This was set up in connection with HM Revenue & Customs (HMRC)'s "Making Tax Digital initiative" which is expected to put an extra reporting burden on small businesses and led to the idea that the penalty system should be less rigid. Penalty points will be given for late submissions and a financial penalty will be imposed after the number of points reaches a set threshold. Penalty points will expire after a period of good compliance, and may be waived if HMRC believes they are not appropriate, or if the taxpayer makes a successful appeal (HM Revenue & Customs, 2018[19]). An approach that takes greater account of businesses' past compliance could be adopted in Croatia.

There is room for tax administration improvements

On the administrative side, taxpayer services targeted at small businesses could be improved. The SME sector – with its high turnover rates, varying levels of financial literacy, and greater exposure to the cash economy – poses specific challenges to tax administrations. In most countries, the specific characteristics, behaviours and risk profiles of different "segments" of the taxpayer population (e.g. large vs small businesses) have led to efforts towards more tailored responses from tax administrations. In Croatia, one approach could be to set up an SME portal or a webpage specifically dedicated to SMEs on the tax administration's website to enhance small businesses' access to information. This could also encourage the use of self-service and electronic channels, as is done in other countries (see Box 10.4). Efforts to enhance e-tax procedures should continue: electronic tax filing is compulsory for incorporated businesses as well as for self-employed businesses with at least three employees, but online tax payment is not available yet.

A small office focusing on tax simplification could also be set up. A small unit could be set up to monitor tax compliance procedures and burdens, as is done in some countries. For instance, the United Kingdom has an Office for Tax Simplification, which is an independent office in the Treasury responsible for giving advice to the government on simplifying the tax system. It conducts and publishes reviews on complex areas of the tax system and identifies options for reform, with a view to reducing tax compliance burdens on individual and corporate taxpayers.

Finally, reforms could focus on strengthening the exchange of information between public administrations. The exchange of information could help streamline small businesses' reporting obligations, as information collected by one public administration, or by a third party, could be shared with multiple public bodies. The exchange of information should also be strengthened with a view to enhancing the detection of fraudulent behaviours. For instance, the information collected through the electronic cash registers (see above) could be crossed with data on businesses' purchases to detect anomalies.

Box 10.3. Small business assistance programmes in Australia

Australian Taxation Office (ATO) app

The ATO app helps small businesses deal with their tax obligations. Some of its features include a list of due dates that can be saved as reminders in smartphones and tablets and a myDeductions function that can be used by sole traders to track business income, expenses and car trips. At tax time, businesses can upload this information to pre-fill their tax returns or email it to their tax agents. A benchmarking tool also helps small businesses compare their performance against similar businesses in their industry.

Small business workshops and webinars

Free face-to-face workshops and webinars are offered on a variety of tax topics including Goods and Services Tax (Australia's value-added tax), activity statements, income tax deductions, home-based business, record keeping and more.

Business Assistance Programme

The programme offers one-to-one tailored support over 12 months for new small businesses, helping them understanding their tax obligations. This programme requires registration. As part of the programme, the tax administration gives taxpayers three calls to help them understand their tax, contributions and GST obligations. Each check-in phone call is an opportunity for small businesses to ask questions and understand how to meet their tax obligations.

Source: Australian Taxation Office website, https://www.ato.gov.au/.

Box 10.4. Tax reform recommendations

General recommendations

- Shift part of the financing of social benefits from SSCs towards other taxes to reduce the reliance of the tax system on labour income taxes
- Consider lowering the PIT exemption threshold
- Consider levying the capital gains tax on shares held for more than two years
- Turn income-based corporate tax incentives into expenditure-based tax incentives
- Introduce online tax payments

Recommendations to improve SME taxation

Tax policy and SSC reforms

- Adopt a single SME definition for tax and non-tax policy purposes and standardise eligibility criteria for all small business tax concessions
- Consider removing the possibility for unincorporated businesses to be taxed under CIT
- Consider reducing the VAT registration threshold, particularly if the standard VAT rate is lowered
- Turn the lump-sum tax for self-employed businesses into a turnover-based presumptive tax, possibly with progressive rates
- Consider levying SSCs for the self-employed and the owner-managers of closely-held corporations on their actual earnings (possibly with some caps)
- Review and scale back parafiscal fees. Consolidate the remaining ones into a smaller number of payments.

Tax simplification and tax administration measures

- Reduce the frequency of advance tax payments under a certain threshold of tax owed or turnover
- Consider revising the tax penalty system by better taking into account taxpayers' past tax compliance records
- Strengthen the exchange of information between public administrations to streamline small businesses' reporting obligations and enhance the detection of fraudulent behaviours
- Enhance taxpayer services aimed at SMEs, create a webpage dedicated to SMEs on the tax administration's website, and make better use of IT tools to reduce small businesses' compliance costs
- Extend the time period for the fiscalisation of VAT receipts and provide small businesses with support to comply with their fiscalisation requirements.

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Notes

[1] Within this definition, a small enterprise is defined as having less than 50 employees and a turnover or a balance sheet total of less than EUR 10 million; and a microenterprise is a firm with less than 10 employees and a turnover or balance sheet total below EUR 2 million (https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en).

[2] Municipal surtaxes are levied on the central government tax liability.

[3] The Zagreb municipal surtax is levied on the central tax liability at a rate of 18%.

[4] If individual entrepreneurs choose to be taxed under CIT, they are obliged to pay CIT instead of PIT for the following three years.

[5] The total gross income of the entrepreneur is at least HRK 3 million (excluding VAT); or two of the following three conditions are met: the net income (gross income less expenses) of the entrepreneur is at least HRK 400 000; the entrepreneur employs on average more than 15 employees; or the value of the entrepreneur’s depreciable assets exceeds HRK 2 million.

[6] One important exception is S-corporations in the United States, which are incorporated but income and losses are passed through to shareholders, and income is taxed at the individual level.

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