COUNTRY PARTNERSHIP FRAMEWORK

FOR THE REPUBLIC OF CROATIA FOR THE PERIOD FY19-FY24

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The International Finance Corporation
Europe and Central Asia

The Multilateral Investment Guarantee Agency

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ABBREVIATIONS AND ACRONYMS

BERD	Business expenditure on R&D
CCA	Croatian Competition Agency
CDS	Credit Default Swap
CEE	Central Eastern Europe
CEPEJ	European Commission for the Efficiency of Justice
CNB	Croatian National Bank
CPF	Country Partnership Framework
CSRs	European Commission's Country Specific Recommendations
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Europe and Central Asia
ECEC	Early childhood education and care
EU	European Union
ESIF	European Structural and Investment Funds
FDI	Foreign direct investment
GDP	Gross Domestic Product
GNI	Gross National Income
GVCs	Global Value Chains
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
HBOR	Croatian Bank for Reconstruction and Development
HCI	Human Capital Index
HRK	Croatian Kuna
LGBTI	Lesbian, gay, bisexual, transgender, intersex
MIGA	Multilateral Investment Guarantee Agency
MoSE	Ministry of Science and Education
MFD	Maximizing Finance for Development
NDS	National Development Strategy
NEET	Neither employed nor in education or training
NPLs	Non-Performing Loans
NUTS	The Nomenclature of Territorial Units for Statistics
OECD	The Organisation for Economic Co-operation and Development
PIM	Public Investment Management
PISA	Programme for International Student Assessment
PLR	Progress and Learning Review
PMR	Product market regulations
PPP	Purchasing Power Parity
RAS	Reimbursable Advisory Services
R&D	Research and Development
SAFE	Survey on the Access to Finance of Enterprises
SCD	Systematic Country Diagnostic
SOE	State-owned enterprises
STARS	Strategic Transformation in Agriculture and Rural Space
STEM	Science, technology, engineering and mathematics
STP2	Second Science and Technology Project
TIMSS	Trends in International Mathematics and Science Study
TFP	Total Factor Productivity
TVET	Technical and Vocational Education and Training
WBG	World Bank Group

The date of the last Country Partnership Strategy (CPS) was June 27, 2013 and the date of the last Performance and Learning Review of the CPS August 31, 2016.

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of January 7, 2019)
Currency Unit = Kuna
USD 1.00 = 6.48 HRK; 1 HRK = 0.15 USD

I.

INTRODUCTION

I. INTRODUCTION

Croatia is a small, open economy and the latest entrant to the European Union. After being severely affected by the global financial crisis, Croatia's economy is recovering, with growth averaging around 3 percent over the last four years. Public finances have improved significantly—fiscal imbalances have been reduced and the country's debt profile has improved from very high initial levels. The country's natural endowment and location continue to support a dynamic tourism industry,[1] which serves as the major driver of growth. Joining the European Union (EU) in mid-2013 has helped boost exports, from below 40 percent of GDP in 2008 to above 50 percent in 2018.

Despite recent progress, the global financial crisis revealed underlying vulnerabilities to exogenous shocks and had a lasting impact on poverty and shared prosperity. Croatia suffered a six-year recession following the global financial crisis, which resulted in a loss of economic output of 12 percent and one of the largest increases in poverty among EU member states. Unemployment surged, and emigration of young and skilled workers increased. The share of poor and vulnerable households[2] rose from one quarter to one third of the population.[3] While Croatia has a relatively high GNI per capita,[4] the geographic distribution of incomes is uneven, and the crisis widened the gap between more prosperous cities and less developed regions.

Croatia's institutional challenges are evident in the country's uneven pattern of development. The country has not fully diversified its sources of growth and relies heavily on one natural resource-based sector—tourism—which might be vulnerable to the external environment. This is combined with a still large presence of the state in productive sectors. The country's geographic and categorical disparities in income and human capital further indicate institutional challenges related to protecting the poor and most vulnerable and creating economic opportunities for all.

Positive economic trends, underpinned by government action on public finance management, have created an environment where the return on further reforms can be high. In 2017, Croatia achieved its first fiscal surplus since independence, and public finances continue to be tightly managed. The European Commission Country Report for 2019[5] confirms that the stock of macroeconomic imbalances continued to be reduced in Croatia, largely driven by a positive economic environment and prudent management of government finances. This is helping boost private sector activity, and as a result, unemployment is falling and demand for labor is increasing. The improved fiscal and economic outlook have also helped Croatia regain investment grade status as of March 2019.[6] However, the country's demographic profile (which features an aging population and increasing levels of outmigration, particularly for young Croatians) and global trends (such as the pace of technological change and the changing nature of work) make it increasingly critical to prioritize actions now to improve the country's long-term growth potential. While current conditions sup-

1 The contribution of tourism to GDP, including indirect effects, rose to over 25 percent in 2016 (World Travel and Tourism Council).

2 Living on less than US$10 per day in PPP of 2005.

3 From 26.6 percent in 2009 to 33.4 percent in 2014.

4 With a GNI per capita in 2017 of $12,430, IBRD classifies Croatia as a high-income country (over 4$12,055) and above the threshold for initiating a discussion on IBRD Graduation (over $6,795).

5 https://ec.europa.eu/info/publications/2019-european-semester-country-reports_en

6 In March 2019 S&P upgraded Croatia's rating to investment grade.

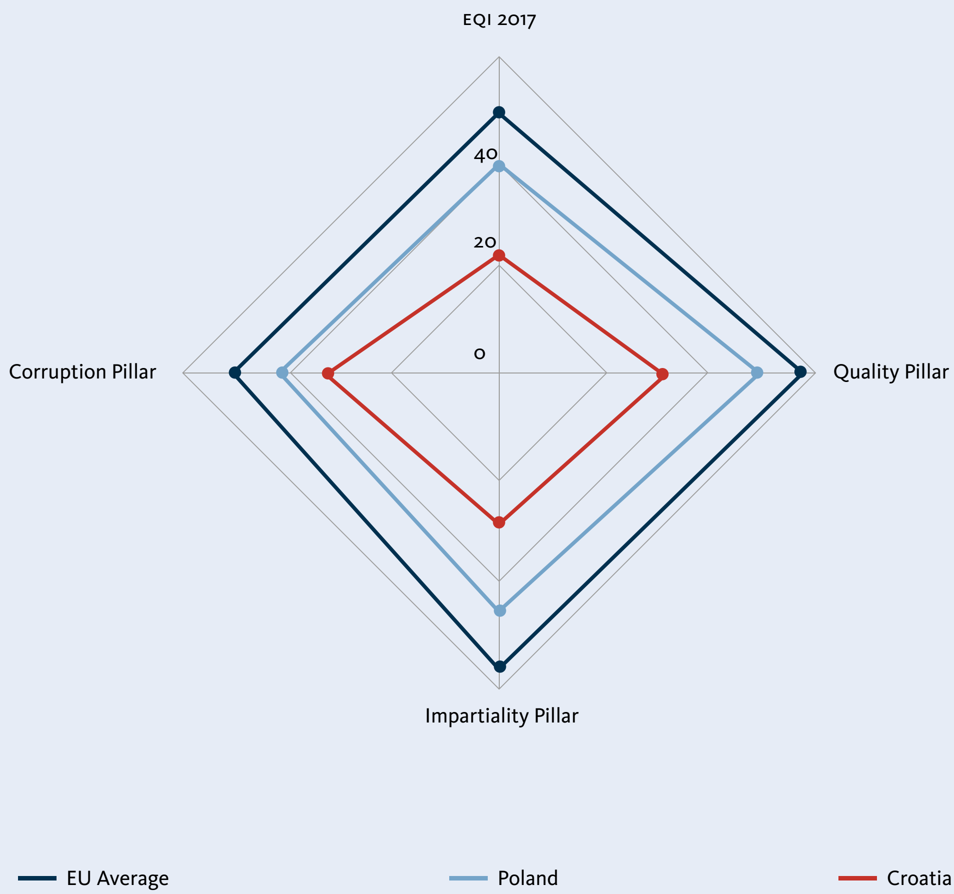
port positive potential growth rates of around 2.5 percent over the medium-term, this is not enough to re-ignite, or accelerate, the pace of convergence with other countries in the European Union.

Croatia, with the right set of policy actions, can both increase returns on public investment—by effectively using EU grant funds in the current and upcoming EU financing period—and attract strategic private investment to create economic opportunities. With the accession to the Eurozone as part of its medium-term agenda, Croatia is planning to implement ambitious and sophisticated reforms to boost growth, build economic resilience and maximize the benefits of euro area membership. Critical reform areas also include investments in human capital and natural resource management to preserve and leverage its natural assets. The success of these reforms will ultimately rely on strengthening Croatia's institutions.

The Systematic Country Diagnostic (SCD) highlighted the quality of Croatia's institutions as a binding constraint for achieving more inclusive and resilient growth. Despite its relatively high income, Croatia continues to lag behind most EU peers in aspects of governance, business environment and human capital indicators, indicating certain institutional weaknesses (Figure 1). The SCD identified three key priority areas, which constrain the productivity and limit the ability to achieve better societal outcomes.

FIGURE 1

Croatia lags EU countries in governance, including those with similar incomes (e.g., Poland)



Source: EU, European Quality of Government Index (EQI), 2017 edition

First, evidence suggests institutional gaps limit government effectiveness. Croatia has a large public sector, which is underperforming in a number of indicators of performance—indicating challenges and weaknesses that cut across sectors and limit prospects for growth and the emergence of a dynamic private sector. Weak administrative capacity is a key reason for the difficulties in programming and implementing EU structural and investment funds. *The main institutional challenges to address include poor planning, lack of effective coordination and cooperation across ministries and levels of government, and a weak public investment management process.*

Second, a lack of capacity to deliver quality services is reflected in suboptimal human capital, particularly in the poorest regions of the country. Croatia's less developed regions are among the EU's worst performers in the European quality of governance index (EQI) measure. Delivering improvements in inclusion, unemployment, and education, particularly for the most vulnerable population, will require strengthening the ability of relevant institutions to provide services to those hardest to reach. *The institutional challenges include capacity gaps among national and local authorities, as high fragmentation of local decision-making authority raises costs and reduces the quality, effectiveness and sustainability of service delivery.*

Third, weaker market institutions—including barriers in the business and regulatory environment with challenges in performance of the state-owned enterprises (SOEs)—remain a long-standing binding constraint in Croatia that limits the potential of the private sector to thrive. The business environment still needs to be improved, and the predominance of the state in many economic sectors stifle growth. Key government institutions, most notably the judiciary and public administration systems, underperform according to both EU and global benchmarks. More generally, lack of competition in parts of the private sector, excessive regulation and a large presence of relatively inefficient SOEs represent institutional challenges that, if addressed, could create employment and investment opportunities and improve longer-term, private sector-led growth prospects. *Improving capability, transparency and predictability of key market institutions—such as justice, competition policy and the regulatory environment and public administration—are key determinants of private sector revival.*

This Country Partnership Framework (CPF) proposes a marked departure from the previous engagement in that it features a highly selective WBG program targeted to the needs of a higher income country. This CPF is different from previous engagement strategies in three ways. First, it features a sharply growing program of reimbursable advisory services (RAS) to support a broad, multi-sector engagement. Second, recognizing Croatia's status as an EU member, WBG engagement is focused on supporting government institutions across sectors to better design and leverage available EU grant financing to accelerate the pace of convergence and to support the government's plan to adopt the euro. Third, any new IBRD and IFC lending will be highly selective, and subject to rigorous selectivity criteria. These include, first and foremost, that *all new IBRD financing is aimed at building essential institutional capacity.* In addition, at least one of the following criteria would also have to be met for financing: (i) providing innovative solutions that benefit the marginalized, poor and vulnerable; (ii) catalyzing private sector investment or leveraging additional resources, including access to and efficient utilization of EU grants; and/or (iii) contributing to regional and global public goods.

The over-arching objective of the WBG Country Partnership Framework (CPF) is to play a catalytic role in supporting institutional improvements needed for a sustainable trajectory towards EU convergence and eventual IBRD graduation. This includes working in close coordination with other partners, most notably the European Commission, in areas where the WBG brings a distinct comparative advantage—particularly in its ability to design pilot programs and build implementation capacity needed to improve utilization of resources. This would primarily be achieved through the use of RAS-financed engagements. The Government has, however, requested that the WBG reserve the option of deploying all financial instruments needed to build institutional capacity, including to leverage IFC support to enable a more dynamic private sector.

WBG corporate priorities are embedded in the CPF program.

- The proposed CPF would support interventions to address Croatia's climate vulnerabilities and protect its natural environment. This would be achieved primarily through ongoing and prospective advisory services, but also through potential WBG investments, including from IFC, and potentially from MIGA guarantees.
- On gender, the recently prepared Country Gender Assessment will serve as an important tool to identify entry points in all new WBG activities, including to identify economic opportunities for women and youth in less developed regions.
- The WBG has been successful in designing innovative Maximizing Finance for Development (MFD) projects in Croatia, including a recent collaboration with the EBRD to modernize and restructure the road sector and IFC's investment in Zagreb Airport expansion and modernization project. Moving forward, the CPF will support efforts to strengthen market institutions and play a catalytic role to leverage available financing. IFC will continue to look for opportunities in the transport and renewable energy sectors to maximize finance for development, and upstream work with IBRD and other partners including the EC, leveraging the Cascade approach[7] to unblock potential regulatory issues which limit private sector activity. Similar to IFC, MIGA, which at present does not have exposure in Croatia, will continue to explore opportunities in key strategic areas, including in the infrastructure and climate finance.

The CPF will cover a five-year period (FY19-24) with one Progress and Learning Review (PLR). This approach includes a relatively narrow results framework that builds primarily on the ongoing portfolio and the nature of RAS-financed engagements. The PLR would provide an update on key areas of institutional weakness, including to measure progress against EU peers where benchmarks are available. While the WBG may contribute only modestly to these outcomes, it expects to play a catalytic role, and monitoring outcome indicators which are comparable across the EU will be particularly important to track progress in the areas on the critical path to accelerate convergence.

7 The cascade approach implies an increased and more systematic emphasis on upstream reforms at the country and sector level ("mainstream the upstream") and a renewed determination to focus concessional and public resources where they can have the greatest development impact ("shift the default").

II.

COUNTRY CONTEXT AND CHALLENGES

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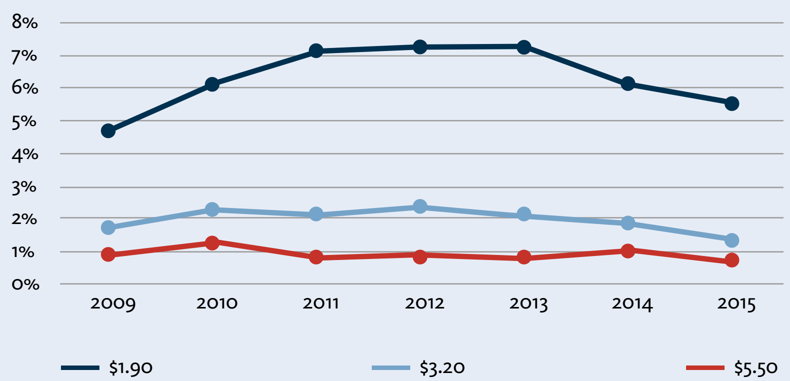
The political environment in Croatia has been relatively stable in recent years however there has been limited scope to implement ambitious reforms. The Croatian Democratic Union has maintained a coalition government since October 2016, supported by a number of MPs from smaller parliamentary caucuses. While the need for consensus has limited the ability to pursue a comprehensive reform agenda, the Government has been successful in implementing policies to improve the country's macro-fiscal situation. The Government's priorities in the upcoming period include preparing for Croatia's first EU presidency in 2020, joining the Schengen area and fulfilling the criteria for the euro adoption. Given the EU Parliament, Presidential and Parliamentary elections in May 2019, late 2019 and 2020 respectively, there are further challenges to accelerate broader reforms beyond these priorities.

TRENDS IN POVERTY AND SHARED PROSPERITY

The two most salient development challenges faced by Croatia from an inclusion perspective relate to regional disparities and demographic trends, both exacerbated by outward migration. Poverty maps shed light on the disparities that exist across the country and confirm stark differences in GDP per capita at the regional level. These range from 60 percent of the national average in Slavonia (in the east) to 125 percent in Istria (in the west) and 175 percent in City of Zagreb (Figure 2). When poverty is analyzed at the level of 21 counties (NUTS 3)[8] large disparities

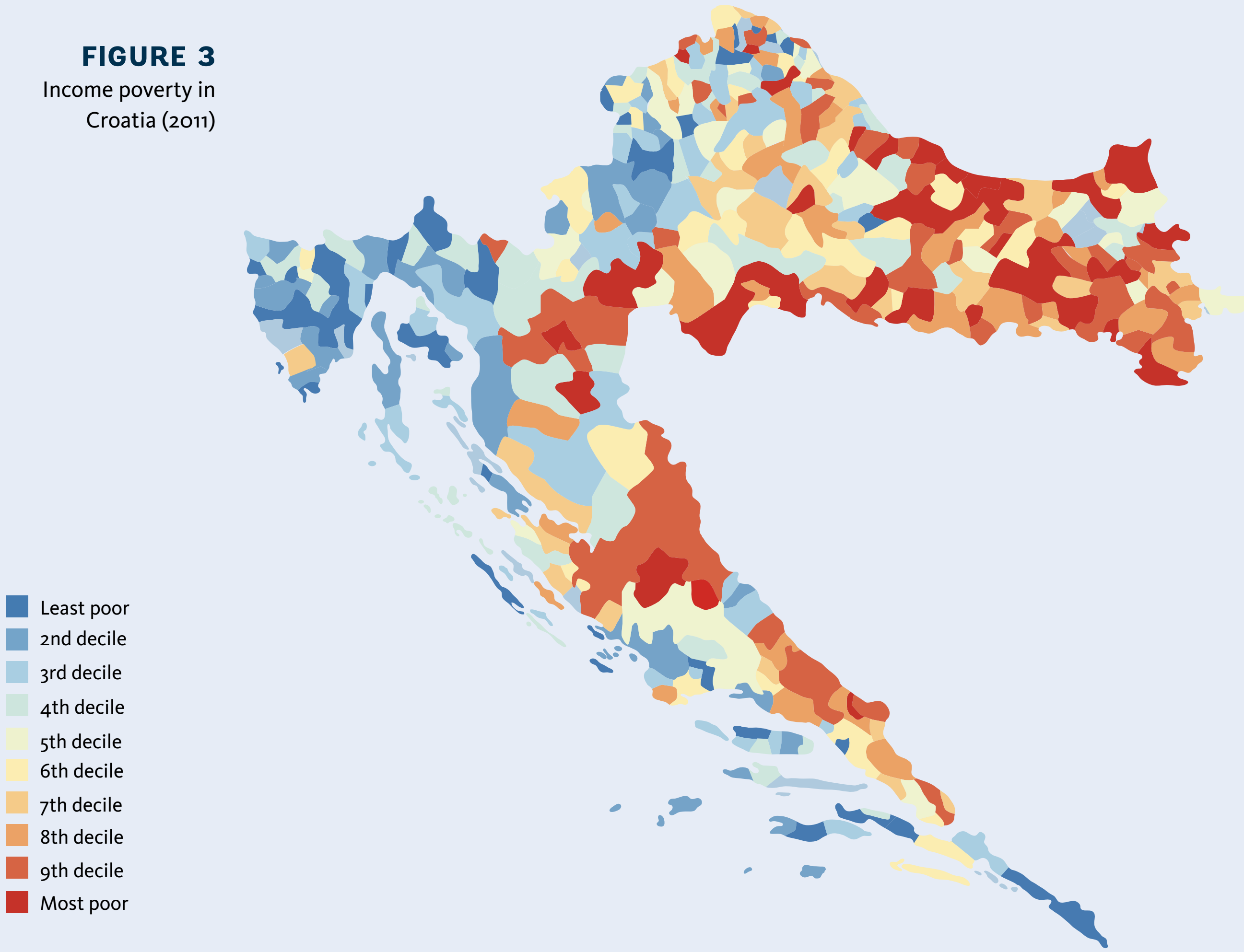
FIGURE 2
International poverty rates for Croatia, 2011 USD PPP per day



Source: World Bank Data

8 The NUTS classification (Nomenclature of territorial units for statistics) is a hierarchical system for dividing up the economic territory of the EU for the purpose of (i) the collection, development and harmonization of European regional statistics and for (ii) socio-economic analyses of the regions. NUTS 3 are small regions for specific diagnoses. There are currently 1348 regions at NUTS 3 level in Europe.

FIGURE 3
Income poverty in Croatia (2011)



Source: Croatian Bureau of Statistics

become evident even within the same region, which can pose challenges for the efficient allocation of resources. In recent years, demographic trends such as a rapidly aging population and higher levels of outmigration, particularly for educated youth, have further complicated the longer-term growth prospects for large parts of the country—with serious implications for shared prosperity.

Poverty and employment were profoundly impacted by the financial crisis, and the situation has taken a decade to recover. Between 2009 and 2014, average real disposable income per capita fell by 12 percent, the largest drop among new EU member states. In the same period, the incomes of the poorest 40 percent of the population fell by a similar degree. This translated into a rising poverty headcount (at 5.50 USD PPP) (Figure 2). After a sizable drop during the crisis period, the employment rate in Croatia started increasing and currently stands at almost 59 percent in 2017; yet this is much lower than the EU-28 average of 68 percent, pointing to stubborn problems of limited workforce participation and high informality. The net change in poverty between 2009 and 2015 was positive, implying higher poverty levels in 2015 relative to 2009, with the change driven mostly by falls in labor incomes and employment and a poorly targeted package of benefits (for both social assistance and pensions) for the most vulnerable. As of 2017, survey-based unemployment rates have improved substantially—but this has been largely driven by outmigration. Long term unemployment and a large number of people not participating in the labor force remain concerns for the country.

Poverty is now below its pre-crisis level. By 2016, poverty at the $5.50 USD per capita per day (in 2011PPP terms) was at a level (4.4 percent) that was better than in 2009 (4.7 percent). Furthermore between 2010 and 2016, every decile of the distribution has experienced an increase in living standards. Moreover, the poorest 70 percent of the population is in a better relative position than they were at the onset of the crisis. This has also been reflected in the improvements in the Gini index, which has decreased from 32.4 in 2010 to 30.9 by 2016.

BOX 1
Summary of Country Gender Assessment (2018)

The Country Gender Assessment reviewed the state of equality between women and men in Croatia in endowments, economic opportunities, and voice and agency. In doing so a mixed methods approach was taken, whereby qualitative tools complemented quantitative analysis. The assessment is the first to highlight the intersection of overlapping disadvantages due to social and spatial exclusion. It brings in the voices of excluded groups—older women, youth and minorities—from the less developed region of Slavonia and the most developed area, the city of Zagreb. Croatia has made substantive progress on including gender equality both institutionally and legally into its policy agenda. Certain indicators of gender equality remain strong, such as equitable primary and secondary school enrollment for boys and girls. There is however need for concerted action to close other gaps.

There is unequal access to economic opportunities for women, youth and retirees. Women constitute 57.4 percent of those excluded from the labor market. Less educated, low skilled rural women aged 45 to 64 face the most barriers to employment. There is a sizable gender gap, with 61 percent of women and 71 percent of active men employed. Higher levels of tertiary education for women do not translate into greater labor market participation. Unemployment rates are 19 percent higher for women than men. Some 32 percent of women ages 25 to 64 are inactive due to care responsibilities. Part- time work which could help reconcile work with care responsibilities is only 5.8 percent below the EU 28 average of 30.9 percent. Formal child care for children under 3 is the 7th lowest in the EU, while care for children age 3 to school age is the lowest in the EU at 51 percent, well below the EU-28 average of 86 percent. Women in their reproductive years are thus disproportionately impacted by unemployment, pointing to discrimination against women aged 25-40 seeking work. Employment rates for older women 55-59 and 60-64 years of age are 29 and 44 percent less than for men. Traditional gender roles put pressure on men to provide for their families, while women provide unpaid care for their children and elderly relatives.

Youth with less skills and education remain at the fringes of the labor market. Croatia has the third highest "not in employment, education or training" (NEET) rates for males at 16.7 percent vs the EU average of 11.5 percent. Female NEET rates are the seventh highest at 19.1 percent vs the EU average of 15.4 percent. **Excluded groups often resort to self-employment out of necessity, however there is a lack of inclusive entrepreneurship opportunities customized to the needs of vulnerable groups.** Entrepreneurship rates in Croatia are low at 11.8 percent compared to the EU average of 14 percent in 2016. The rates for youth were 2.6 percent, for women 8.1 and for older people 18.7 percent.

There is a distinct ethnic dimension to gender equality with the Roma population the most excluded minority. Inequalities for Croatian Roma girls start early and intensify over the lifecycle. Roma girls in particular are disproportionately excluded from early childhood development opportunities with 78% leaving school early, in comparison to 60% of Roma boys. Only 6 percent of the Roma women complete secondary or higher levels of education, compared to 24 percent of Roma men. Croatia has the second-highest Roma NEET rate in Europe, after Spain, at 82 and 72 percent for women and men respectively.

Location plays an important role in determining welfare, with the worst outcomes for rural women. Rural areas remain far behind urban areas in terms of poverty reduction, employment, education, and access to services. The coverage of kindergartens is the highest in Zagreb at 91 percent and the lowest in the counties of Slavonia where it ranges from 32 to 13 percent. Countries with better developed pre-school and kindergarten coverage have the highest rates of women's employment and low coverage of childcare and low levels of female labor force participation are characteristic for the counties of Slavonia.

Age is a key determinant of poverty with a distinct gender dimension. The at risk of poverty rate for women is 35 percent greater than that for men. Women also receive 23 percent lower levels of pension. This is concerning as elderly women will constitute14 percent of the population. Healthy life years for women who live on average to 80 is only 72 years as opposed to 66 for men whose life expectancy is 75 years. Older women are less likely to receive informal care than men as women live longer and thus live alone.

Vulnerabilities exist in several segments of society, especially elderly women in rural and lagging regions. Roma, a minority at 1 percent of the population, are left behind, and persons with disabilities are particularly vulnerable. The percentage of Roma, representing 1 percent of the population, have much lower education attainment. Their participation rate in secondary education, for example, is 45 percent, roughly half that of children in surrounding neighborhoods (85 percent). Persons with disabilities continue to face important challenges and despite some efforts to transition to community and family-based care, most still live in long-stay residential institutions.[9]

9 The number of deinstitutionalized children and persons with disabilities reached 1,500 in the period 2015-mid-2017, but the overall number of institutionalized persons did not decrease as new persons continue entering the institutions.

RECENT ECONOMIC DEVELOPMENT AND OUTLOOK

After a prolonged recession, GDP growth was restored from 2015. The country suffered one of the longest economic recessions in Europe,[10] The recovery started in 2015 and was driven primarily by a strong rise in foreign demand and pick-up of private consumption. The strong export performance was supported by record high tourist seasons and recovery of merchandise exports (though overall exports, at around 50 percent of GDP, remains small compared to EU peers). Private consumption increased due to a rise in disposable income, subdued inflation, and improved consumer confidence. The recovery in private investment has been accompanied by significant corporate deleveraging, while government investment is impacted by the utilization of EU funds.

TABLE 1
Croatia / Selected Economic and Social Indicators, Projections 2014-2020

	2015	2016	2017	2018	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.4	3.5	2.9	2.6	2.5	2.5	2.4
Private Consumption	1.1	3.5	3.6	3.5	3.6	3.4	3.2
Government Consumption	-1.0	0.7	2.7	2.9	2.2	2.2	2.0
Gross Fixes Capital Investment	3.8	6.5	3.8	4.1	6.3	6.4	6.1
Exports, Good and Services	9.4	5.6	6.4	2.8	2.1	1.9	1.7
Imports, Good and Services	9.2	6.2	8.1	5.5	4.7	4.5	4.2
Real GDP growth, at constant factor prices	2.3	3.5	2.1	2.6	2.5	2.5	2.4
Agriculture	3.8	7.3	-2.1	2.1	2.0	2.0	2.0
Industry	2.8	5.0	0.9	0.5	2.4	2.4	2.4
Services	2.0	2.8	2.8	3.4	2.5	2.6	2.4
Inflation (Consumer Price Index)	-0.5	-1.0	1.0	1.5	0.9	1.4	1.4
Current Account Balance (% of GDP)	4.5	2.7	4.5	2.9	2.1	1.3	0.9
Financial and Capital Account (% of GDP)	-3.5	-1.6	-3.4	-2.9	-1.5	-0.7	-0.2
Net Foreign Direct Investment (% of GDP)	0.5	4.2	2.5	2.1	2.2	2.2	2.4
Fiscal Balance (% of GDP)	-3.4	-0.9	0.9	0.0	0.3	0.4	0.5
Debt (% of GDP)	83.7	80.2	77.5	74.0	70.7	67.3	63.9
Primary Balance (% of GDP)	0.0	2.1	3.5	4.4	2.5	2.4	2.6
Poverty rate ($3.2/day, PPP terms)[a, b, c]	1.3	1.3	1.2	1.1	1.0	0.9	0.8
Poverty rate ($5.5/day, PPP terms)[a, b, c]	5.5	4.9	4.6	4.2	3.9	3.5	3.2

Source: World Bank, Macroeconomics, Trade and Investment Global Practice and Poverty Global Practice.
Notes: f = forecast. In annual percent change unless indicated otherwise.
(a) Calculations based on 2014-EU-SILC survey. (b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita constant PPP. (c) Projections are from 2016 to 2019.

However, current growth rates remain among the lowest of countries in Central and Eastern Europe (CEE), with concerns that the composition of the economy does not support strong increases in overall productivity. The share of manufacturing has been stagnant over the recent period, while tourism has become a key driver of economic growth. While tourism has helped to drive the recovery, the sector tends to be less innovative, suggesting that overall productivity gains could be limited. Over-reliance of the economy on tourism, whose performance is seasonal and depends on external factors, can create economic vulnerabilities. However, if better backward linkages are established, tourism could serve to promote other sectors, including successful international market penetration.

10 During the 2009-2014 period Croatia lost 12 percent of its output, the share of population at risk of poverty increased considerably, and unemployment steadily increased from 8.5 percent in 2008 to a peak of 17.3 percent in 2014.

Low total factor productivity (TFP) growth, an aging population and rising levels of emigration limit growth prospects. Unlike most of its peers, where pre-crisis potential growth was largely driven by TFP increases, Croatia benefited mostly from capital accumulation related to public investments in infrastructure and real estate. Total factor productivity made a negative contribution to growth from 2005 to 2014, and only a small positive contribution in 2015-17. This may partly mirror the excessive allocation of resources towards less productive sectors, low level of R&D spending by both public and private sectors, comparably lower quality of human capital, a cumbersome business environment, a relatively large and inefficient SOE sector, as well as institutional and regulatory weaknesses.

BOX 2
European Structural and Investment Funds (ESIF)

As Croatia only acceded to the EU in July 2013, the implementation of the European Structural and Investment Funds for the budget period of 2014-2020 began only recently. EUR 10.7 billion of grant funding was allocated by Croatia in four Operational Programs targeted at: Strengthening Competitiveness and Cohesion (EUR 6.8 billion), Developing Efficient Human Resources (EUR 1.6 billion), Stimulating Rural Development (EUR 2 billion), and Supporting Maritime and Fisheries (EUR 0.2 billion).

Such Funds represent a major opportunity for enhancing Croatia's socio-economic recovery and reform agenda, representing one of the highest intensities in the EU of ESIF allocation per-capita. However, this potential has yet to be fully exploited, although implementation and absorption is expected to intensify in the latter part of the 2014-2020 period. As for many new EU entrants, the implementation of projects co-funded from EU grants has been hindered by constrained administrative capacity, over-regulation of the national rules, insufficient strategic planning and weak inter-ministerial and interagency coordination.

The ESIF absorption rates, while progressively catching up, remain one of the lowest in the EU.[11] Opportunities for a faster picking-up of implementation are being created by an acceleration in publishing calls and in contracting.[12] Considering EU Funds are a very important contributor to the overall public investments budget, it is important to focus on better project selection and prioritization and faster implementation.

The Government is well aware of such challenges and is tackling both design and implementation issues. For example, in 2017 the Government initiated the preparation of a National Development Strategy 2030 that will facilitate the programming of the next ESIF period of 2021-27 and strengthen and streamline the country's planning processes. Continued efforts are also being made in staffing, capacity building, simplification of structures and procedures

11 Source: European Commission data, https://cohesiondata.ec.europa.eu/countries/HR

12 Launched calls are at 84%, contracted projects at 64% for all ESIF programs; https://strukturnifondovi.hr/financijski-pregled-eu-fondova/, update: Feb 28, 2019.

Growth is expected to remain below 3 percent for the medium run. Expected improvements in EU fund utilization would boost future capital investment, but current investment levels (20 percent) are well below the pre-crisis level of investment of around 27 percent of GDP. Adverse demographic trends are being exacerbated by net emigration and it is expected that lack of labor input (both availability and quality) will also constrain growth in the upcoming period. Without a significant increase in productivity, Croatia will not be able to reach growth rates that would allow the country to converge towards the income levels of peers in the region, let alone that of advanced economies in Western Europe.

A significant reduction in the government deficit reversed the unsustainable trajectory of public debt, but fiscal vulnerabilities remain. Over the course of three years, the government has achieved a strong fiscal adjustment, and a budget surplus was recorded in 2017. As fiscal imbalances narrow, and growth accelerates, public debt seems firmly on a downward path decreasing around 2.5 percentage points of GDP on average per year since 2015. However, at around 75 percent of GDP, general government debt remains high and the country continues to be vulnerable to potential worsening of external borrowing conditions or interest rate shocks. Furthermore, with a relatively large share of debt denominated in foreign currency, Croatia is also exposed to exchange rate risk, although this is mitigated by the Central Bank's policy of a tightly managed float of the Kuna's exchange rate against the euro. Downside risks to the downward debt trajectory stem from lower GDP growth and materialization of contingent liabilities including from SOEs. Regarding the composition of the budget, the share of capital spending decreased by more than half compared to the pre-crisis level and compensation of public employees remains the highest in the CEE region (in percent of GDP).

Monetary policy has helped to provide macroeconomic stability in Croatia and the banking sector remains well capitalized, highly liquid and profitable. Monetary authorities continue to use the EUR/HRK exchange rate stability as the main nominal anchor for inflation expectations and financial stability. This continues to be critical, as the economy is exposed to currency risk, with total public and private foreign currency debt (including debt with a currency clause) exceeding HRK 500 billion (about 140 percent of GDP), and more than 90 percent of this amount denominated or linked to euros. Conservative macroprudential policies of the Croatian National Bank throughout the years has enabled the banking sector to withstand six years of economic downturn without any major bank going into bankruptcy. However, the crisis resulted in a significant worsening of the quality of banks' loan portfolio. The NPL ratio tripled and, while on a declining path since 2015, it is still high relative to pre-2008 levels (10.3 percent as of September 2018 compared to 4.9 percent in 2008).

Croatia has full access to international capital markets and financing terms have improved significantly over the last three years. Croatia lost its investment grade in 2012 because of high fiscal deficits, increasing levels of public debt and a prolonged recession. As a result, borrowing conditions worsened significantly. However, Croatia remained present on the market with at least one international issue every year. As the economy recovered and fiscal sustainability improved, all rating agencies have been revising Croatia's grade upward, and in March 2019 S&P upgraded Croatia's rating back to investment grade. Over the last two years, the CDS spread has fallen by more than 200 basis points and is currently around 100 basis points. The last international bond issuance took place in June 2018, when the Government raised EUR 750 million from a 10-year bond sale with a yield of 2.898 percent. Investor demand was strong, and the issue was oversubscribed almost 5 times.

DEVELOPMENT CHALLENGES AND INSTITUTIONAL ASSESSMENT

The SCD identified the main challenges for accelerating growth and improving social outcomes in Croatia; and is complemented below by further analysis of the institutional constraints that are relevant for the country's sustainable path towards IBRD graduation. Despite its relatively high income, Croatia is underperforming in a number of indicators of institutional performance, indicating underlying challenges and weaknesses that cut across sectors and impact both public and private institutions. This section outlines the SCD priorities and provides complementary analysis on the institutional weaknesses that limit Croatia's potential. It draws on the SCD for both qualitative and quantitative evidence, and benchmarks results primarily against EU peers.

The SCD identified three key priority areas where Croatia's institutional weaknesses constrain productivity and limit the ability to achieve better societal outcomes:

First, evidence suggests institutional gaps limit government effectiveness. Croatia has a large public sector, which is underperforming in a number of indicators. Weak administrative capacity creates difficulties in programming and implementation of investment, including EU structural and investment funds. *The main institutional challenges to address include poor planning, lack of effective coordination and cooperation across ministries and levels of government, and a weak public investment management process.*

Second, a lack of capacity to deliver quality services is reflected in suboptimal human capital outcomes which limit the economic opportunities, particularly in the poorest regions of the country. Delivering improvements in inclusion, unemployment, and education, particularly for the most vulnerable population, will require strengthening the ability of relevant institutions to provide services to those hardest to reach. *The institutional challenges include capacity gaps among national and local authorities, as high fragmentation of local decision-making authority raises costs and reduces the quality, effectiveness and sustainability of service delivery.*

Third, weaker market institutions—including barriers in the business and regulatory environment with challenges in performance of the state-owned enterprises (SOEs)—remain a long-standing binding constraint in Croatia that limits the potential of the private sector to thrive. Key government institutions, most notably the judiciary and public administration systems, underperform according to both EU and global benchmarks. *Improving capability, transparency and predictability of key market institutions—such as justice, competition policy and the regulatory environment and public administration—are key determinants of private sector revival.*

TABLE 2
Croatia / Selected Economic and Social Indicators, Projections 2014-2020

	SCD Objectives:		
	Enhancing the performance of the public sector	Boosting participation and contribution of individuals to economic and social development	Enabling the emergence of a dynamic enterprise sector
SCD Priorities	Pursue efforts to reduce fiscal and debt vulnerabilities	Improve learning results and skills of the workforce	Foster a more competitive environment
	Improve quality and efficiency of public administration	Foster labor market participation	Boost justice system performance
	Ensure the preservation of natural capital	Ensure productive aging through lifelong learning, healthy aging and promotion of longer working lives	Unleash firm innovate capabilities

A. ENHANCING THE PERFORMANCE OF THE PUBLIC SECTOR

Pursue efforts to reduce fiscal and debt vulnerabilities

There have been noteworthy improvements in the areas of monetary, fiscal and debt policies, though vulnerabilities remain. Since 2008, the level of public debt has doubled. The bulk of the debt accumulated during the crisis was either issued abroad or issued domestically in euro or indexed to it. While the Government has made significant efforts to reduce fiscal imbalances, vulnerabilities are still present. A recently approved new national fiscal framework will help to assure sustainability over the longer term, including with regards to quasi-fiscal activities. Adoption of the EU fiscal compact would further strengthen fiscal governance and is required for full membership in the Eurozone. The planned adoption of the euro will reduce the currency risk faced by the Government and other borrowers. Liabilities from the State-Owned Enterprise (SOE) sector, remain a concern for fiscal sustainability.

Improve quality and efficiency of public administration

Croatia's public-sector performance lags EU peers across several governance indicators and measures of institutional quality. The country features in the lower distribution of perception and expert assessment-based indicators when compared to EU28[13] and global rankings of countries with similar income levels. Croatia also features one of the lowest absorption rates of European Structural and Investment Funds (ESIF), which, as of February 2019, was at 17 percent for all EU certified ESI Funds.[14] The ESIF contracted rate of 64 percent, however, indicates recent progress in intensifying implementation and bodes well for an acceleration in absorption towards the end the 2014-2020 programming period.

The inefficiency of the public sector is amplified by the large state presence in the economy. Croatia has a larger state footprint and the highest tax burden on the economy among its peers in Central and Eastern Europe. In addition, SOEs are present in almost all sectors – both network industries such as transport and energy and productive sectors including agribusiness, chemicals and pharmaceuticals production and hotel management. SOEs account for around 10 percent of employment, a fifth of total turnover and a third of total assets. Rates of return on assets are below that of SOEs in other CEE countries, and the rate of state subsidies is higher than the EU average. While some companies are profitable, the rationale for government ownership in some industries is weak and raises efficiency and competition concerns. Some SOEs generate substantial fiscal costs and contingent liabilities for the state (e.g., the road sector), and resources diverted could be applied towards more efficient uses. Addressing the weaknesses in the SOE sector, including with respect to corporate governance,[15] and reducing the overall role of the state in the economy is considered a binding institutional constraint.

Indicators of well-being differ significantly between regions, reflecting a lack of opportunities but also disparities in public sector service delivery at the local level.[16] In the 2017 European Quality of Governance Index (EQI),[17] Croatia ranked 4th from the bottom among

13 The European Quality of Government Index—based on a multi-dimensional concept consisting of high impartiality and quality of public service delivery, along with low corruption—scores Croatia towards the bottom, together with Greece, Romania and Bulgaria.

14 As of end February 2019, launched calls were at 84% for all ESIF programs; https://strukturnifondovi.hr/financijski-pregled-eu-fondova/

15 Absence of regulatory neutrality, as exemplified by different rules for procurement in SOEs and private companies, is still an issue.

16 In general, rural areas are less-developed. The share of the population living below the US$10 PPP threshold in 2013 was 45 percent in rural areas but only 29 percent in urban areas.

17 The EQI measures the level of governance at the national and subnational levels in the European Union, across three pillars: impartiality, corruption, and quality of services (Charron et al., 2018).

all EU-28 countries;[18] and Croatia's two NUTS-2 regions are among the EU's worst performers in the EQI measure, reflecting important efficiency gaps for regional and local authorities. Insights gained from the EQI at the NUTS-2 level hide regional disparities underneath the classification, particularly for the counties of Slavonia and other lagging regions, which could be classified among the worst performing NUTS-2 in the EU. Evidence suggests the high degree of fragmentation raises costs and reduces the quality, effectiveness and sustainability of service delivery. There is also strong overlap between central and local governments, which hinders the implementation of public policies and increases costs and leads to inefficiencies in the use of resources.

Available evidence suggests that ineffective institutions are hampering public policy-making and implementation. The planning framework is fragmented, with over 130 strategies with little connections among them. Croatia has 576 local and regional government units for about 4 million people and is often challenged by a lack of effective coordination and cooperation between agencies and levels of government which limits policy coherence and prioritization. In terms of implementation of policies, this translates into limited connections between plans, budgets, actual outputs, and performance, including a weak public investment management process. The 2016-18 National Reform Programs (NRP) envisaged important steps to simplify this complex system, improving the efficiency of public administration in the provision of public services, but the strategy and timetable is dragging. The outcome is evident in the delay of planned investments, especially those financed from the EU budget such as research and innovation or ICT infrastructure. Institutional shortcomings also limit the government's ability to address environmental and climate related challenges using EU funds, including the commitments it made towards meeting EU Directives (see paragraphs below).[19]

Ensure the preservation of natural capital

Managing increasing pressure on local resources and services in an environmentally sustainable manner is critical for Croatia, particularly given vulnerabilities. The dramatic growth in tourist visits should be supported through strategic investments to avoid environmental degradation. This is particularly challenging given the country has over 1200 islands, islets and rocks and more than a third of its territory under protection. Croatia faces significant threats from wildfire, flood, and extreme heat. Impacts of these hazards are likely to increase significantly with climate change and can negatively affect critical sectors such as tourism and agriculture. Floods occur frequently in the south and east of Croatia and climate change is expected to result in more intense yet unpredictable rain which will exacerbate flooding (the areas at highest risk of flooding coincides with the highest number of poor and vulnerable). To achieve resilient growth will require addressing weaknesses constraining the resource intensity of its economy, particularly in relation to energy use and waste.

Despite its low per capita energy consumption, the economy's energy and carbon intensities remain respectively 55 percent and 20 percent higher than the EU average. Croatia's decarbonization goals require a substantial expansion of renewable energy penetration, however progress has been slow due to governance weaknesses related to the presence of a strong incumbent, capacity to formulate and implement strategy and address regulatory issues, including for example pricing policies, also providing challenges in meeting EU Directives.

Croatia lags other EU countries in terms of resource efficiency, and the country risks not meeting several EU environmental targets. The country is unlikely to meet the EU 2020

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18 A pilot survey was conducted in the 5 counties of Slavonia with the goal of replicating the EQI for each county. The poor performance of Slavonia's counties is linked to poor administrative capacity in the region, which may explain the hindrance towards implementation of ESI funds and policies in the country (EU commission, 2016).

19 Cross sectoral coordination in the environmental sector is underachieving and in many cases strategies, policies and action plans are not regularly updated, harmonized nor set towards achieving same objectives.

target of 50 percent of municipal waste recycled, and little progress has yet to be made towards a more circular economy and eco-innovation. Only 18 percent of municipal waste is being recycled at the national level, and in the larger cities such as Zagreb and Split recycling is below 3 percent. Eighty-three percent of municipal waste is placed in landfills, compared to an EU average of 28 percent for 2014.[20] The construction of new waste management centers faces delays, together with the required closure of unsanitary illegal landfills scheduled for end-2018. These challenges suggest institutional shortcomings at central and municipal level, compounded by limited economic incentives to both municipalities and end users to improve treatment and waste segregation. Addressing these constraints is critical to ensure long-term resilience, as waste management failures risk affecting the value of Croatia's natural assets, including its marine areas.

B. BOOSTING PARTICIPATION AND CONTRIBUTION OF INDIVIDUALS TO ECONOMIC AND SOCIAL DEVELOPMENT

Improve learning results and skills of the workforce

Public sector institutions are generally not effective in supporting the development of Croatia's human capital. The recently released WBG's Human Capital Index ranks countries on how effectively they are preparing their citizens for the future. Using this methodology, a child born in Croatia today will be 72 percent as productive when she grows up as she could be if she enjoyed complete education and full health.[21] These human development outcomes suggest weaknesses in public sector service delivery. For example, when the years of compulsory schooling are adjusted for the quality of learning, estimates suggest that a child in Croatia only benefits from 10.8 years of schooling: a learning gap of 2.5 years. This learning gap is particularly large for poor students, with OECD's PISA results for 2015 showing that more than half of students from the poorest 20 percent of the population are functionally innumerate by age 15.[22] In terms of health outcomes, the percentage of 15-year-olds that will survive to age 60 is only 91 percent.

The eastern part of Croatia is doing substantially worse in terms of employment and skills. Unemployment rates are between 19 and 29 percent, compared to a national average of 15 percent.[23] Eastern Croatia (the five counties which represent Slavonia region) hosts almost one-third of Croatia's unemployed population, but less than one fifth of its total population. The age profile of unemployed persons is similar to the national average, but the unemployed cohort is significantly less skilled: at least 30 percent of unemployed persons have only basic skills, compared to 20 percent in Zagreb city and 24 percent in Split county. In general, the indicators of well-being in less developed regions suggest a strong correlation between the quality of government and human capital outcomes.

Foster labor market participation

Croatia has one of the lowest labor force participation and employment rates across Europe. The weak performance of the public sector at the local and regional level (see above) raises concerns regarding the ability to deliver enhance economic opportunities. There is underdeveloped potential in many productive sectors. For example, in agriculture, EU resources could be

20 The progress has been limited: in 2016 only 26% of municipal waste was collected separately and only 21% recycled (EU target is 50% by 2020), and recycling of construction waste is at 61% (EU target 70% by 2020).

21 The HCI measures the amount of human capital that a child born today can expect to attain by age 18. It conveys the productivity of the next generation of workers compared to a benchmark of complete education and full health. It is constructed for 157 countries. It is made up of five indicators: the probability of survival to age five, a child's expected years of schooling, harmonized test scores as a measure of quality of learning, adult survival rate (fraction of 15-year olds that will survive to age 60), and the proportion of children who are not stunted.

22 That is, their performance on the PISA test were at or below "basic proficiency" in math.

23 Most recent data available from HZZ, http://www.hzz.hr/UserDocsImages/CES_Yearbook_2016.pdf.

better leveraged to support higher levels of growth, employment and income levels in rural and lagging areas. The Government is investing in human capital to create employment and investment opportunities in less developed regions through a program backed by the allocation of EUR 2.5 billion of EU funds. However, more has to be done to improve coordination and institutional capacity to deliver outcomes. To encourage employment and reduce the cost of labour, new regulations, part of a larger plan for tax reforms, were introduced in January 2017, according to which every person receiving minimum salary is not liable to pay income tax.

Tax and social insurance policies as well as labor market institutions undermine labor market opportunities for the poor and for women. A high marginal tax rate for the lowest income bracket and significant losses in social transfers when taking up employment reduce incentives to participate in the labor force. Generous eligibility criteria for pension and disability insurance schemes also bias against labor market participation.[24] Active labor market policies and programs in support of labor participation and activation, despite improvements in the last years, continue to be limited and underfunded, and are often not targeted to those most in need of activation. There are limits to labor market flexibility in working arrangements, with only 6 percent of the employed working part-time in 2016, compared to nearly 20 percent in the EU. Combined with the limited formal care for children and the elderly, this creates a barrier for women with family responsibilities.

The national policy framework and institutional capacity to effectively use resources for social assistance needs improvement. The social assistance system was unable to avoid a sharp rise in poverty during the recent recession.[25] While general government spending on social protection accounts for 14.2 percent of GDP, and is in line with other EU Member States, fragmentation of public transfer programs, different sets of eligibility criteria for different services, the lack of monitoring and information systems, feedback from citizens and weak coordination between agencies at the central and regional level limit the effectiveness of this spending.[26] This is an area that features consistently in the EC's Country-Specific Recommendations (CSRs), and where progress is needed.

Ensure productive aging through lifelong learning, healthy aging and promotion of longer working lives

Institutional capacity to make evidence-based policies to promote human capital investments and implement reform programs could be strengthened. Across both the health and the education sectors, implementation of reforms has generally not been informed by a careful analysis of existing systems, and results have been slow to materialize. Examples of institutional challenges in the education sector include delayed efforts to reform the curriculum and expenditures that continue to rely on staffing norms as opposed to per student formulas, restricting the government's ability to develop cost-effective solutions that could be better adapted to local needs.[27] In health, the piloting of centralized procurement of medicines, commodities and

24 As of 2017, around 12 percent of Croatia's active population was unemployed compared with the EU27 average of 7 percent. These outcomes have their origins in various rigidities (tax policy, social transfers structure, labor legislation, pension eligibility etc.). Thus, effect of taxation on incentives to work is ranked particularly low in international comparisons (133 out of 137); restrictive labor regulations such as, hiring and firing practices (131 out of 137); and, inadequately educated labor force (131) affect the labor market efficiency and are also a concern for investors (GCR, 2017–18).

25 The share of the population living in poverty rose by nearly 7 percentage points from 2009 to 2014—the largest among the EU's newer member states.

26 The overall social protection system has been fragmented and not properly coordinated (three ministries set policies and four administer social protection programs), with overlaps among the programs, but some improvements have taken place on the last few years in response to efforts for improving the coordination and undertaking policy reforms to improve equity, efficiency and quality of service delivery.

27 According to the GCR (2017-18) "Inadequately educated workforce" is one of the problems (9th) cited among the 16 factors that people perceive (3.4%) as affecting doing business in Croatia. The quality of the education system (ranked 112 out of 137); the Internet access in schools (119); the quality of management of schools (93); as well as the quality of primary education (71) are the cause for the negative perception on the quality of education. In addition, in math, reading and science, the performance of Croatian students in problem solving is one of the lowest among PISA-participating countries and economies. Croatia placed 43 out of 50 in this aspect of PISA 2015.

devices has started with evidence of economic benefits, but the Government faces difficulties in scaling up implementation. Hospital functional integration and hospital arrears reform have also been hampered by weak hospital management capacity and constraints at the central level to design and implement actionable policies.

Similar to other European countries, Croatia is facing a profound change in its population age-structure. Due to this demographic and related epidemiological transition, adjustments in the service delivery model are needed, particularly in at the local level where capacity is limited.[28] Amenable mortality rates, frequently used as a measure of hospital care, reflects issues of the timeliness and effectiveness of care delivered. The rates for Croatia are almost twice the average rate for the EU, implying significant deficiencies in the care delivery processes.[29] Hence there is a growing need for palliative and chronic care which is better provided in non-hospital settings. Advances in technology and surgical techniques mean that more services can be delivered in ambulatory and day care settings therefore reducing the need for care beds and increasing the need for integrated health networks.

C. STRENGTHENING MARKET INSTITUTIONS TO ENABLE A DYNAMIC ENTERPRISE SECTOR

Foster a more competitive environment

The performance of the Croatian business environment is deteriorating due in part to slow implementation of reforms and lack of determined action. Croatia is ranked 58th within 191 countries in the 2019 Doing Business rankings and is among the lowest-ranked in the EU. Low levels of product and services market competition reflects a misallocation of resources caused by the strong presence of SOEs in several economic sectors. The degree of regulatory uncertainty and issues of regulatory neutrality relate to the lack of public sector transparency resulting in a low level of predictability of the business environment. The regulation of professional services in Croatia is the most restrictive in the EU, with 50 percent more regulated professions than the EU average. Market institutions in Croatia reflect a lack of administrative capacity and coordination challenges that are hampering the achievement of policy objectives. These gaps will need to be addressed to unlock the country's latent growth and productivity potential.

At the core of Croatia's transport challenges are weak policy institutions, which have not been able to leverage the full benefit of EU accession. The operation of rail and road infrastructure continues to depend on public support, backed by substantial subsidies. Key bottlenecks to the effectiveness of investment include: (i) piecemeal investment approaches; (ii) slow implementation; (iii) poor prioritization; and (iv) limited integration across modes (e.g. passenger rail to bus / tram). The process for making investments in road and rail infrastructure and to put in place the complementary institutional elements around those investments could be strengthened to gain full advantage of enhanced passenger services and integrated logistics chains. There has been little progress in improving the quality and frequency of passenger rail services and implementing of the new "Treaty Establishing the Transport Community".[30] While there are advanced logistics operators in Croatia, the system is weakened by the quality of rail freight, the low development of inland waterways, and substandard facilitation processes at the main ports.

28 Significant geographical variations in service delivery and utilization exist. In 2017, across counties, specialist referral rate ranges between 9.2 and 23.4; Emergency visits range between 88 and 423 per 1,000 inhabitants; Primary care visits range between 7.8 and 10.4 per capita.

29 https://ec.europa.eu/eurostat/statistics-explained/index.php/Amenable_and_preventable_deaths_statistics

30 The treaty was signed between Western Balkans countries and the European Union in 2017. The treaty applies key provisions of the EU acquis and offers an opportunity for Croatia to benefit from streamlined transport with its three Western Balkans neighbors.

Boost justice system performance

The justice system remains weak compared to regional indicators of institutional performance, with implications for the business environment. The EC recently published the 2018 EU Justice Scoreboard which scores Croatia among the lowest of all EU countries.[31] Only 23 percent of those polled rate the justice system as good in terms of the independence of courts and judges. Despite improvements over the last three years, the number and disposition time in litigious civil and commercial cases remain among the highest in the EU.[32] Judiciary inefficiency and unpredictability was identified as an issue for doing business during CPF consultations. According to the Doing Business Report 2019, Croatia dropped to rank 25 in enforcing contracts, as it takes 650 days to resolve a commercial dispute. In resolving insolvency Croatia ranks 59 and the time required to resolve bankruptcies (3.1 years) is significantly higher compared with ECA and OECD countries, while the recovery rate of claims is below the average (34.8 cents on the dollar).

Unleash firm innovate capabilities

The unfinished public R&D sector modernization hampers innovation in Croatian firms, particularly small and medium-sized enterprises. While services play a large role in Croatia's exports (two thirds of the economy), the sophistication of services exports remains well below that of peers. Croatia scores at the bottom in terms of indicators of innovation and the country's business expenditure R&D (BERD) as a share of GDP is lower than the EU-27 average, remaining at the same level as in 2009. Underlying institutional factors that contribute to this low performance include: a low level of R&D-driven innovation, limited access to internal and external resources including highly qualified personnel, barriers to science-industry collaboration as well as pervasive weaknesses in the governance of Croatia's innovation ecosystem. These weaknesses also limit the capacity of the public research and innovation sector to absorb EU funds. Given the pace of technological change, it is critical for Croatia to begin to close this gap and use technology to improve productivity and diversify the composition of its economy.

Croatian firms view access to finance as a more binding constraint than the average in the European Union and enhancing the responsiveness and relevance of the financial sector to the needs of enterprises, entrepreneurs and society remains a key challenge for policy makers. Overall, access to financing is limited, due to lack of financial resources for the riskier stages of development and generally still risk-averse banking sector towards SMEs, which rely mostly on own resources. For larger corporates that can diversify away from bank financing, the equity markets are underdeveloped, constrained by small market size and little local institutional investor appetite. Availability and affordability of financial services, as well as ease of access to loan, equity financing and funding through venture capital score unfavorably compared to peer countries.[33] Also improving the supervisory practices in the non-banking sector continue to be a priority.

31 The EU Justice Scoreboard is a comparative information tool that aims to assist the EU and Member States improve the effectiveness of their national justice systems by providing objective, reliable and comparable data on a number of indicators relevant for the assessment of the quality, independence and efficiency of justice systems in all member states.

32 Croatia has made efforts to improve case clearance rates in courts. The number of pending unresolved judicial cases peaked at 1.6 million in 2004 and has slowly been reduced to 407,062 in 2018.

33 Access to finance is among the factors identified by the surveys as important to businesses. Croatia ranks 85th in terms of getting credit (DB19). Access to finance is the most important concern for 7% of the EU SMEs, while in Croatia this share is 18% in case of small, and 13% in case of medium-sized companies.

III.

WORLD BANK GROUP PARTNERSHIP FRAMEWORK

III. WORLD BANK GROUP PARTNERSHIP FRAMEWORK

A. GOVERNMENT PROGRAM AND MEDIUM-TERM STRATEGY

The Government's Program outlines a plan for the country's future development. The Government's priorities emphasize four main objectives, including achieving stable and lasting economic growth; creating new, high-quality jobs; curbing emigration and demographic renewal; and promoting solidarity and social justice.[34] The Government's action plan is presented through annual National Reform Programs prepared in the context of the European Semester; and is consistent with the areas identified in the WBG's SCD (see Table 2). The Government, under the coordination of the Ministry of Regional Development and EU Funds, is currently developing a new 2030 strategic vision for Croatia.

Euro adoption is a key pillar of the Government's future strategy, and many structural reforms will need to be implemented to maximize this opportunity. Jointly with the Croatian National Bank, the Government has presented in 2018 a strategy analyzing the economic benefits for euro adoption. This strategy clearly outlines the conditions for sustainable economic convergence. Croatia's macroeconomic foundations are solid, which should facilitate its entry into the Exchange Rate Mechanism (ERMII)[35] but the timing of entry into the euro area will depend on how Croatia will follow the nominal convergence criteria: preserving price level and exchange rate stability, discipline in public finances and the necessary degree of convergence of the long-term interest rates, as well as the speed at which it will be able to implement reforms. However, beyond the nominal convergence criteria, evidence suggests that countries with stronger institutions seem to be more successful (as they reap relatively more benefits) within the Eurozone.

B. PROPOSED WBG COUNTRY PARTNERSHIP FRAMEWORK

LESSONS FROM FY14-18 CPS COMPLETION REPORT

Croatia values the WBG as a strategic partner, particularly in complex areas where it can bring global knowledge and experience to bear. The composition of the program has focused on areas of long-term engagement where development challenges are complex, and outcomes take time to materialize. As a result, positive outcomes were achieved over the CPS period, including in land administration where the WBG developed an approach over a multi-operation engagement that leveraged EC funds, and in the road sector where the Bank supported both financial and operational restructuring through different instruments (see Box 4) and in close partnership with EBRD. During the CPF period, the WBG will further build on these trends and look to replicate this in other sectors.

34 Program of the Government of the Republic of Croatia, 2016-2020 mandate.

35 A country must participate for at least two years in the ERMII before it can qualify to adopt the euro.

Operating in Croatia requires keeping a focus on results but being flexible in the use of instruments. The implementation of the CPS has demonstrated the value of using a combination of lending and advisory services to deliver results. The CPS included development policy lending, results-based financing, traditional investment loans and guarantees, and a limited amount of reimbursable advisory services. A significant growth in the RAS program, towards multi-year engagements that help build capacity, started in FY2018 and will be continued under the new CPF. During the CPF, the WBG will continue to employ a multi-instrument approach designed to support institutions. This includes the possibility of development policy lending if it is underpinned by a robust institutional reform program in areas where WBG technical assistance can add value, and where reforms are complex and well underway.

Political volatility impacted project implementation during the CPS period, but operations in long-standing areas of WBG engagement were resilient and had positive development impact. Several operations were cancelled or restructured during the CPS period, however many withstood challenges of political volatility by building implementation capacity through models that could be scaled-up or serve as demonstration. For example, the EU Natura 2000 Integration Project, Coastal Cities Water Supply Project, Second Science and Technology Project (STP2), and Land Administration are successful follow-up operations. Under STP2, R&D programs were tested under a previous loan, and then brought to scale. Based on this lesson, the proposed CPF will design interventions in areas where the WBG has a tested model (e.g., in the areas of innovation, or of railways) or that are in long-standing areas of WBG engagement.

IFC's value proposition included the design of innovative private sector solutions, particularly in the pioneering infrastructure projects, promoting investments in less developed regions, and upgrading the capacity of domestic firms to compete and expand globally. These are areas which continue to be relevant for the proposed CPF. IFC also achieved success in supporting the climate change agenda through windfarm investments, supporting projects which account for 25 percent of the total installed wind capacity in the country. The key lesson learned during the period is that, without progress in strengthening market institutions to attract private investors, demand will be limited. It will also depend on IFC's financial additionality, particularly longer tenors. The restructuring and privatization of SOEs, and the development of Croatian equity and capital markets, particularly in the bonds, private equity and risk capital space, will be key for IFC engagements in Croatia. MIGA has issued no guarantees in Croatia over the CPS period, reflecting similar dynamics to those faced by IFC, namely low demand from foreign investors seeking coverage against political risk and/or credit insurance, and MIGA additionality given current market conditions.

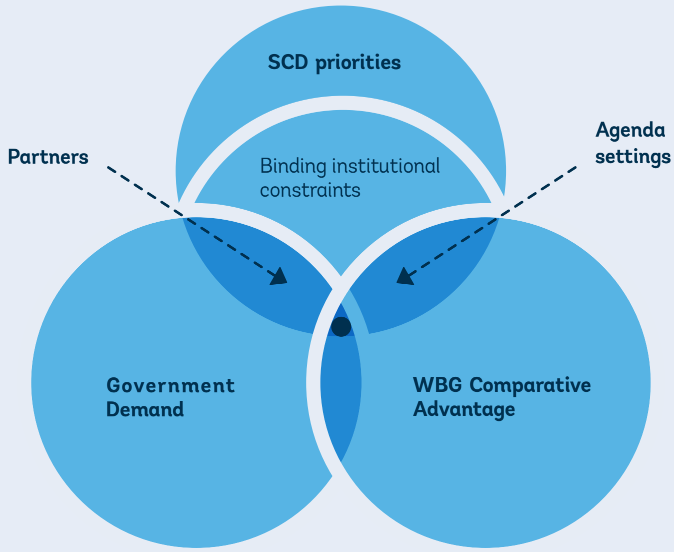
LESSONS FROM PUBLIC CONSULTATIONS

The consultations for the new CPF were designed to be broad, inclusive, and extensive. Countrywide consultations had not taken place in Croatia since 2008, and the WBG engaged from July until December 2018 throughout all regions in Croatia (see Annex 5). The outcome of the process revealed a consistent vision from different stakeholders on the major challenges and where WBG support was most critical. The lack of efficiency of the public administration, the quality of education and weaknesses in the justice system, were among the most consistent issues raised. In addition, concerns were expressed related to the business environment and private sector competitiveness, including lack of transparency, overregulation, collusion and corruption. Finally, stakeholders expressed it could be important for WBG to support acceleration of structural reforms to help Croatia meet its full potential.

OVERVIEW OF WORLD BANK GROUP STRATEGY

The CPF proposes a two-stage process of selectivity to ensure a primary focus on strengthening policies and institutions required for sustainable IBRD graduation. First, the "core" CPF engagement will be highly selective and consistent with: (i) the SCD priorities (but with a focus on the binding institutional constraints identified); (ii) the WBG comparative advantage (in particular, its ability to tailor interventions to support institutional strengthening and capacity); and (iii) Government demand (the Government has requested WBG to continue to advise, accompany and finance interventions in areas where complex reforms are required, where the WBG has a long-standing engagement, and where institutional reforms are needed).

FIGURE 4
Selectivity filters



Many development areas will not be directly supported by WBG intervention (Figure 4). SCD priorities outside of the WBG comparative advantage vis-à-vis other partners in Croatia include, for example, civil service reform. In such cases the WBG would mainly coordinate with partners – for example, European institutions. In SCD priority areas with no current government demand but where the WBG has a comparative advantage (for example, social protection) the CPF would continue with due-diligence analytical work, including in a regional context, that defines the agenda, identifies challenges and informs stakeholders of best practices. For non-SCD priorities in which government demand does not meet the financing selectivity filters – such as financing for infrastructure that does not address key institutional constraints — the Bank would continue to consolidate its lending portfolio over the CPF period and use RAS-financed engagements as appropriate.

The second stage of selectivity considers the most appropriate use and design of instruments for a high-income country that still faces complex institutional challenges. To ensure a highly selective lending program, all new IBRD financial support would have to demonstrate that it builds essential institutional capacity required for sustainable IBRD graduation (see Table 3). In addition, at least one of the following filters would also have to be met: (i) provide innovative solutions that benefit the marginalized, most poor and vulnerable; (ii) catalyze private sector investment or leverage additional resources, including access and efficient utilization of European Union funds; and/or (iii) contribute to regional and global public goods.

TABLE 3
Croatia's proposed short-term lending program would build essential institutional capacity and address additional selectivity filters

Proposed lending	Proposed key institution-building focus	Additional selectivity filters met
Improving the quality and efficiency of education FY20	**Increase capacity** of government to effectively and efficiently deliver key pre-school, primary and secondary education services, including by introducing per-student financing model. **Improve capacity of government to monitor, evaluate and adapt reforms** focused on learning outcomes	Improve educational access and quality for the **marginalized, poor and vulnerable**, including in less-developed regions Increase ability of the educational system to **access and efficiently utilize EU grants** in the 2021-27 financing period
Justice for Business FY20	**Strengthen efficiency and institutional capacity** of the Ministry of Justice for improved planning and management of its court infrastructure Address **market institution weaknesses** to improve the business environment Improve **agency coordination** for effective delivery of reforms to improve business environment	Address court improvements, including in lagging regions, to provide equal and efficient access to justice for the **marginalized, poor and vulnerable**
Enhancing Access to Finance in Lagging Regions FY21	**Strengthen capacity** of the Croatian Bank for Restructuring and Development (HBOR) to effectively and efficiently address market failures, have enhanced internal processes and comply with new supervisory norms	Focus on improving access to finance **in the least developed parts of the country** to address the needs of the marginalized, poor and vulnerable

In line with the selectivity filters identified above, IFC will strategically prioritize engagements across key industries, particularly with a view to mobilizing private investments within the MFD/Cascade approach and contributing to regional/global public goods including climate change mitigation. First, IFC will support regionally competitive and innovative local firms operating in sectors that can contribute to quality job creation, with large SME supply chains especially in lagging regions. Second, IFC will target innovative capital market instruments such as green bonds and possibly covered bonds that address the climate change and bring in innovative private sector solutions. IFC will also consider equity-based finance by supporting private equity funds that promote disruptive technologies and innovation. Third, in key MFD/Cascade related areas such as public private partnerships in renewable energy and transport infrastructure, IFC will closely collaborate with the Bank to promote an enabling environment for private sector participation. Finally, in the renewable energy space, IFC will seek multiple points of engagement with its investment and possibly advisory projects to help the expansion of renewable energy in Croatia as envisioned under the new renewable energy law.

The RAS Program supports a broader engagement, including to address institutional weaknesses that cut across sectors. In many cases, RAS-financed engagements will be de-

TABLE 4
Croatia's RAS-financed engagements support institutional strengthening: Examples

Proposed lending	Proposed key institution-building focus	Additional selectivity filters met
Support for Establishing the System for Strategic Planning and the Preparation of the National Development Strategy – Croatia 2030	Increase capacity of government to effectively and efficiently deliver key pre-school, primary and secondary education services, including by introducing per-student financing model. Improve capacity of government to monitor, evaluate and adapt reforms focused on learning outcomes	Establishing *strategic planning system* in line ministries and other public bodies to strengthen *coordination mechanisms*, improving public investment *management and monitoring* based on key performance indicators. Supporting training of civil servants to *improve capacity* for strategic planning in selected ministries.

Proposed lending	Proposed key institution-building focus	Additional selectivity filters met
Strategic Transformation of Agriculture and Rural Space	Advisory support to the Ministry of Agriculture in the formulation of National Agriculture and Rural Development Strategy, and a Multi-annual fisheries development plan for the post-2020 period of the Common Agricultural Policy (CAP) and Common Fisheries Policy (CFP) of the EU.	*Increasing the capacity* of the Ministry of Agriculture for evidence based *strategic planning, implementation and monitoring.*
Growth and Jobs in Eastern Croatia	Advisory support to the Ministry of Regional Development and EU Funds in maximizing the impact of EU Operational Program funds on economic development in Eastern Croatia (EUR 2.5 billion earmarked during 2014-2020, with more planned for 2021-2027), through support in design, and implementation, of reforms and operations under these Funds.	Support the Government to improve synergies of various initiatives through *enhancing coordination* at national level, while *building capacity* at the regional level to foster growth. *Capacity building* for public investment management and improved support for lagging regions in Eastern Croatia to upgrade economic and innovation infrastructure and mobilize private investment.

signed as large, multi-year and multi-sector interventions that can support capacity building efforts and target the institutional weaknesses that limit the effectiveness of the public sector and improve utilization of EU resources. The WBG will continue to employ RAS-financed engagements to address institutional bottlenecks that are more complex and challenging, including those that cut across development challenges and areas identified in the SCD assessment, and, as such, require multi-sector solutions and ownership from several government ministries (see Table 4).

FOCUS AREAS AND OBJECTIVES SUPPORTED BY THE WBG PROGRAM

The proposed CPF engagement targets interventions that address the institutional constraints limiting progress towards more sustainable and resilient economic and social convergence. The three focus areas of the CPF are: (i) enhancing public sector performance and institutions. Interventions address weaknesses in public policy making and public-sector effectiveness, as well support capacity enhancement to deliver services and improve human capital outcomes, particularly in the poorest regions; (ii) preserving and leveraging natural capital to ensure low carbon growth. Institutional shortcomings limit the government's ability to address environmental and climate related challenges, including the commitments it made towards meeting EU Directives; and (iii) strengthening market institutions to enable a dynamic enterprise sector. Activities address weak market institutions, including regulatory and business environment barriers. Opportunities to address gender gaps, support vulnerable groups and promote citizen engagement will be identified for all WBG engagements.

FOCUS AREA 1: ENHANCING PUBLIC SECTOR PERFORMANCE AND INSTITUTIONS

Addressing the institutional weaknesses and capacity constraints in Croatia can improve the quality and efficiency of the public administration and improve the well-being of all citizens. Efforts are needed to address inadequately performing organizational structures, overlapping functions, coordination and execution, missing links between strategic documents and budget. The large presence of the state in the private sector, and fiscal vulnerabilities, reflect weaknesses that are hampering Croatia's ability to meet its economic potential. It has also resulted in uneven in terms of poverty and inequality. The disparities in income indicate challenges that limit the State's ability to protect the poor and most vulnerable and create economic opportunities for all. These issues cut across the first two SCD priority areas and addressing them will be critical to build resilience against shocks and achieve sustainable and equitable growth.

The Government is committed to boosting the participation and contribution of all individuals to economic and social development. This includes a focus on learning and skills to raise the productivity of Croatia's rapidly ageing and shrinking work force and meet the needs of the economy of the future. Improving labor market participation, particularly in less developed regions where employment rates are lower, unemployment rates are higher and poverty rates remains significant will be critical.

The WBG objectives within this focus area include efforts to improve human capital and economic opportunities, particularly for the poor and most vulnerable. The government is putting high priority on reforming its education sector, supporting policies that address health care to meet the needs of an aging population, and addressing the low labor force participation and demographic decline, especially in lagging regions. The WBG would support efforts to invest in human capital to achieve higher incomes, as well as foster inclusion and engaged citizenry for shared prosperity.

OBJECTIVE 1

Improve efficiency of public administration to implement strategy and deliver services

Institutional Constraints:	WBG Instruments:
– Weak strategy formulation – Lack of coordination, overlapping functions across government institutions, lack of clear roles within government institutions, and inadequate policy coordination – Weak implementation capacity, with inadequate monitoring systems and accountability lines	**IBRD Lending:** Health System Quality and Efficiency Improvement (PforR ongoing) **RAS:** National Development Strategy (NDS) 2030 RAS (ongoing) Strategic Transformation in Agriculture and Rural Space (STARS) RAS (ongoing) Eastern Croatia/Slavonia RAS (ongoing) Health sector RAS or ASA (planned)

The Government recently established a new strategic planning framework and launched the preparation of a National Development Strategy (NDS), which will enable Croatia to streamline its reform agenda, prioritize projects with highest value added and make the best of the EU funds post-2020. A coherent national strategy with clear development goals and objectives is the first step towards improving the efficiency of the country's public institutions and strengthening its public administration. The WBG is helping through the RAS "Support for Establishing the System for Strategic Planning and for Preparing the 2030 National Development Strategy (NDS)". The main objective is to enhance the Government's planning and policy implementation capabilities, which has been identified as a critical institutional constraint. Bank support focuses on the processes to develop the NDS, analytical inputs for the preparation for the 2030 NDS; and strengthening the performance monitoring framework for long-term, medium-term and short-term plans; applying the new planning methodology on a pilot basis; and building capacity in the government to develop, implement and monitor its plans. The NDS will also develop a clear prioritization of projects and adequate performance indicators to allow regular monitoring of implementation.

The STARS RAS and Eastern Croatia/Slavonia RAS are also supporting efforts to improve national strategy formulation and coordination among ministries and levels of government, with the objective of improving the absorption and impact of EU resources.

The cumbersome implementation of procurement rules is one of the reasons for the low absorption of EU funds. Taking into consideration that the annual public procurement volume accounts for about 13 percent of GDP, mainly used for public service delivery; managing public procurement interventions in a more systematic approach may have a better development impact. The Bank could explore the opportunity of using advisory services to strengthen the public procurement system in line with the horizontal enabling conditions of the ESI funding envelope 2021-27.

The SCD identified institutional gaps in the health care system, including related to the efficiency of both financing and delivery of services. The ongoing Health P4R supports government efforts to improve the quality and efficiency of service delivery. This includes promoting primary care practice, day-hospitals and hospital functional integration to create more cost-effective organizational settings and rapid-access care for patients. Centralized procurement of drugs and medical supplies will also reduce unnecessary cost in service delivery, minimize waste and ensure equal care countrywide. The Government has requested a RAS to support the development of a strategy for the next 10 years that would align actions with longer-term needs, related to a rapidly aging society and improving access to care in less populated regions and supplement institutional capacity in the health system.

OBJECTIVE 2

Support policies that reduce fiscal vulnerabilities, with a focus on State-Owned Enterprises

Institutional Constraints:	WBG Instruments:
– Inefficient public investment management – Regulatory instability, high administrative burden, low transparency and predictability of administrative bodies – Inefficient State-Owned Enterprises impeding effective resource allocation	**IBRD Lending:** Roads Modernization (IPF and Guarantee ongoing) Railways Project (IPF ongoing) **RAS:** Macro-modeling RAS (planned) **IFC potential investments:** IFC public private partnership investment and advisory in transport

The Government has pursued significant fiscal consolidation efforts over the last few years, putting public debt on a downward path, but vulnerabilities remain. The Government's efforts have been helped by a favorable cyclical position, reduced borrowing costs, and restrained growth in capital expenditures. Vulnerabilities remain, however. Capital spending has decreased by more than half, suggesting public investment management issues. The utilization of EU funds is impacted by challenges in investment prioritization, delays in developing a project pipeline, and cumbersome national procedures, and difficulties in securing co-financing by beneficiaries. Under the coordination of the Ministry of Regional Development and EU Funds, a major effort has been launched to address these challenges through simplification of and acceleration of procedures, the reinforcement of national structures dedicated to EU funds, and projects for building capacity in public administration.

In addition, state owned enterprises (SOEs) continue to generate contingent liabilities and in some cases direct fiscal costs that deplete funds that could otherwise be used for productive spending. The current favorable external environment is an opportunity to introduce deep structural reforms, build fiscal resilience and create a strong foundation for sustainable growth over the CPF period. If conditions warrant, including evident progress in implementing a comprehensive institutional reform program, a potential DPL operation could support SOE reform.

The transport sector, which features costly and unsustainable operations models, has been a focus of significant investment in Croatia. The Bank is supporting the Ministry of Transport and the respective SOEs with operations in roads and rail, to rationalize expenditures and create a sustainable model for both sectors. In the road sector, the Bank is financing technical assistance to bring all roads and motorway companies to an appropriate size and improve the management of their core functions (see Box 4). In the railway sector, Bank support targets rationalization of subsidies for both infrastructure and passenger services to improve service delivery and focuses on rationalization measures to review the companies' organization, including cargo, and the whole railways network, given it is outdated and does not reflect current demand.

IFC will seek MFD/Cascade opportunities including public private partnership investments in transport infrastructure (ports, airports and cargo railways) to promote private sector solutions and reduce public sector expenditures. Building on the recent success in developing Croatia's air transport sector for which IBRD and IFC engaged strategically harnessing the Cascade approach and leveraging MFD solutions including upstream advisory, TA, and an innovative infrastructure financing mechanism, IFC will seek to support modernization of auxiliary regional airports through its public private partnership advisory services.

OBJECTIVE 3

Create opportunities for people, particularly in less developed regions

Institutional Constraints:	WBG Instruments:
– Local government fragmentation, undermining human and financial capacity to effectively utilize EU funds – Lack of modern land-use planning and knowledge systems in the agriculture sector leads to productivity losses – Weak capacity for evidence-based policy formulation – Lack of modern public-sector policies in the education sector	**IBRD Lending:** Education Project (FY20) Regional access to finance initiative HBOR (FY21) **RAS:** Slavonia/Eastern Croatia RAS STARS RAS **IFC potential investments:** IFC investment in real sector companies which have significant presence in the less developed regions and/or have supply chains in lagging regions.

There is broad consensus in Croatia on the need to improve educational outcomes to provide opportunities, including to meet the evolving nature of work. In elementary and secondary education, a new curriculum—involving more focus on modern teaching practices and building problem-solving skills in students—is being piloted during the school year 2018/19 before roll-out at national level. In higher education, incremental budgeting is being replaced with elements of performance-based financing (with funding tied to agreed-upon indicators). Judging by Croatia's past education reforms, and those of countries at similar income level, successful implementation of such reforms will require substantial amounts of technical support, guidance and investment. A somewhat unique implementation challenge for Croatia, given its demography and its income level, is that it still has more than 65 percent of its students enrolled in schools that operate in double shifts, while at the same time having a growing number of small, spread out schools. Re-organizing these schools to respond to the new education models and into a network of single shift schools – that can offer longer school days with more instructional hours – will be an important (and difficult) part of the reform efforts.

The education project under discussion would aim to support the Government in improving the efficiency of the education system and strengthen institutional capacity to deliver enhanced student learning outcomes. The project would focus on helping the government increase instruction time, optimize the school network, improve assessment of learning outcomes and introduce more modern public-sector management practices, among others. Some of the planned activities include: (i) develop and introduce "whole day schools" based on international experiences (which may require infrastructure investments to address current bottlenecks associated with some double shift schools); and (ii) introduce per student financing/block grants to schools, alongside more autonomy to enable schools and local authorities to make better use of their resources (and incentivize them to consolidate classes and schools, which would facilitate whole day schooling, making it more effective, thereby allowing them to improve learning). The project would be designed to leverage EU funds, as it would develop models and initiatives to be implemented over a 10-20 years horizon and, hence, require substantial additional resources mobilized from EU and other sources.

The Government of Croatia is committed to creating opportunities in less developed regions. This includes the five counties located in the eastern part of the country, often referred to as Slavonia, which feature a concentration of high poverty and deprivation across multiple dimensions for the 20 percent of the population living there (see Box 3). While the 2011 national headcount poverty rate was 16.3 percent in 2011, poverty in the five Slavonian counties ranged between 24.9 percent (Osijek) and 33.9 percent (Brod-Posavina). Households exhibit deprivation across several indicators, including lack of access to economic opportunities, physical infrastructure, and social services, and the situation has worsened between 2011 and 2015. The poor indicators reflect disparities and weaknesses in public sector capacity to deliver services and economic opportunities at the local level. Slavonia's agro-ecological endowments and infrastructure are better than many other low-income regions in the EU with more favorable economic and human development outcomes. Accordingly, sector-specific and economy-wide analysis suggest that Slavonia's economy has potential for much higher rates of growth and job creation, including in some of the industries already present, such as agriculture, agribusiness, ICT, tourism, and processing and machinery. The Government has launched a high-profile initiative to leverage EU and other funds to develop this region and improve living standards, while also focusing on the challenges of other territories, including those living on the islands and in mountainous areas.

BOX 3
Spatial Analysis of Poverty and Policies

The CPF engagement is informed by the results of the Spatial Analysis of Poverty and Policies RAS which the government used to increase its knowledge of Croatia's disparities. A detailed geo-referenced database was developed, providing estimates of poverty data at the level of counties, cities and municipalities. Such poverty profiles analysis and a new Index of Multiple Deprivation can now be used to better understand the nature of poverty and to create more effective cross-sectoral policies and interventions for poverty eradication. This evidence has helped the Government understand the need to focus on lagging regions and informed the engagement in Slavonia region. It included a survey in five Slavonia counties on service satisfaction, based on the European quality of governance index (EQI), which assesses quality, impartiality and corruption in three basic services: education, health and law enforcement. The survey informed policy makers on how the citizens perceive the services the state provides. According to the latest EQI Index (DG Regio, 2017), the two Croatian NUTS 2 regions are among the worst performers in the EU, reflecting important efficiency gaps of regional and local authorities.

The Bank will support the Government in implementing a multi-sector investment program in Eastern Croatia. The three-year RAS-financed engagement will support Croatia to enable the design/preparation of a revamped implementation of EU funds for the ongoing 2014-20 period, to recommend ways to improve the quality of the project pipeline and identify national and local level reforms that could unleash the potential of the Eastern Croatian economy while improving opportunities for vulnerable groups. The design of the RAS is informed by a Bank's diagnostic of the regional economy, which included benchmarking and identification of opportunities in multiple industries and sectors. The RAS builds on the WBG's comparative advantage of implementing multi-sector, multi-instrument engagements to leverage the impact of all investments and to improve outcomes by building capacity for better programming and implementation for high priority initiatives. This support will engage citizens and be closely coordinated with the EC and other partners. The Agriculture STARS RAS will help develop a new agriculture strategy to unleash the country's vast agricultural potential. Investing in agriculture would create economic opportunities in rural areas and regions such as Slavonia, including through pilot projects.

The Bank's engagement in lagging regions will also include access to finance and a partnership with Croatia's development bank, HBOR. Past support has included a Partial Credit Guarantee for a Financial Intermediation Project, the first-ever guarantee operation for a financial intermediation done by the Bank. HBOR has requested Bank support to address regional constraints in access to finance in lagging regions, including financing projects using EU funds, and to support SMEs and Croatian exporters, and to increase availability of equity financing.

In the real sector, IFC will target companies with significant presence in the less developed regions of Croatia. IFC will support local innovative and regionally competitive companies that have large SME supply chains in lagging regions and operate in sectors with potential to create quality jobs including in sustainable tourism, agriculture, and value-added manufacturing. In addition, IFC will prioritize supporting vulnerable groups such as women and youth as well as rural population. Where possible, MIGA support would also be considered to increase foreign investments in specific areas, such as municipal financing and/or infrastructure public private partnerships via its political risk insurance and non-honoring guarantees.

FOCUS AREA 2: PRESERVING AND LEVERAGING NATURAL CAPITAL TO ENSURE LOW CARBON GROWTH

This focus area supports interventions to protect Croatia's natural capital, address climate vulnerabilities and reduce the energy intensity of the economy. Preserving the country's natural assets is critical for a sustainable growth model. The current and future prospects of the tourism and agriculture sectors are limited by current rates of environmental degradation, which is a growing cause for concern. The vulnerabilities related to climate change call for additional urgency, with the country already facing significant threats, particularly from flooding, with economic consequences for tourism and agriculture. Reducing adverse environmental impacts on the economy and society starts with "no regret" institutional reforms. This requires addressing shortcomings affecting the country's use of water resources, wastewater pollution control and solid waste management systems.[36] Compounded by delayed sector and institutional reforms in these sectors, and a need for major investments, including to meet compliance standards of the EU legislations. Finally, despite its low per capita energy consumption, the economy's energy and carbon intensities remain respectively 55 percent and 20 percent higher than the EU average. In addition to contributing to local ambient

36 The eutrophication of Croatia's surface water resources is already leading to economic damages, with the damage to ecosystems' health estimated at 80 million euro per year.

air pollution and related health costs, the high energy intensity of the economy is a drag on growth. Institutional weaknesses and unreformed utility policies limit progress and have important consequences in terms of meeting EU Directives and access to EU resources, especially for the next EU programming period. WBG support in this area would be delivered primarily through advisory services but could also call for innovative policy instruments to support bold environment, resilience and climate change reforms, as well as through IFC products, and potentially through MIGA guarantees.

OBJECTIVE 4

Reduce the energy intensity of the economy and energy transition

Institutional Constraints:	WBG Instruments:
– Lack of Energy Strategy – Stalled RE legislation – Inadequate tariff structures and subsidies for the poor and vulnerable	Energy Sector Reform RAS (planned) **IFC Potential Investments:** RE Investment and advisory – RE finance (solar) – EE credit lines for SMEs – Real sector investments with potential EE gains Innovative financial products such as Green Bonds

Croatia intends to increase energy efficiency on both the supply and demand side and promote renewable energy generation. Addressing the current policy gap requires achieving a whole-of-government vision for Croatia's energy future, backed by a new strategy aligned with the EU Energy Package and NDC and, more importantly, a renewed understanding of the domestic benefits to both economy and society to be drawn stimulating sustainability investments. Crucially, it will require articulating this vision in a legislative reform package addressing key institutional shortcomings. On the renewable energy generation front, for instance, progress revolves around addressing the impact of the 2015 discontinuation of the feed-in-tariff system, which will require consideration to tariff structures of electricity pricing. This will in turn call for targeted measures to alleviate distributional impacts on the energy poor, who are currently not entitled to any official social support but are often hovering above the poverty line.

By leveraging its ongoing analytical work, the Bank will continue to provide policy support to the articulation of the legal and institutional reform package necessary to implement Croatia's upcoming energy strategy. IBRD engagement will be aimed at facilitating the scaling up energy efficiency, on both supply and demand side, including by encouraging innovative financial frameworks to fill the gap in district heating investments. It may also include promoting renewable energy, by assisting the development of an enabling framework for further deployment of renewables, including a transition to well-structured transparent auctions, and a framework for facilitating decentralized, or distributed renewable generation solutions. IFC will support this agenda through both investment and advisory support, including RE finance, EE credit lines for SMEs, and real sector investments with potential EE gains, and energy efficient productions lines as well as introducing innovative financial products such as Green Bonds. Particularly in the renewable energy space, IFC will leverage its global experience to help the Government and the energy market operator operationalize the recently enacted RE Law, which aims to incentivize renewables in Croatia by moving to a system of premiums and quotas from the previously implemented feed-in tariff mechanism. IFC will seek to support bankability of the RE tenders under the new scheme and help bring in private sponsors both in solar and wind power. Subject to availability of demand, IFC could provide financing at the local level where EU funds are not sufficient to support subnational projects that can contribute to development of regional/global public goods including climate change. MIGA will explore opportunities in RE in close collaboration with the IBRD and the IFC.

OBJECTIVE 5

Improve water, waste water and solid waste delivery and management

Institutional Constraints:	WBG Instruments:
– Stalled progress in water utilities agglomeration – Inadequate tariff structures hampering financial sustainability of water utilities – Lack of economic incentives reflecting environmental externalities of landfilling – Absence of regulatory frameworks incentivizing local government's collective action – Horizontal and vertical coordination failures	**ASA and RAS:** Water and Sanitation Sector Reform ASA and RAS (planned) Solid Waste Management ASA and RAS (planned) **IFC Potential Investments:** Public private partnerships for landfills, municipal financing for water, waste water and solid waste as a waste to energy source.

The WBG will help Croatia speed up progress on environmental and water management shortcomings, which are creating adverse impacts on the economy and threatening non-compliance with EU directives. In addition to concerns related to the country's continued tourism attractiveness, the stalemate affecting the solid waste sector and delays in water and wastewater investments create risks of EU infringement procedures and decommissioning of EU funds. Reforming these sectors requires addressing delayed reforms, institutional and utilities weaknesses, and lack of progress in advancing investment projects in the pipeline. Continuous efforts at preservation are also needed to protect Croatia's natural habitats and continue the good practices promoted in previous World Bank financed projects aimed at protecting Natura 2000 sights.

Solid waste sector reform could provide an incentive framework for private and public actors. In addition to low technical and financial capacity within local government units that would implement investments needed to move away from landfilling, there are other current institutional shortcomings; these include a lack of regulatory frameworks enabling LGUs cooperation (for instance through inter-municipal grouping), and economic incentives encouraging LGUs to invest in separation, recycling, and waste treatment centers, rather than maintaining landfilling as the default option. Additionally, limited progress with the implementation of the "polluter pays principle" through adequate waste charges continues to hamper the introduction of private sector participation in the sector.

On the water and sanitation front, the Bank could support Government efforts to relaunch reforms towards agglomeration of water utilities and help to maximize the effectiveness of EU resources. Through advisory services, potential RAS, and advocacy, the Bank will support government efforts to define the necessary institutional and sustainable finance solutions. If there is demand from local governments, IFC could invest in public private partnerships for landfills, and provide municipal financing for water, waste water and solid waste projects.

FOCUS AREA 3: STRENGTHENING MARKET INSTITUTIONS TO ENABLE A DYNAMIC ENTERPRISE SECTOR

The SCD suggests much can be done to improve the enabling environment for innovation and private sector growth in Croatia, as the country lags most countries in Europe across various measures of performance. The lack of dynamism in the enterprise sector is limiting productivity growth and the potential of Croatia's export sector. The strong reliance on tourism is under-exploited in terms of linkages and spillover effects to other sectors. Reducing state presence, increasing competition in the product and service markets and cutting red tape are necessary preconditions to develop the productive structure of the economy. Strengthening firm capabilities, innovation, and entrepreneurship will increase firm level productivity and improve the composition and resilience of the economy. Institutional constraints are impacting

OBJECTIVE 6

Improve business climate and increase the private sector's role in the economy

Institutional Constraints:	WBG Instruments:
– Weak regulatory environment – Less effective justice sector processes impeding business environment – Agency coordination for effective delivery of reforms	**IBRD Lending:** Integrated Land Administration System Project (IPF AF ongoing) Roads Modernization (IPF, Guarantee ongoing) Justice for Business (FY20) **ASA:** Central Business Registry - phase 2 (TF) **IFC:** IFC corporate governance support (through investments in real sector companies and private equity funds)

potential reforms and policy making processes. Thus, improved coordination, accountability and vision is required to unleash the full potential of the private sector.

The large state presence in the economy is hampering sustainable and productive growth. SOEs across the board are less productive than non-SOEs and compete with a more dynamic and productive private sector. The role of the state could be upgraded by privatizing some of the legacy companies and further improving the corporate governance of SOEs. The economy would benefit from strengthening the use of state aid regulation, competition policy and improving the capabilities for strategy, planning, analysis, and policy making of the state bodies in charge of supervising SOEs. The Bank is working, together with EBRD, with SOEs in the transport sector to increase the efficiency of the public sector.

Restrictive product and service market regulations are distorting market functioning. Croatia has one of the most restrictive services sectors in the EU, with approx. 300 regulated professions. The level of restrictiveness of regulation in professional services in Croatia is the highest in CEE. Restrictive regulations increase costs for firms for basic services, such as legal and engineering services. Responding to feedback from firms and reducing the level of restrictions in the service sector would result in sizable productivity gains. The WBG is supporting the Croatian government to deregulate its services sector, by working closely with the Ministry of Economy, Entrepreneurship and Crafts and other related ministries. Depending on progress with the privatization agenda, IFC will look to support strategic investors to help enhance the competitiveness and productivity of privatized companies. IFC will focus its support to these firms in areas where it can deliver innovative solutions, promote inclusive business models and advance climate change agenda. IFC will seek to improve corporate governance in the companies it invests in the real sector or through private equity (PE) funds. It will target PE funds that promote local entrepreneurship, modern management practices, export competitiveness and innovation in high-value add sectors. To the extent possible IFC will work with investee companies to prepare them to tap the domestic and international capital markets. IFC' support to these companies will aim to create the appropriate governance structures that would make them competitive for potential investors.

To foster the "renewal" of the economy would require streamlining procedures for firm entry, operation and exit. The Bank has carried out a set of small-scale targeted operations to assist in improving the business environment in Croatia, most notably on design and implementation of doing business reforms (reforms in areas measured by the Doing Business report) and establishment of a unified business registry. The length and cost of starting a business in Croatia remains above the regional average in Europe and Central Asia and the OECD. The Government has recognized this as a priority in its national reform program and the WBG intends to continue supporting such efforts.

The Government continues its efforts on simplification and acceleration of business processes in land administration system to introduce legal security in real estate transaction and protect ownership rights. The Bank has been supporting improvements in the land administration system, which has undergone a profound transformation. This has led to significant improvements in service delivery including reduced transaction time and establishment of centralized web-based system, interoperable with various business registries, and growing online services to citizens, businesses and state administration. Further investments are needed to move to a fully paperless and less costly system, and to further expand the government's e-services agenda under which all digital services are to be unified and more accessible to users. The recently approved additional financing for the ILAS project will contribute to this objective by improving land market data availability, quality and reliability for all. The Project will support the continued automation of land administration services, further reduce registration time, and overcome the systemic delays in the major land registry offices standardizing services provided to the public across the country. It will also continue to ensure components for EU financing are fully developed and ready.

Croatia has significantly improved justice sector performance, but additional reforms and investments in the justice system are strongly demanded by citizens. The performance of the legal and institutional framework in the justice sector creates challenges for business environment and citizens. Modernization of judicial infrastructure are needed to allow the functioning of a sound judicial investment management system and for implementing the envisioned technology upgrade (such as for the unified information system). Croatia lags behind in terms of cost and length of insolvency procedures).[37] The Bank project being designed under the CPF would support complex improvements in the quality of system performance, including developing judicial investment and maintenance management plans, support to human resource management, development of e-services for court users and implementation of the e-justice agenda, and promoting utilization of the alternative dispute resolution.

OBJECTIVE 7

Promote entrepreneurship, competition and innovation

Institutional Constraints:	WBG Instruments:
– Lack of coordination between government institutions, academia and private sector – Barriers to science-industry collaboration – Weaknesses in the governance of Croatia's innovation ecosystem	**IBRD Lending:** STP 2 (IPF ongoing and potential Innovation Project) **RAS:** Public Expenditure Review in Science, Technology and Innovation STARS RAS (component on innovation system) **Potential IFC Investments:** IFC investment in Croatian companies expanding in the region and export sectors IFC investment in inbound and outbound FDI IFC AS and investment in capital markets and equity-based finance (Green bonds, local currency bonds, covered bonds, PE funds) IFC Distressed Assets Resolution Program (DARP)

37 Well-structured and simple bankruptcy/insolvency regimes are important to enable market re-entry of entrepreneurs who have previously failed in their business activity.

Gross domestic research and development (R&D) expenditures (as a share of GDP) are much lower in Croatia than in peer countries.[38] The gap is even larger for business expenditures in R&D. Key factors explaining the low level of R&D-driven innovation, especially among medium and small firms, include limited access to internal and external resources (both funds and qualified personnel), limited information on technology and markets, modest research excellence, barriers to science-industry collaboration, and pervasive weaknesses in the innovation ecosystem governance. The weak performance of the innovation ecosystem is also reflected in the limited complexity of Croatia's goods export basket.

The WBG has been supporting the Croatian innovation agenda since 2006, with lending operations and advisory work. The ongoing second Science and Technology Project (STP) supports instruments to alleviate market failures and boost innovation, targeting the different stages in the innovation process (from basic and applied research to product development, commercialization and early stage financing) and fostering partnership between the business and the scientific community in the country and abroad. The Bank has a demonstrated comparative advantage to support capacity building efforts and instruments in these areas. Examples include developing financing models for business related R&D through Proof of Concept (small grants to finance early stage financing which other institutions are not providing) and supporting SMEs' ability to invest in R&D (resulting also in patent applications and demonstration of technical feasibility leading to R&D commercialization stages). Expectations are to remain engaged in this area, including through potential lending, in addition to RAS. This CPF will also explore opportunities for productivity gains, including for the tourism and agriculture. This could include strengthening managerial skills and technology adoption by existing and new entrepreneurs (including potential links with the Slavonia and Agriculture RAS).

IFC will leverage its IFC 3.0 solutions to promote entrepreneurship, competition and innovation in Croatia. It will strategically support Croatian companies in the manufacturing, agribusiness and services, including sustainable tourism. Supporting real sector companies, IFC aims to increase their competitiveness through supporting exports and investments in innovation and technological upgrades that lead to increased productivity and standards as well as strengthening of value chains building on the outcome of the IBRD/FCI executed RAS program on Croatia GVCs (*Competitiveness Reinforcement Initiative*). IFC will also look to support both inbound and outbound FDI, particularly for technology transfers and in innovative sectors, as well south-south investments in key sectors of the economy that contribute to job creation and local economic development. IFC could support private sector investments to foster tourism-based local economy with improved linkages to local manufacturing and agribusinesses as well as developing tourism-related infrastructure including modernization of auxiliary airports through public private partnerships.

IFC will continue to look for opportunities to invest in the local capital markets with a view to deepen and diversify financial markets and products. IFC will support alternatives to bank finance by investing in capital market instruments such as covered bonds, local currency bonds, and Green bonds. IFC will also support opportunities to increase availability of scarce equity- and risk-based finance; e.g., private equity, particularly those that promote entrepreneurship and SMEs in the less-developed regions of Croatia and focus on export-oriented and higher value-added sectors. In addition, IFC will explore opportunities to engage in addressing distressed assets portfolios of banks so as to help strengthen banks' balance sheets to free up capital and generate liquidity and capacity to originate new loans.

38 According to Eurostat data, investment in R&D was 0.86 percent of GDP in 2016 and 2017, significantly lower than the EU target of 3 percent, and differing from the trend in other CEE countries.

C. IMPLEMENTING THE FY19-24 COUNTRY PARTNERSHIP FRAMEWORK

The program described above will be implemented through a mix of instruments, which includes limited IBRD borrowing and an increase in reimbursable knowledge services. As part of the CPF preparation process, the Government expressed its interest in maintaining WBG support, with access to the full range of WBG financing and advisory instruments. The Government also expressed a preference for WBG support that plays a catalytic role in leveraging resources and building essential institutional capacity for the public sector and private markets, building on the success of previous operations (see Box 4 below as an example).

IFC's strategy in Croatia is consistent with its priorities for more highly developed countries, including an emphasis on the additionality and development impact and a focus on very selective interventions that either: (i) deliver innovative private sector solutions; (ii) develop inclusive business models that target underdeveloped groups including women, youth, the urban poor and SMEs; (iii) maximize finance for development by crowding in private sector financing in viable projects; and (iv) advance the climate change agenda; (v) support companies operating in less developed regions; and (vi) help firms be competitive in regional and global markets. Similar to the IFC, MIGA's strategy in Croatia is expected to be consistent with its strategic priority areas for more highly developed countries, including an emphasis on high additionality and climate.

BOX 4
Maximizing Finance for Development (MFD) in the Road Sector in Croatia

The Croatia Modernization of the Road Sector Project is an MFD intervention in a sector with complex issues of SOE debt and restructuring. The Government was seeking an (innovative) financial solution to the debt, but also a counterpart that could bring together key interlocutors on debt, major infrastructure company restructuring, as well as transport infrastructure management and operations. The operation involved a variety of instruments, crowded in private financing and improved infrastructure management. Results are exceeding expectations.

Improved road infrastructure delivery was the core of Croatia's development strategy

- As a new state in the late 1990's, Croatia focused on developing its strategic ("trunk") road network as the most fundamental element of its national integration. At this time half of the country was isolated.
- This expansion of the road network impacted the institutional landscape. The state road agency gave way to public road companies that could raise funds for the ambitious construction program (and a couple of public private partnerships). Today Croatia has some 1300 km of motorways and 7000 km of state roads.
- By 2015, three State-owned companies had amassed a debt that exceeded 5 billion euros (exceeding 10 percent of the country's GDP)—mostly commercial loans with some funding from DFIs. Prior efforts to resolve this issue failed, with the government needing to service 1 to 2 billion euros of debt.
- As a result, the companies were forced to refinance loan obligations with very short term commercial debt. This put significant pressure on cashflows (and on the Croatian government as a guarantor) and resulted in a debt profile where refinancing occurred every two to three months with increasing amounts.

A sustainable solution required structural sector reforms and crowding in commercial financing

- The WBG had a long-standing engagement in the road sector and led a participatory process with the Ministries of Transport and Finance and all the companies, also involving EBRD. A strategy was approved early in 2017 through a Letter of Sector Policy endorsed by the Cabinet, articulated around:
  - (i) the financial optimization of the road companies' commercial debt, which had ballooned over the last five years, in order to improve its terms (maturity, interest rates)
  - (ii) the restructuring of the companies by: (i) merger of most motorway operations, as well as (ii) cost-cutting measures to bring the overall system to acceptable European standards (on average requiring 30 percent decrease of the cost structure of the motorways) and (iii) reviewing the tolling revenue system to ensure that it could form the long-term basis for the sector's future development.
- Consistent with the MFD approach in April 2017, the Bank approved the Modernization and Restructuring of the Road Sector project to support to the Government through a **22 million euro loan** with the possibility of a **350 million euro IBRD guarantee.**
- The loan provided **technical assistance** for transaction advisory services on the debt optimization exercise, as well as the restructuring of all the companies and of the sector and support initial voluntary reduction **in motorway staffing.** EBRD financing also supported the sector restructuring.
- The Bank guarantee was to support the debt optimization of the road companies, **but only as a last resort and on condition that the sector restructuring,** as defined in the letter of sector policy, showed **satisfactory progress.**

Impact of the Operation

- The financial optimization of the road companies' debt started in November 2017, with **issuance of a sovereign bond mobilizing 1.275 billion euro** of commercial financing to on-lend to the companies for refinancing existing short term, expensive loans at significantly more attractive terms.
- The **overall impact in terms of saved interest payments for the sector will likely exceed 400 million euro** over the next 10 years. These savings, coupled with expected final tenor extension, will underpin the sustainability of the new commercial financing raised.
- The operational restructuring of the system has begun, with some initial cost savings measures in progress, including the merger of motorway operations and more than 200 retrenchments. On the revenue side, toll levels restructuring has led to an increase of 12 percent of the motorway revenue.

The strategy includes providing implementation support that could help with efficient management of EU resources in the post 2020 programming period. The CPF proposes to leverage WBG engagements to better help Croatia maximize the full potential of EU resources. The engagement in Land Administration is a good example of the WBG value proposition in using a relatively small IBRD loan to pilot activities and build capacity that could later be scaled-up using EU funds (see Box 5). The ongoing cross-sectoral work in Eastern Croatia and the engagement in agriculture and innovation sectors also has similar potential to leverage resources.

BOX 5
Supporting institutional strengthening and leveraging EU resources

The Integrated Land Administration System (ILAS) Project helped the Ministry of Justice and the State Geodetic Administration establish the Joint Information System (JIS) that manages and integrates a joint land database unifying the land register and cadaster data. The JIS offers the possibilities to further improve the efficiency of land administration services and could potentially support a reorganization of the structure and governance of the land registration and cadaster offices. Moreover, ILAS provides the TA for the formulation and implementation of the first joint cadaster and land registration strategy, with a common vision for the sector to improve management and investment planning conducive to investments and economic development. The additional loan also supports the priorities set in the Government's 2018 National Reform Program aimed at aligning land registry and cadastral data to reach EU average level of regulation of property rights by 2020, through financing systemic harmonization process in select cadastral municipalities.

ILAS project has leveraged significant EU resources, which financed roll-out of JIS in land registration offices in courts and in cadaster offices through EU IPA funding. The activities under ILAS additional loan were designed to support further implementation of the National Spatial Data Infrastructure (NSDI) as an integral part of the European Spatial Data Infrastructure defined by the INSPIRE Directive. The original loan financed the NSDI Geoportal, katastar.hr, which registers a constantly increasing number of queries, and is the basis for future EU-funded centralized infrastructure cadaster information system. Finally, the digital services component will expand activities on data quality improvement setting the grounds for EU-funded additional e-services, whereas the ILAS-supported piloting of sporadic data harmonization through JIS will lead to scaling up this work for an additional 2,100 cadastral municipalities with state budget and EU funds.

CITIZEN ENGAGEMENT AND GENDER

A Citizen Engagement and Gender Roadmap has been developed as part of this CPF. The WBG is committed to identifying entry points and implementing genuine citizen engagement across the CPF instruments. The CE Country Roadmap (included in Annex 6) sets out actions that will be taken to improve the quality of citizen engagement and to create models for citizens to engage with government actors in development initiatives and key country reforms. Specific CE approaches will be established to strengthen institutional and regulatory reforms, support human capital investment, and enable markets. The approach will ensure that engagement will include the development of a responsive public sector, but also go beyond the public sector to engage individuals and firms to better target private sector initiatives, and to ground beneficiary feedback in the design of the interventions (an example is the work being carried out in Slavonia with large stakeholders' engagement). The objective is to intensify and broaden WBG reach to all stakeholders, but particularly in less developed regions and with more vulnerable groups (such as youth, elderly, women). Consistent with Croatia's efforts to improve e-services and online services, where relevant, WBG efforts will support innovative technologies and draw on behavioral insights. The efforts to enhance citizen engagement in IPFs will also be developed in the various RASs planned in the CPF period.

The existing WBG portfolio and indicative pipeline present opportunities to address the findings of the Country Gender Assessment in a meaningful way. The Country Gender Assessment identifies gaps and potential entry points to support interventions in several areas, including education, health and the labor market (see Box 2). It also provides an analysis of disparities at the regional level, where outmigration and employment issues are particularly stark, and this has helped to inform activities which will be included as part of the Eastern Croatia/Slavonia RAS. A gender roadmap has been developed (Annex 7) to address how the WBG will engage to close gender gaps, including tools to track progress and screen future activities. Opportunities in the pipeline of projects include in the justice and education sectors. Progress on implementation of the roadmap will be tracked periodically and will be reviewed during the Performance and Learning Review for the CPF, including overall progress in closing gaps identified as part of the Gender Assessment.

PARTNERSHIPS AND COORDINATION

The CPF preparation included consultations with the core development partners to ensure alignment and complementarity of the WBG's selective areas of engagement. Strong dialogue and regular coordination mechanisms exist, particularly with the EU Commission, where there is a recognition of a distinct WBG value addition and close alignment on key reform priorities. The WBG is supporting the Government's efforts to prepare for EU programs, including in the innovation and smart specialization agenda, through ongoing IBRD lending. In addition, the large multi-sector RAS are helping to build capacity for strategy, prioritization and implementation which will be critical for the new EU programming period (2012-27). The Bank is also working with the EC's Structural Reform Support Service (SRSS) in areas related to improving the business environment. As the EC's instruments evolve to further support to key structural reforms, there is potential to deepen this cooperation, particularly in areas where there is a strong WBG Comparative Advantage, including, for example, to strengthen local institutions. There is close cooperation and alignment with the EBRD, whose priorities include strengthening private sector competitiveness, deepening financial markets and reforming SOEs. The WBG program in these areas will continue to be closely coordinated with the EBRD. EIB is focused on supporting investments and reforms in major infrastructure, SOEs and the health sector. Opportunities to further explore synergies with the Council of Europe Bank and the Norwegian grant funds, in areas such as justice, education, and climate change, will also be pursued.

D. MANAGING RISKS

Achieving CPF outcomes will require coordination across sector, ministries and the private sector, and among different levels of Government. Over the previous CPF period Croatia experienced several government reshuffles, which, in addition to Cabinet level changes, resulted in changes at the lower levels of the administration. Experience during the previous CPS period has proven that under these circumstances it can be difficult to sustain commitment to reforms over the longer-term, build implementation capacity and manage complex programs requiring coordination across levels of Government. Frequent government changes result in staff turnover that hampers planning and investment prioritization and reduces the ability of the authorities to exercise oversight functions on the large SOEs sector. As a result, political and governance risk is rated as substantial. To mitigate this risk the CPF proposes to design programs that consider these challenges, including through embedding a process of consensus-building among different stakeholders and building capacity to improve coordination, enhance transparency and implement long-term strategies.

While macroeconomic performance has improved, the country remains economically vulnerable to several factors that would be closely monitored during this CPF period. The main fiscal risk stems from a potential slowdown in growth, which may tempt the Government to introduce pro-cyclical policies. This would have serious implications for the WBG program in terms of poverty reduction and fiscal sustainability. The country's reliance on tourism, as one of the most important economic drivers, also increases Croatia's vulnerability to exogenous shocks and creates environmental pressures.

The lack of institutional capacity for implementation poses a challenge. Weak governance in the public sector and lack of organizational effectiveness are often reflected in slow decision-making and lack of accountability, which has delayed implementation of WBG projects over the CPS period. To address this risk, the CPF proposes to use selectivity filters to target efforts towards building institutional capacity to deliver results. This includes in assessing implementation readiness, choosing the most appropriate financing instrument and strengthening communication and M&E aspects for all IBRD engagements. Similarly, the most recent RAS-financed activities have been designed to include capacity building elements and implementation support. The demand for IFC engagement will also be linked to progress in strengthening market institutions to attract private investment.

TABLE 5
Risks to the CPF Objectives in Croatia

Risk Categories	Rating (H, S, M, L)
1. Political and governance	S
2. Macroeconomic	S
3. Sector strategies and policies	M
4. Technical design of project or program	M
5. Institutional capacity for implementation and sustainability	S
6. Fiduciary	M
7. Environment and social	M
8. Stakeholders	M
Overall	**M**

ANNEXES

ANNEX 1. CPF RESULTS FRAMEWORK FY19-24

FOCUS AREA 1: ENHANCING PUBLIC SECTOR PERFORMANCE AND INSTITUTIONS

CPF OBJECTIVE 1: Improve efficiency of public administration to implement strategy and deliver services

Intervention Logic: The SCD prioritizes the need to improve the quality and efficiency of public administration as a basic foundation for enhanced service delivery and ultimately economic growth, noting Croatia lags peers across several dimensions of indicators. Public sector performance is particularly weak at local levels. The European Commission (EC) emphasizes the need to reduce the territorial fragmentation of public administration, and to streamline the functional distribution of competencies in the system while enhancing public administration capacity to design and implement public policies.

The WBG will support the government through a combination of instruments that address the following specific constraints: weak strategy formulation; lack of coordination (overlapping functions across government institutions) and poor policy coordination; and, poor implementation capacity, with inadequate monitoring systems and accountability lines. New RAS and multi-sector engagements target institutional constraints, and seek to support building capacity of public administration, enhancing effectiveness in delivery of public services to citizens and improving coordination between public bodies. This includes support to establish a system for strategic planning to help the government prepare the National Development Strategy (Croatia 2030). A current RAS is also supporting the development of the government's strategy to transform agriculture and rural space. Leveraging these strategic engagements will support this objective and address institutional constraints related to translating strategies into implementation, improving monitoring and evaluation and ultimately helping to position Croatia for the next EU Programming Period (2021-2027). Collectively, the interventions under this Objective will support Croatia in enhancing public administration and in its capacity to effectively utilize available ESIF. This is particularly true in terms of the RAS engagements.

Improvements to service delivery would be supported primarily through the Health System Quality and Efficiency Improvement (P4R) which is contributing to enhanced quality and efficiency of service delivery.

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 1. NDS is implemented as evidenced by Government monitoring macro-governance variables across strategic areas Baseline: No Target: Yes (2023)	**SPI 1.1: National Development Strategy 2030 adopted to prepare for the next EU programming period** Baseline: No Target: NDS Croatia 2030 adopted (June 2020) **SPI 1.2: A least one Ministry is testing new strategic planning methodology** Baseline: No Target: Testing of new methodology in one ministry (June 2021)	**RAS:** – Support for Establishing the System for Strategic Planning and the Preparation of the National Development Strategy – 2030; – Strategic Transformation in Agriculture and Rural Space
Indicator 2. Strategic Plan for Agriculture and Fisheries under implementation and M&E framework developed (as required by CAP) Baseline: No Target: Yes	**SPI 2.1: National Agriculture Strategy prepared and ready to guide formulation of CAP** Baseline: No Target: Adopted by Government (June 2020) **SPI 2.2: Capacity for strategy development, implementation and monitoring has been generated, as measured by:** – strategy formulation methodology delivered – monitoring framework established – staff training completed Baseline: No Target: June 2020	
Indicator 3. National Hospital Accreditation System (NHAS) in place and functioning Baseline: No Target: April 2024	**SPI 3.1: Percentage of acute hospitals meeting mandatory quality standards, as defined in the Ordinance of Quality Standards and their Implementation from 2011, confirmed through a proxy-accreditation process** Baseline: 0 have been confirmed as meeting the standards through proxy-accreditation process Target: 80 percent (2020)	**IBRD LENDING:** – Health System Quality and Efficiency Improvement (P4R)

CPF OBJECTIVE 2: Support policies that reduce fiscal vulnerabilities, with a focus on State-Owned Enterprises

Intervention Logic: The financial crisis hit Croatia hard, and it has taken a decade to return to pre-crisis levels of growth, employment, and well-being. The crisis exposed institutional constraints that require action to ensure a sustainable path towards IBRD Graduation. There has been notable progress in recent years in terms of fiscal consolidation, but continued efforts are needed to reduce fiscal vulnerabilities and strengthen the fiscal framework over the longer-term. Budget efficiency has improved compared to the pre-crisis period; however capital spending is half the pre-crisis level, and utilization of EU funds, while progressively improving, remains a challenge. State owned enterprises (SOEs) continue to generate contingent liabilities that, in some cases, inhibit potential for productive spending. The SCD suggests gains could be derived from reducing the footprint of the state in the economy (SOEs). The EC also recommends improving corporate governance in SOE and intensifying the sale of SOEs and non-productive assets and further recommends for example, reducing the burden of parafiscal charges and legislative requirements, and enhancing competition in business services and regulated professions.

The WBG program will help address specific constraints including inefficient public investment management and SOEs, regulatory instability, high administrative burden, and low transparency and predictability of administrative bodies. The WBG program is supporting fiscal consolidation efforts primarily in the transport sector. The WBG has contributed to a successful debt restructuring in the roads sector and is continuing its support to restructure SOEs in both roads and rail – including supporting rationalization of expenditures and creation of sustainable road and rail models. The current favorable external environment presents an opportunity to introduce deep structural reforms, build fiscal resilience, and create a strong foundation for sustainable growth. If conditions allow - e.g., evident progress in implementing a comprehensive reform program - a potential DPL operation could be considered. A RAS is also being discussed to support macro modeling development with MoF. IFC will support this objective by looking for opportunities to promote MFD/Cascade activities (public private partnerships) in sectors such as: ports, airports, cargo railways, roads and renewable energy. Existing investment projects in support of the railway infrastructure will be reinforced by new engagements in railways (potential follow-up investment lending).

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 4: Prioritized railway sector development and infrastructure maintenance program developed Baseline: No Target: Program in place by December 2019	**SPI 4.1: Letter of Sector Policy to guide implementation of Railway Sector Reforms adopted by September2019** Baseline: No Target: 2019 **SPI 4.2: HZ Infrastructure operating expense (net of depreciation, impairment, and provisions) per total train kilometers (passenger + freight)** Baseline: HRK 51.5 (2017) Target: 49.6 / train-km (passenger + freight) (2021)	**IBRD LENDING:** – Sustainable Croatian Railways in Europe (IPF) – Modernization and Restructuring of the Road Sector (IPF) – Development Policy Operation to support economic resilience (potential) **RAS:** – Macro modeling with MoF **IFC (planned):** – IFC investment in cargo railways, Rijeka port, and Croatian roads depending on the results of IBRD's restructuring/ financing efforts with transport SOEs
Indicator 5: Ability of MSTI to monitor and enforce performance of Road Sector SOEs using Key Performance Indicators (KPIs) Baseline: Inadequate monitoring system (2019) Target: Integrated monitoring system in place by December 2021	**SPI 5.1: HAC operating expenses per kilometer of network** Baseline: 0.68 (2017) Target: < 0.60 (2021)	

CPF OBJECTIVE 3: Create opportunities for people, particularly in less developed regions

Intervention Logic: The SCD and the EC highlight the need to reform the education and training systems to improve education quality, educational outcomes and labor market relevance, reflecting the second main objective of the NRP that seeks to achieve better connection between a reformed educational system with the labor market. The SCD also identifies as critical, the need to improve labor market participation, particularly in less developed regions where employment rates are lower, and unemployment and poverty rates are higher. The SCD also calls for a focus on learning and skills to help raise the productivity of Croatia's rapidly ageing and shrinking work force and to meet the needs of the economy of the future but notes that progress is hampered by constraints such as local government capacity, and lack of coordination.

The WBG program will deploy a range of instruments to support the government under this objective, which will serve to address specific constraints such as fragmentation of effort at local level (which undermines human and financial capacity to effectively utilize EU funds), A proposed Education Project would contribute to enhancing the quality and efficiency of the education system, including to contribute to better student learning outcomes. The project would be designed to leverage EU funds, as it would likely pilot models and initiatives that could then be expanded with additional resources mobilized from other sources. The Bank will support the Government in implementing a multi-sector investment program in Eastern Croatia. The three-year RAS-financed engagement will include support for a revamped implementation of EU funds for the ongoing 2014-20 period, to improve the quality of the project pipeline, and to identify national and local level reforms that would unleash the potential of the Eastern Croatian economy while improving economic opportunities for vulnerable groups. The RAS builds on the WBG's comparative advantage of implementing multi-sector, multi-instrument engagements to leverage the impact of all investments and to improve outcomes by building capacity for better programming and implementation for high priority initiatives. This support will engage citizens and be closely coordinated with the EC and other partners. The Bank's engagement in lagging regions will also include access to finance and a partnership with HBOR. HBOR has requested Bank support to address regional constraints in access to finance in lagging regions, including financing projects using EU funds, and to support SMEs and Croatian exporters, and to increase availability of equity financing. IFC will target companies with significant presence in the less developed regions of Croatia. IFC will support local companies that have large SME supply chains and operate in sectors with potential to create quality jobs including in sustainable tourism, agriculture, and value-added manufacturing. IFC will prioritize supporting vulnerable groups such as women and youth as well as rural population. MIGA guarantees will also be considered to in support of specific areas, such as municipal finance or infrastructure public private partnerships.

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 6: Reduction in number of schools operating in double-shifts Baseline: 0 Target: TBD at PLR	**SPI 6.1: Reformed school curriculum for basic education adopted:** Baseline: no Target: Revised curriculum for basic education adopted by (TBD as part of IPF)	**RAS:** – Eastern Croatia/Slavonia RAS – STARS RAS – Education Project (planned FY20)
Indicator 7: Private capital mobilized for investments in Slavonia[39] Baseline: 2018 value Target: 10 percent increase (2023)	**SPI 7.1: New strategic initiatives coordinated with regional bodies and adopted by Ministry of Regional Development and EU Funds and Ministry of Economy, Entrepreneurship and Crafts by December 2020** a. Innovation b. Managerial Skills - SMEs c. Investments – FDI d. Vocational education and training e. Social Inclusion Baseline: no Target: December 2020	**IBRD Lending:** – HBOR operation focused on lagging regions (FY21) – Education Project (planned) **IFC (possible investment)** – IFC investment in real sector companies with significant presence in less developed regions and sectors with large SME supply chains

39 Calculated as the co-financing portion from SME grant schemes (plus financial instruments), and any new major direct investments (e.g. FDI) in Slavonia. The co-financing figures can be obtained from Ministry of Regional Development and EU Funds or Ministry of Economy, Entrepreneurship and Crafts and the FDI figures can be obtained from Croatian National Bank.

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
	SPI 7.2: Pilot projects being implemented *(requires collaboration of regional bodies and alignment of different ministries)* Pilot projects proposed under both STARS and Slavonia RAS Baseline: No Target: December 2021 **SPI 7.3: Outreach to Stakeholders in Agriculture Sector**[41] Number of people who have accessed the online platform and provided feedback Baseline: 0 Target: 1,000 (2019)	– IFC investments prioritizing vulnerable groups (Ex. women; minorities) – IFC IS/AS support to promote agri-tourism linkages in Slavonia – IFC equity-based finance (VC, PE) to promote entrepreneurship in lagging regions – IFC municipal finance
Indicator 8: Fiscal equalization strategy implemented based on an index of multiple deprivation[40] Baseline: No Target: Yes (2023) **Indicators for IFC engagement will be added subject to the nature and scale of investments secured.**		

FOCUS AREA 2: PRESERVING AND LEVERAGING NATURAL CAPITAL TO ENSURE LOW CARBON GROWTH

CPF OBJECTIVE 4: Reducing the energy intensity of the economy and energy transition

Intervention Logic: The high energy intensity of Croatia's economy hampers the country's overall sustainable growth prospects. Although per capita energy consumption in Croatia is a third less than the EU average, the energy intensity of the economy is 55 percent higher than the EU average. Croatia is looking to scale-up energy efficiency on both the supply and demand side as well as promoting renewable energy generation. Croatia's decarbonization goals require a substantial expansion of renewable energy penetration.

Planned RAS and other interventions would seek to address critical constraints such as: the lack of an Energy Strategy; stalled RE legislation; and inadequate tariff structures and subsidies for the poor and vulnerable. By leveraging its ongoing analytical work, the Bank will continue to provide policy support to the articulation of the legal and institutional reform package necessary

40 The WBG supported the development of an index of multiple deprivation as part of the Poverty RAS which the Government has committed to use for the purpose of allocation of EU and other fiscal transfers.

41 There will be mechanisms as part of the STARS RAS to reach a broad group of stakeholders (through stakeholder consultations and an online platform which is anonymous and open to the public at large).

to implement Croatia's upcoming energy strategy. IBRD engagement will be aimed at facilitating scaling up energy efficiency (supply and demand side), including by encouraging innovative financial frameworks to fill the gap in district heating investments. Bank support may also include promoting renewable energy, by assisting the development of an enabling framework for further deployment of renewables (e.g., well-structured transparent auctions, and a framework for facilitating decentralized, or distributed renewable generation solutions). IFC will support this agenda through both investment and advisory support, including RE finance, EE credit lines for SMEs, and real sector investments with potential EE gains, and energy efficient productions lines as well as introducing innovative financial products such as Green Bonds. Subject to availability of demand, IFC could provide financing at the local level where EU funds are not sufficient to support subnational projects that can contribute to development of regional/global public goods including climate change. MIGA will explore opportunities to support RE, including alongside IBRD and IFC.

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 9: Energy intensity of the economy[42] Baseline: 7.02 million tons of oil equivalent (final energy consumption 2016) 2023: 6.93 million tons of oil equivalent **Indicator 10: Cumulative RE energy generation from existing IFC RE investments between 2019 and 2023** Baseline: No Target: 1500 GWh	**SPI 9.1:** Assessment of climate resilience in the National Agriculture Strategy by June 2020 Baseline: no Target: June 2020	**RAS (planned):** – Energy Sector Reform **IFC (possible investment)** – RE Investment and advisory – RE finance (solar) – EE credit lines for SMEs – Real sector investments with potential EE gains – Innovative products such as Green Bonds

CPF OBJECTIVE 5: Improving water, waste water and solid waste delivery and management

Intervention Logic: The SCD emphasizes the importance of preserving Croatia's natural capital and managing the impact of climate change to support sustainable growth. The dramatic growth in tourism requires strategic investments to avoid environmental degradation. Managing increasing pressure on local resources and services in an environmentally sustainable manner is critical, particularly with respect to wastewater pollution control and waste management. Croatia also faces significant threats from wildfire, flood, extreme heat and impacts of these hazards are likely to increase significantly with climate change. Climate change also poses increasing supply risks for agri-food value chains.

Through advisory services, and possible financial assistance, the WBG seeks to support the Government to define the necessary conditions to allow for institutional reform at central (Environmental Protection Fund) and local (municipalities) level by addressing constraints such as stalled progress in water utilities agglomeration and inadequate tariff structures that hamper financial sustainability; lack of economic incentives reflecting environmental externalities of landfilling; and absence of regulatory frameworks incentivizing local government's collective action, as well as weaknesses (horizontal and vertical) in coordination. The WBG program will help Croatia speed up progress on

42 International Energy Agency method. The draft Energy & Climate Plan Croatia submitted to the European Commission in Dec 2018, consistent with the moderate scenario of the upcoming Energy Strategy, has a target for 2030 of 6.85 million tons of oil equivalent.

environmental and water management shortcomings that create adverse impacts on the economy and threatening non-compliance with EU directives. This will become increasingly important for the upcoming EU Programming period with the introduction of enabling conditions. The Bank could also support Government efforts to relaunch reforms towards agglomeration of water utilities and help maximize the effectiveness of EU resources. The WBG will assist the government through on-going and planned lending, ASA and RAS with a view to improving energy efficiency and enhancing waste recycling and treatment. ASA is planned in relation to solid waste management. Subject to demand from local governments, IFC could invest in public private partnerships for landfills, and provide municipal financing for water, waste water and solid waste projects.

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 11. Percentage of municipal waste recycled Baseline: 18 percent (2018) Target: TBD (2023) **Indicator 12. Level of agglomeration achieved in water utilities** Baseline: 160 utilities Target: no more than 40 utilities	**SPI 11.1: Assessment of the financing gap to meet recycling targets by 2021** Baseline: No Target: December 2021 **SPI 12.1: Progress towards Urban Wastewater Treatment Directive (UWWTD) Compliance** Baseline: 32 agglomerations (approximate value calculated as national connection to public wastewater system) Target: compliance with UWWTD in agglomerations> 10,000 population equivalent in sensitive areas and relevant catchments (73 agglomerations) December 2020	**ASA & RAS:** – Solid Waste Management ASA & RAS (potential) – Water and Sanitation Sector Reform ASA & RAS (potential) **IFC (planned):** – Public private partnerships for landfills, municipal financing for water, waste water and solid waste, as a waste to energy source.

FOCUS AREA 3: STRENGTHENING MARKET INSTITUTIONS TO ENABLE A DYNAMIC ENTERPRISE SECTOR

OBJECTIVE 6: Improve business climate and increase the private sector's role in the economy

Intervention Logic: The SCD identifies the need to promote a competitive environment and improve the performance of the justice system. The EC recommends reducing the burden of parafiscal charges and legislative requirements and enhancing competition in business services and regulated professions. The first objective of the NRP is to increase the competitiveness of the Croatian economy through improving the business environment, enhancing the management of state-owned assets, and improving efficiency in the judicial system. The WBG will support the government in its efforts to improve competitiveness and enhance the role of the private sector in the economy. The program will seek to address identified constraints including weak regulatory environment and certain justice sector processes that impede the business environment. Ongoing Trust Fund support is allowing the Bank to engage with reforming the business environment and to support reform in occupational regulation. Ongoing lending in integrated land and administration as well as planned lending in transforming justice services will serve to ease the burden on the private sector and to improve the environment for doing business. The planned World Bank project in the justice sector will seek to improve investment management in the sector and to rehabilitate and renovate the physical infrastructure of the courts. The project reflects close cooperation with government and other partners including the EU (which, among other supports, is continuing work initiated by the World Bank in digitizing the land registry and collating data on a central system) and the Norwegian Financial Mechanism (which is supporting the further professionalization and evaluation of the judiciary).

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 13: Ease of Doing Business Index Baseline: 71.4 (2019) Target: CEE average (2023)	**SPI 13.1: Number of professions with removed licenses, quotas, price regulation, or other unnecessary restrictions to competition.** Baseline: 1 (2018) Target: 8 (2021)	**IBRD LENDING:** – Integrated Land and Administration Project (IPF) – Justice for Business (FY20) **ASA:** Central Business Registry - phase 2 (FY20) **IFC:** IFC corporate governance support (through investments in real sector companies and private equity funds)
Indicator 14: Reduced transaction processing times in land registry Baseline: 18 days (2018) Target: 10 days (2023)	**Indicator 14.1: % of applicants per annum lodging land registration requests online.** Baseline: 6.2 % (2018) Target: 20 % (2021) **Indicator 14.2: Increased use of shared spatial and ownership data by government agencies/ ministries.** Baseline: 28 (2018) Target: 30 (2020)	
Indicator 15: Number of Total Direct Jobs Supported by IFC clients Baseline: 5600 (2017) Target: 8000 (2023) ***o/w Female Employment Supported*** Baseline: 2700 (2017) Target: 4000 (2023)		

CPF OBJECTIVE 7: Promote entrepreneurship, competition and innovation

Intervention Logic: The SCD found SME development is inhibited through limited access to internal and external resources (both funds and qualified personnel), limited information on technology and markets, modest research excellence, barriers to science-industry collaboration, and weaknesses in the innovation ecosystem governance. Gross Domestic R&D expenditures (as a share of GDP) are much lower in Croatia than in peer countries - the gap is even larger for Business Expenditures in R&D.

The WBG program will address identified constraints to entrepreneurship, competition and innovation including: lack of coordination between government institutions, academia and private sector; barriers to science-industry collaboration; and weaknesses in the governance of Croatia's innovation ecosystem. The WBG will seek to strengthen capacity for results-based decision making, and coordination mechanisms between the public sector, private entities and academia. The WBG has been supporting the Croatian innovation agenda since 2006, with lending operations and advisory work. The ongoing second Science and Technology Project (STP) supports instruments to alleviate market failures and boost innovation, targeting the different stages in the innovation process (from basic and applied research to product development, commercialization and early stage financing) and fostering partnership between the business and the scientific community in the country and abroad. The Bank has a demonstrated comparative advantage to support capacity building efforts and instruments in these areas. Examples include developing financing models for business related R&D through Proof of Concept (small grants to finance early stage financing which other institutions are not providing) and supporting SMEs' ability to invest in R&D (resulting also in patent applications and demonstration of technical feasibility leading to R&D commercialization stages). Expectations are to remain engaged in this area, including through potential lending, in addition to RAS. This CPF will also explore opportunities for productivity gains, including for the tourism and agriculture sectors. This could include strengthening managerial skills and technology adoption by existing and new entrepreneurs (including potential links with the Slavonia RAS).

IFC will strategically support Croatian companies (manufacturing, agribusiness and services, sustainable tourism) aiming to increase their competitiveness through supporting exports and investments in innovation and technological upgrades that lead to increased productivity and standards as well as strengthening of value chains. IFC will also look to support both inbound and outbound FDI, particularly for technology transfers and in innovative sectors, as well south-south investments in key sectors that contribute to job creation and local economic development. IFC could also support private sector investments to foster tourism-based local economy with improved linkages to local manufacturing and agribusinesses as well as developing tourism-related infrastructure including modernization of auxiliary airports through public private partnerships. IFC will continue to look for opportunities to invest in local capital markets to deepen and diversify financial markets and products. IFC will also support alternatives to bank finance by investing in capital market instruments such as covered bonds, local currency bonds, and Green bonds. IFC will also support opportunities to increase availability of scarce equity- and risk-based finance; e.g., private equity funds, particularly those that promote entrepreneurship and SMEs in the less-developed regions of Croatia and focus on export-oriented and higher value-added sectors.

CPF Objective Indicators	Supplementary Progress Indicators (SPI)	WBG Program
Indicator 16: Increase in the level of innovation, as measured by: – PCT patent applications per billion GDP (in PPS) Baseline: 0.63 (2015) Target: 0.7 (2023) – Trademark applications per billion GDP (in PPS) Baseline 4.22 (2016) Target: 5 (2023) – Design applications per billion GDP (in PPS) Baseline: 0.86 (2016) Target: 9 (2023) **Indicator 17: Number of IFC investment in innovative capital market and private equity instruments (local currency bonds, covered bonds, green bonds, equity funds)** Baseline: 0 Target: at least 1 IFC investment	**SPI 16.1: Enhanced capacity of the public research and innovation sector to absorb EU funds measured by:** – Number of new IPR filings for new products/ processes/designs developed Baseline: 0 (2019) Target: 40 (2021) – Leverage of EU fund absorption (1WB dollar added X EU fund usage). Baseline: 0 (2019) Target: $200 million (2021) – Number of projects (products/processes/ designs) commercialized Baseline: 0 (2019) Target: 60 (2021)	**IBRD LENDING:** – Second Science & Technology II – Innovation Project (FY22) **RAS:** – Public Expenditure Review in Science, Technology and Innovation (planned) – STARS RAS (component on innovation system) **IFC (planned):** – IFC investment in Croatian companies expanding in the region and export sectors – IFC investment in inbound and outbound FDI – IFC AS and investment in capital markets and equity-based finance (Green bonds, local currency bonds, covered bonds, PE funds) – Distressed Asset Resolution Program (DARP)

ANNEX 2.
SELECTED INDICATORS OF BANK PORTFOLIO PERFORMANCE AND MANAGEMENT
(AS OF 02/28/2019)

Indicator	FY16	FY17	FY18	FY19
Portfolio Assessment	9.0	8.0	6.0	5.0
Number of Projects Under Implementation[a]	3.8	3.6	5.0	4.8
Average Implementation Period (years)[b]	11.1	25.0	33.3	20.0
Percenta of Problem Projects by Number [a,c]	15.2	19.6	59.4	49.7
Percenta of Problem Projects by Amount [a,c]	11.1	25.0	33.3	49.7
Percenta of Projects at Risk by Number [a,d]	15.2	19.6	59.4	49.7
Percenta of Projects at Risk by Amount [a,d]	25.4	21.6	17.0	26.4
Disbursement Ratio (%) [e]				
Portfolio Management				
CPPR during the year (yes/no)				
Supervision Resources (total US$)				
Average Supervision (US$/project)				

Memorandum Item	Since FY80	Last Five FYs
Proj Eval by IEG by Number	48	8
Proj Eval by IEG by Amt (US$ millions)	3,184.8	670.5
% of IEG Projects Rated U or HU by Number	31.3	37.5
% of IEG Projects Rated U or HU by Amt	29.3	23.6

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of project rated U and HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undusbursed balance of the Bank's portfolio at the beginning of the year: Investment project only.
* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

ANNEX 3.
OPERATIONS PORTFOLIO (IBRD/IDA AND GRANTS)
(AS OF 02/28/2019)

Closed Projects 51 IBRD/IDA*	
Total Disbursed (Active) of which has been repaid (1)	208.29 17.57
Total Disbursed (Closed) of which has been repaid	3,528.97 2,296.55
Total Disbursed (Active + Closed) of which has been repaid	3,737.26
Total Undisbursed (Active)	145.14
Total Undisbursed (Closed)	0.14
Total Undisbursed (Active + Closed)	145.29

Active Projects		Last PSR Supervision Rating			Original Amount in US$ Millions					Difference Between Expected and Actual Disbursements	
Project ID	Project Name	Development Objectives	Implementation Progress	Fiscal Year	IBRD	IDA	Grants	Cancel.	Undisb.	Orig.	Frm Rev'd
P147499	Croatia Railway	MS	MU	2015	183.4	0.0		0.0	89.8	65.3	31.2
P144871	Health Sector Reform Project	MS	MS	2014	103.5	0.0		15.1	21.0	0.0	0.0
P122219	INTEGRATED LAND ADMIN SYSTEM	MS	MS	2012	47.9	0.0		0.0	22.2	2.6	2.6
P155842	Modernization and restructuring of roads	S	MS	2017	23.3	0.0		0.0	0.0	0.0	0.0
P127308	Science and Technology II	S	S	2013	26.2	0.0		0.0	4.6	4.6	2.0
Overall Result					**384.3**	**0.0**		**15.1**	**145.1**	**72.5**	**35.9**

ANNEX 4.
STATEMENT OF IFC'S HELD AND DISBURSED PORTFOLIO
(AS OF 12/31/2018)

		Committed					Disbursed Outstanding				
FY Approval	Company	Loan	Equity	**Quasi Equity	*GT/RM	Participant	Loan	Equity	**Quasi Equity	*GT/RM	Participant
FY13	ATLANTIC TRADE	8.12	0.00	0.00	0.00	0.00	8.12	0.00	0.00	0.00	0.00
FY13	JELINAK D.O.O.	7.09	0.00	3.28	0.00	15.08	7.09	0.00	3.28	0.00	15.08
FY12	RP GLOBAL	12.49	0.00	4.83	0.00	31.22	12.49	0.00	4.83	0.00	31.22
FY14	RUDINE DOO	18.48	0.00	0.00	0.00	23.10	18.48	0.00	0.00	0.00	23.10
FY14	ZAIC	37.62	14.43	7.18	4.75	0.00	37.62	14.43	6.93	4.27	0.00
Total Portfolio:		**83.80**	**14.43**	**15.29**	**4.75**	**69.40**	**83.80**	**14.43**	**15.04**	**4.27**	**69.40**

ANNEX 5.
CPF CONSULTATIONS

The Croatia CPF consultation process took place from July until December 2018 and was undertaken jointly by IBRD and IFC teams. The goal of the consultation process was to involve a broader audience to discuss the country's key development challenges, priorities for future WBG engagement in the country, SCD analysis and recommendations and to validate the identified development and engagement priorities. In addition, consultations helped in increasing the WBG's visibility, the understanding of the Bank's role and work in Croatia and helped in engaging many stakeholders throughout Croatia beyond the traditional partners. Consultations involved workshops and many individual meetings with private sector, national and local government, SOEs, public service providers, academia, civil society (including representatives of marginalized and vulnerable groups like youth, women, LGBTI and Roma), international community (embassies, IFIs, donors, UN agencies, IMF, European Commission), parliamentarians, and other experts. Half day multi-stakeholder workshops with representatives from a wider region were organized in Zagreb, Sisak, Slavonski Brod, Split and Knin (red circles). Additionally, private and public sector missions with individual meetings were organized in Istria, Sisak-Moslavina region and Northern Croatia (blue circles).

FIGURE 5
CPF consultations-stakeholders involved

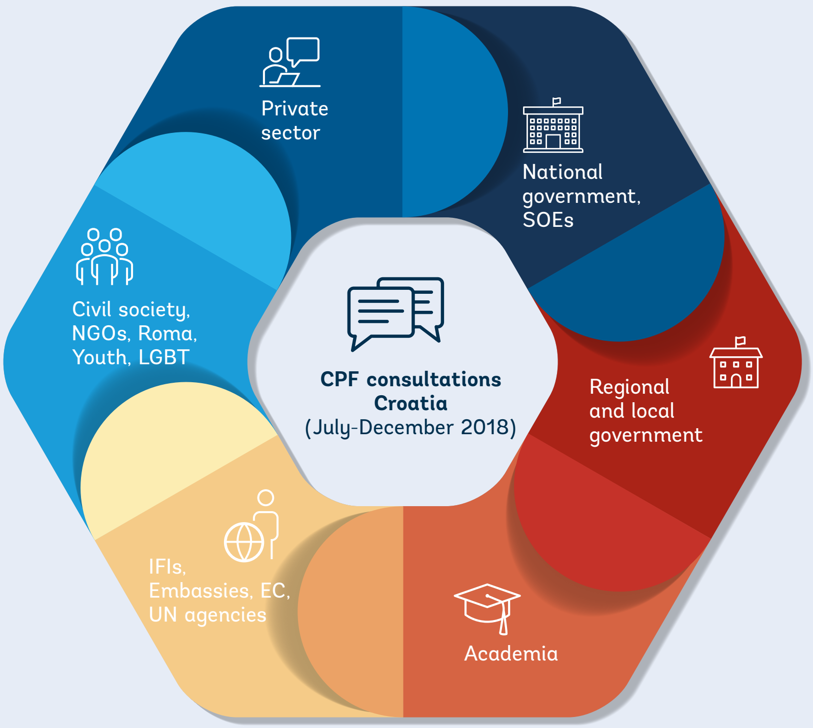
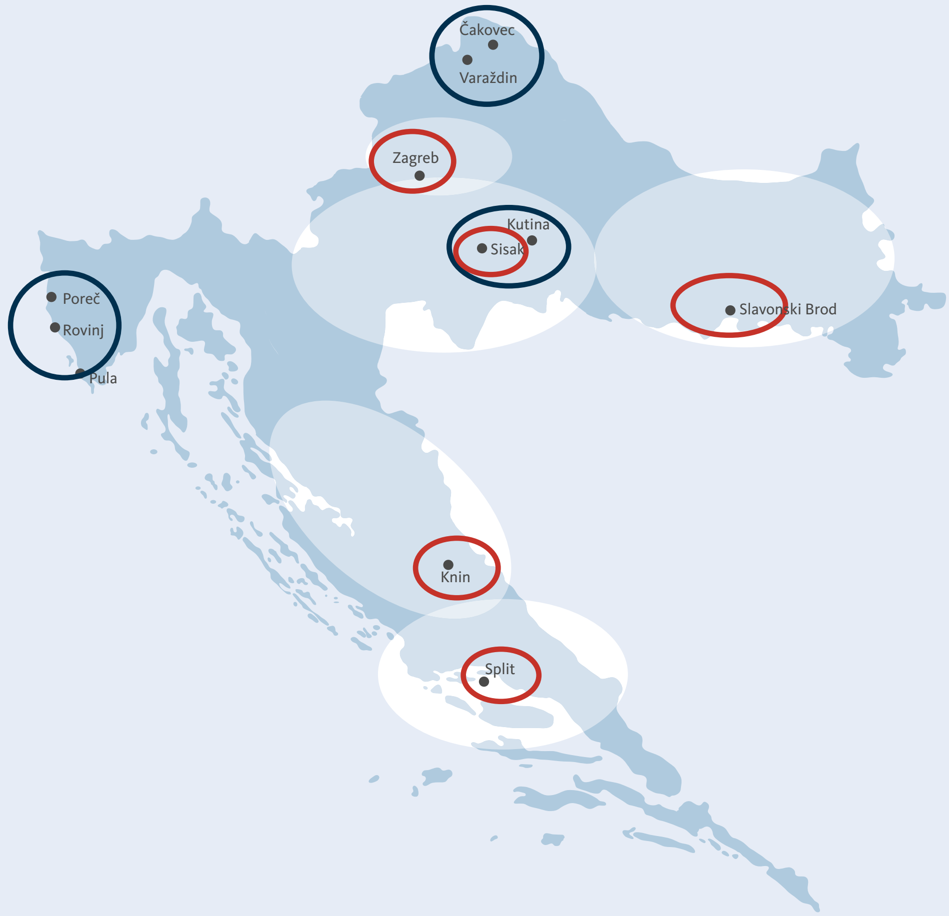


FIGURE 6
CPF consultations - Map of locations and areas covered



During the workshops, after the presentation and discussion, representatives of the private, public and civil sector were given a survey to rank the areas which Croatia needs to address in order to reach higher growth rates, and what are the areas where the WBG should be engaged in to support Croatia's development in the future. The results from 161 participants were the following: on the question "*What are the areas Croatia needs to address in order to reach higher growth rates?*" public sector efficiency; education system, jobs and skills mismatch; and private sector competitiveness were the top three responses. On the question "*What are the areas the WBG should be engaged in Croatia?*", strengthening the quality of education; improving the business environment; and improving the quality of judiciary took the first three places.

In addition to workshops and individual meetings, an online consultations webpage was created to broaden consultations opportunities for national and international audiences and to increase the interest for the consultation process. The webpage included an online survey which was also promoted on the World Bank Croatia Facebook page to capture the views of Croatian public about the country's key development challenges and proposed priorities for the WBG future engagement in Croatia. The online survey results mostly overlap with the workshop results, with an exception of improving the quality of the judiciary which was identified as the number one challenge that Croatia needs to address to reach higher growth rates.

FIGURE 7
CPF Consultations - workshop survey results

What are the areas Croatia needs to address in order to reach higher growth rates?

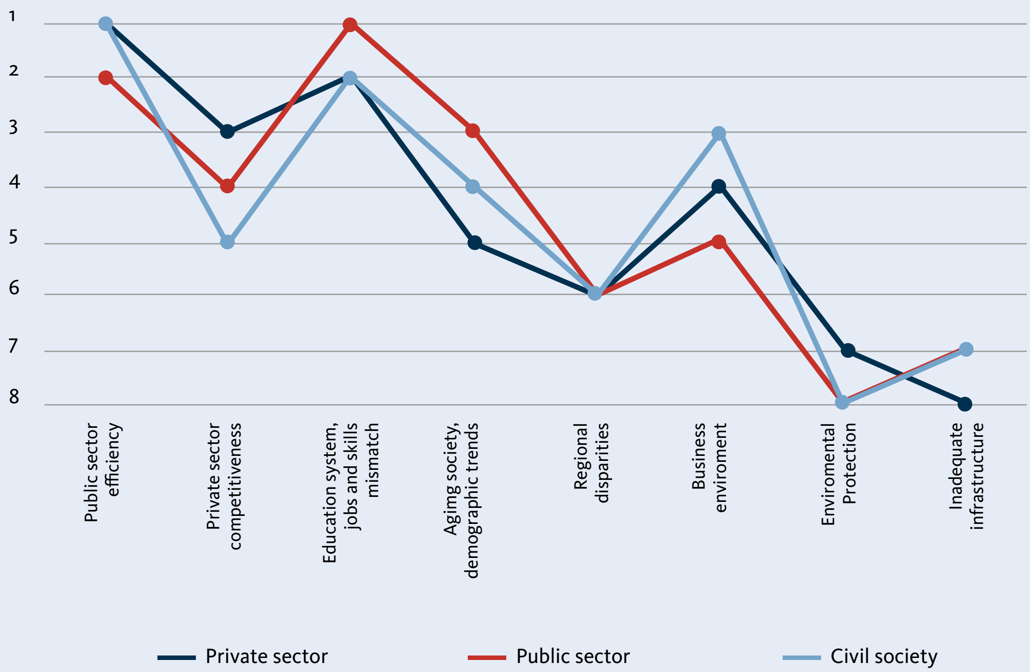
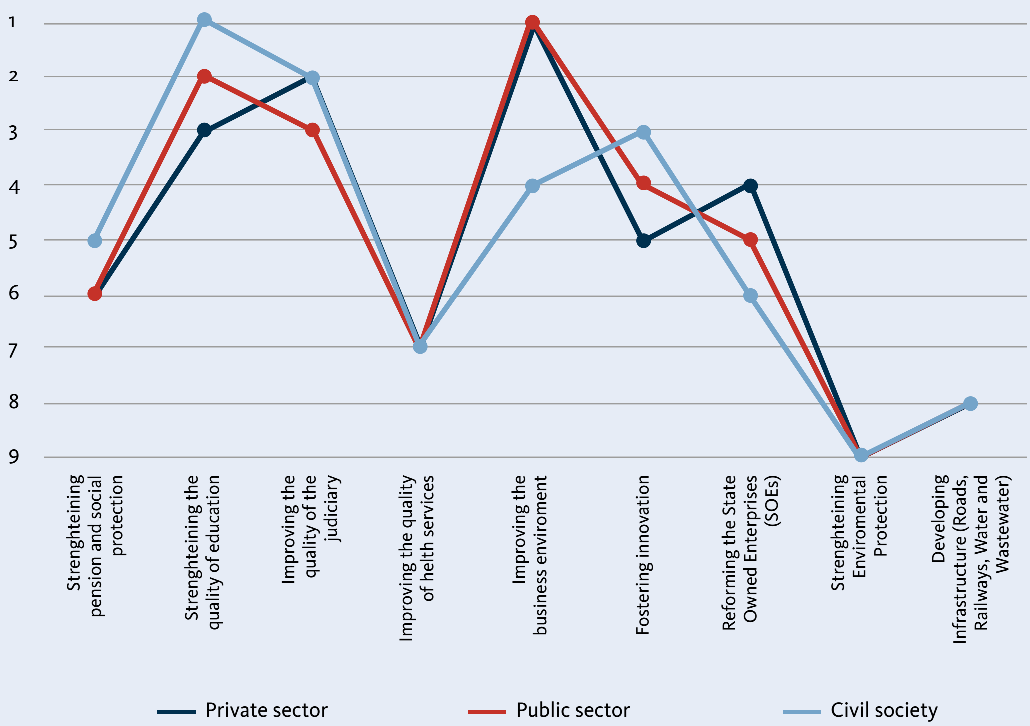


FIGURE 8
Consultations - workshop survey results

What are the areas WBG should be engaged in Croatia?



ANNEX 6.
CITIZEN ENGAGEMENT ROADMAP

CPF CITIZEN ENGAGEMENT OBJECTIVE:

Improving the quality of citizen engagement and creating models for citizen to engage with government actors in development initiatives and key country reforms.

CITIZEN ENGAGEMENT STRATEGIES

RESPONSIVE PUBLIC SECTOR
Capacity Building of government for enhanced CE in service delivery
- Intensify support in lagging regions and develop strategies for reaching vulnerable groups
- Introduce civic tech approaches to counterparts to promote improved accountability and transparency

ENGAGING PRIVATE SECTOR BENEFICIARIES
Strengthen engagement of individuals and firms in the private sector
- Review current approaches
- Develop opportunities for strengthening established mechanisms
- Introduce civic technologies to engage with enterprises.

INCLUSION
Develop more inclusive platforms of CE in projects under preparation
- Develop mechanisms for, and monitor, inclusion of all groups in CE activities,
- Deepen engagement through well targeted CE tools.

CPF FOCUS AREAS

Focus Area I:
ENHANCING PUBLIC SECTOR PERFORMANCE AND INSTITUTIONS

Key opportunities for CE models:
- Sustainable Croatian Railways
- Modernization of Road Sector
- Health PforR
- Education (new lending)

Focus Area II:
STRENGTHENING MARKET INSTITUTIONS TO ENABLE A DYNAMIC ENTERPRISE SECTOR

Key opportunities for CE models:
- Second Science & Technology (II and III)
- Integrated Land and Administration
- Transforming Justice Services
- Access to Finance

Focus Area III:
NATURAL RESOURCES AND RESILIENCE

Key sector opportunities for CE:
- Solid Waste

Integrating Citizen Engagement in RASs
Create models for the development of genuine CE in RASs and disseminate experience to other sectors.

Key opportunities for CE in RAS models:
- Support for National Development Strategy – Croatia 2030;
- Strategic Transformation in Agriculture and Rural Space
- Growth and Jobs in Slavonia

ANNEX 7.
CROATIA GENDER ROADMAP

MAINSTREAMING GENDER EQUALITY ACROSS COUNTRY PORTFOLIO
Support and intensify gender equality in relevant sector reforms, IPFs, & ASAs

STRATEGIC GOALS		CONCRETE ACTIONS

1. CPF FOCUS AREAS WITH HIGH IMPACT FOR GENDER EQUALITY

Strategic goal	Projects
Enhancing public sector performance and institutions	Justice for Business Education Project NDS RAS STARS RAS
Preserving and leveraging natural capital to ensure low carbon growth	RAS Slavonia Water and Solid Waste RAS
Strengthening market institutions to enable a dynamic enterprise sector	Justice for Business

- Strengthen **capacity to respond to violations** of human rights including GBV and other forms of discrimination
- Develop **a gender filter** for the NDS and apply a gender lens to related policy notes
- Support **greater economic inclusion** of the excluded rural women, youth and retirees including in growth sectors
- Enhance **the role of women** in the agriculture sector
- Support **enabling environment** for women owned and led enterprises
- Support **incentives for enterprises** of women small farmers and youth

2. MAINSTREAMING GENDER EQUALITY IN THE PORTFOLIO INCLUDING PIPELINE

Strategic goal	Concrete actions
Develop a gender dimension in all WB activities including the pipeline	— Systematic application **of a gender equality filter** to the whole portfolio and pipeline — Use the Roadmap to **improve efficiency and effectiveness of gender equality mainstreaming** in the country portfolio — **Track progress on gender equality** across the country portfolio and address it in annual portfolio reviews and PLR by reporting on gender equality result indicators in relevant operations and the CPF
Advocate for gender equality with government using all opportunities to engage	— Promote the **gender equality filter as good practice** with government and other development partners including the EC — Develop **effective communication activities** on gender equality, including capacity building of selected PIUs — Support the **greater economic inclusion** of women, youth and marginalized groups
Develop a network of support for greater social and economic inclusion of excluded groups	— Engage **a broad network of supporters** including government agencies, private sector and civil society to exchange information and best practices on gender equality — Organize a **media campaign** for greater inclusion of groups experiencing economic and social inclusion

ANNEX 8.
COMPLETION AND LEARNING REVIEW

Croatia FY2014-2017 CPS Completion and Learning Review
Date of CPS FY2014-17: June 27, 2013 (Report No. 77630-HR)
Date of PLR: August 31, 2016 (Report No. 106507-HR)

I. INTRODUCTION

The launch of the Country Partnership Strategy (CPS) FY14-17 coincided with Croatia's entry in the European Union (EU) in mid-2013. At the time of the CPS Croatia had successfully transposed the EU *acquis*, harmonized the norms and legislation[43] and reoriented its institutional mechanisms to EU structures, albeit with major challenges ahead. In spite of the opportunity for EU accession, and amid a protracted recession, the country showed important macro vulnerabilities and was in need of robust fiscal consolidation efforts. The average registered unemployment rate was at 15.9 percent (2012), with deteriorating public finances including an annual deficit at around 5.3 percent of GDP (2012).[44] Anticipating a slow recovery, and adverse effects to poverty, the WBG program focused on the need to improve the Country's growth prospects through fiscal adjustment, enhancing competitiveness and helping maximize EU membership. The CPS supported institutions in adopting policies to implement structural reforms and prepare for the expected major influx of EU funds.

The WBG program focused on restoring fiscal sustainability and improving fundamentals. The Government's Economic Program of April 2013 had to be harmonized with many EU mandated reforms, including in fiscal policy, labor regulation, privatization and the judiciary. Government measures supported a return to growth in 2015, after a six years recession. The program also addressed long-term structural issues such as pension, social protection and health sector reforms, modernization of public administration, competitiveness, entrepreneurship and private investment, as well as SOEs restructuring. The WBG program supported these efforts through the *Second Economic Recovery Development Policy Loan* (ERDPL2.)[45] The WBG focused on fiscal consolidation and key structural issues through ERDPL2 and designed a complementary financial program to address other critical challenges. The trajectory of the progress made, however, was difficult to sustain because the commitment to reforms diminished following the 2015 elections and subsequent administrative disruptions. The remainder of the CPS period was characterized

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43 Croatia CPS FY2009-13 supported Croatia's goal of joining the EU (reference to CPS FY09-13 Completion Report). The EU acquis is the body of EU laws.

44 According to methodology ESA 2010.

45 ERDPL2 was originally designed to be the second in the programmatic series of two-single tranche DPLs, of which the first loan was approved in May 2011, but the series was discontinued due to the delay in implementing the reforms.

by limited continuity between the governments, shift of competences within ministries and political reshuffling resulting in frequent changes of ministers.[46]

The CPS design was aligned with the 2013 Croatia Economic Program[47] and anticipated strong monitoring mechanisms by the European Commission (EC). Croatia was voluntarily participating in the European Semester and delivered its first Economic Program in April 2013. Given the high deficit and rising public debt level, the EU put Croatia under the Excessive Deficit Procedure (EDP) in January 2014 to help her restore fiscal sustainability.[48] The identified imbalances informed the Country Specific Recommendations[49] (CSRs) issued to Croatia by the European Council in June 2014. Initially, the EDP provided a new impetus for reform around which the WBG oriented its policy and analytical support including through the *National Reform Program TA, Spending Review and Macro-structural dialogue*. The financing program was equally aligned with the EDP and the CSRs, which related to public finances (fiscal rule and expenditure review), tax policies (compliance, efficiency), pension and health systems (efficiency, including the hospital system), labor market policy, social policy (consolidation of benefits, one-stop-shop and targeting), business environment and judiciary, among other. However, with frequent political and administrative changes, the policy in the health sector was reversed thus significantly slowing down reform achievements, whereas the consolidation of the social protection programs was abandoned due to a change in the government's vision and priorities.

The CPS indicative financing provided for up to $800 million in IBRD lending, whereas IFC expected to invest up to $600 million. The CPS program delivered over $600 million in lending and $370 million for the *Roads operation* guarantee, an operation not initially envisaged. The CPS program continued to support the health sector, social protection, R&D, judicial areas, private sector and competitiveness, as well as SOE restructuring. The IFC program aimed at enabling larger scale investments that could drive the recovery and included major investment for the Zagreb airport, as well as the support to renewable energy and export companies.

The overall development outcome of the CPS program is rated *Moderately Satisfactory*, with six objectives achieved, two mostly achieved, and one not achieved. The program contributed to Croatia's increased revenues through fiscal adjustments by supporting revenue enhancing policies, including containing health expenditures, rationalizing road sector expenditures and improving the public debt profile. Despite early progress under ERDPL2, the CPS did not achieve improvements in the targeting of the social assistance program. However, the program made notable progress in improving the country's performance of the judiciary with positive impact to the business environment and country's competitiveness. It contributed to diversity and security of energy supply and supported the export companies. Given the recession, a strong regulatory framework that attracted private investors and IFC's additionality in terms of financial structuring and long tenors, combined with flexibility under IBRD loan, helped the companies stay on a growth track. The CPS program succeeded to help Croatia better manage and use the European Structural Investment Funds (ESIF) in several sectors. Almost all CPS interventions contributed to this objective by improving the readiness of the public sector to fulfill ex-ante conditionalities and build the project pipeline.

46 The current Government, sworn in October 2016 after snap elections, has seen changes of leadership in nine out of twenty ministries.

47 A requirement under the European Semester as part of the EU's economic governance, later referred to as National Reform Programs (NRP) for each subsequent year.

48 This was anticipated during the preparation of CPS and ERDPL2 as referenced in the documents.

49 Council Recommendation of 8 July 2014 on the National Reform Programme (NRP) 2014 of Croatia https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014H0729(10)&from=EN

Croatia FY14-FY17 CPS Pillars, Rating of Objectives Objectives	Proposed rating
PILLAR 1: Fiscal Adjustment through Reforms at the Sector Level – Moderately Satisfactory	
1: Improving sustainability of revenue enhancing policy	Mostly Achieved
2: Improving the targeting of social assistance programs	Not Achieved
3: Introducing cost rationalization and efficiency measures in the health sector	Achieved
4: Contributing to the coherence and implementation of strategic plans in railway and energy, and improvements in airport infrastructure	Achieved
PILLAR 2: Innovation and Trade Competitiveness for Growth and Shared Prosperity – Moderately Satisfactory	
5: Improving efficiency and reducing arrears in the judicial system	Achieved
6: Contributing to diversity and security of energy supply by financing energy efficiency and renewable energy projects	Achieved
7: Supporting competitive local companies to expand in the region and increase exports	Mostly Achieved
PILLAR 3: Helping Maximize the Economic Benefits of Becoming an EU Member State - Satisfactory	
8: Improving coherence and credibility of national strategic and policy documents needed for the EU funds absorption and management	Achieved
9: Contributing to Croatia's readiness and capacity to build the project pipeline for absorbing EU Funds in selected sectors	Achieved

The performance of the WBG in designing and implementing the CPS program is rated as *Good*. The program was well aligned to country objectives, addressed key development issues and remained relevant. A mix of instruments were used to respond to critical needs - helping with fiscal consolidation, competitiveness and supporting capacity building and readiness for the management of the EU funds and the European Semester coordination. In 2013, Croatia had barely started the programming of EUR12.6 billion-worth EU funds allocation, and the CPS design adequately addressed this challenge, and was reflected in the results matrix.[50] The strong pace of institutional change that characterized the pre-accession period has not continued following membership accession, with some signs of institutional fatigue present. Implementation challenges for the CPS included weak capacity of counterpart institutions to implement complex projects and use new instruments, including RAS-financed engagements. However, the program was flexible and responded with innovative instruments, including to address unsustainable debt levels in the road sector in 2017. The risks were adequately identified, although some mitigation strategies (e.g. project restructuring) could not overcome inconsistencies in the implementation. The EC monitoring framework, even with the EDP triggered, the CSRs closely aligned with the WBG program and the strong coordination with the EC, has not been sufficient to focus the government's orientation to reforms amid new political priorities. [51] On IFC's side, the program design and implementation was consistent with the economic environment in Croatia during the CPS period. IFC's support of the Zagreb airport concession, one of the most significant investment projects

50 In September 2018, Croatia had spent 14 percent of the EU allocation, and contracted 58 percent. European Structural and Investment Funds – Open Data Portal https://cohesiondata.ec.europa.eu/countries/HR.

51 Agrokor crisis was one such example due to its major impact on economics; then shipyards and energy sector – industries employing large workforce.

for the government, was a positive example of how large concessions need to be structured and financed. IFC and IBRD coordinated the work in the energy sector and were closely aligned in supporting exporters in the context of the prolonged recession.

The Croatian economy started to recover in the second half of 2014. During the 2015-2017 period, average GDP growth reached 3.0 percent, mainly due to a significant rise in export of goods and services, as well as recovery of private consumption. The unemployment rate started to decline after peaking at 17.3 percent in 2014, reflecting a rise in employment but also accelerating emigration after EU accession. Finally, external vulnerabilities significantly diminished over the 2014-2017 period, with external debt falling by more than 25 percentage points of GDP. However, growth potential remains the lowest among the CEE peers and prospects for reinitiating stronger real convergence and promoting inclusive growth remain weak.

Croatia's fiscal position improved markedly during the CPS period. Positive cyclical effects together with tax policy changes resulted in an increase of total revenues, while spending was restrained. This led to a major reduction of fiscal deficit, and in 2017 for the first-time since Croatia's independence, a general government surplus was recorded. Fiscal consolidation reversed the unsustainable trajectory of public debt, however, the tax burden remained comparatively high, budget composition worsened and, in general, fiscal vulnerabilities remain as a high level of public debt persist.

II. PROGRESS TOWARDS CPS DEVELOPMENT OBJECTIVES

The CPS program performance is rated *Moderately satisfactory.* Overall, the CPS aimed to support Croatia in developing its economic potential in the context of its imminent EU membership. This was envisaged through three pillars: (i) fiscal adjustment through reforms at the sector level; (ii) innovation and trade competitiveness for growth and shared prosperity; and (iii) helping maximize the economic benefits of becoming an EU state. The following sections discuss the highlights of the assessment of the program objectives. The status of all objectives and indicators is detailed in the Annex 1.

PILLAR I FISCAL ADJUSTMENT THROUGH REFORMS AT THE SECTOR LEVEL

Efforts to improve fiscal performance included enhanced revenue policies and rationalization of expenditures in the social sectors and the transport sector. Progress made has been moderately satisfactory, reflecting mixed performance, most notably limited progress on targeting of social assistance programs.

OBJECTIVE 1. Improving sustainability of revenue enhancing policy

Croatia has had steady revenue performance over the past years. The WBG made its primary contribution to this objective under the ERDPL2 and *Revenue Administration Modernization Project (RAMP), as well as under the Modernization and Restructuring of the Road Sector. ERDPL2* helped in achieving sustainable fiscal policy by strengthening the independence of the Fiscal Board and rationalizing the expenditures in social sectors. Government efforts continued in this area, leading to deficit reduction in 2017. The contribution under RAMP focused on improving tax compliance through modernization of business processes and new information systems. Introduction of e-services and functional realignment of the Croatian Tax Administration (CTA) allowed improved segmenting of large taxpayers, estimated to account for a share of around 40 percent of revenues. The CTA implemented the e-enforcement ("e-ovrha"), one of the recommendations made as part of the business analysis and reengineering under RAMP, which has helped increase compliance. Since 2016, the CTA has been able to further recover loss of revenue through the full implementation of the Compliance Risk Management System (CRMS), which enable the CTA to focus on high-risk taxpayers and specific risk areas, analyzing risk compliance for all type of taxes and taxpayers' categories (re. CTA Strategy for 2016-20[52]). Although previously used indicators are not possible to track,[53] the revenue mobilization is corroborated by an alternative indicator on VAT Gap estimates per "Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report".[54] In the 2014-2016 period, the amount of VAT revenues collected rose by close to 9 percent, which resulted in a significant drop in VAT gap, from 3 percent in 2014 to 1 percent in 2016.

Croatia's improved fiscal performance is also due to containment of expenditures, with contribution under the *Modernization and Restructuring of the Road Sector* project and analytical work. The *Roads project* supported successful financial restructuring and debt restructuring through hands on implementation support. The IBRD guarantee, although not used, helped the government and the companies restructure more than 60 percent of the debt of the companies, extending maturity and reducing the cost of the debt by more than EUR 400 million.[55] The *Public Finance Review* (PFR) facilitated a strong dialogue on public finance and was followed by a Spending Review in 2015 in a response to the EC's CSRs. The PFR (FY14) provided a roadmap to restructure spending, from recommendations for debt sustainability strategy to fiscal adjustment policy mix through a combination of revenue, tax administration, social sectors, subsidies and public administration. A *Spending Review* focused on five sectors and had a positive impact on the dialogue with respect to actions aimed at exiting the EDP, which materialized in June 2017. In the railways sector, the Public Service Obligation contracts for the passenger railway transport were redesigned and improved upon recommendations. The *Macro structural dialogue* (FY17) informed the fiscal consolidation strategy and policy coordination under the 2017 National Reform Program. A recently passed Fiscal Responsibility Act is consistent with the recommendations of this work, including a structural balance rule and public debt rule to strengthen the binding nature of the annual and medium-term expenditure ceilings – and complies with the 2014 CSR.

OBJECTIVE 2. Improving the targeting of social assistance programs

Initial progress to increase the share of means-tested social assistance has been reversed. This objective was continued from the previous CPS and sought to improve efficiency in Croatia's social programs by orienting resources to the most vulnerable. Bank support included *ERDPL2*, but also *NRP TA (FY2015)*, analyzing and supporting parametric reforms (including simulations for child tax allowance), which resulted in some improvements increasing the share of means tested social programs in overall central government social spending from 16.1 percent in 2012 to 17.1 percent in 2016. The objective was to be further supported by the *Social Protection System Modernization Project (SPSMP)*, approved in September 2014. However, government support for means-tested benefits and consolidation of social protection benefits through a One-stop-

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52 https://www.porezna-uprava.hr/HR_o_nama/Strategije/StrategijaPorezneUprave2016_2020%20FINALNO.pdf

53 Tax gap as a percent of total GDP was on track at 2.5 percent in 2016 (PLR) from 2.7 percent in 2012.

54 Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report https://ec.europa.eu/taxation_customs/sites/taxation/files/2018_vat_gap_report_en.pdf

55 The road sector's financial restructuring is being sustained through operational restructuring under Roads project, which has focused on institutional arrangements and governance, toll revenues and retrenchment, with initial gains achieved.

shop was not present following the change in administration in 2016. The Bank supported additional option analysis however the Project was cancelled in 2017.

OBJECTIVE 3: Introducing cost rationalization and efficiency measures in the health sector

Croatia has seen levelling in per capita health spending over the past ten years, and its total health expenditures account for 7.4 percent of GDP in 2015, between EU15 (9.6 percent) and EU13 (6.8 percent). However, the country's ageing population will mean higher demand for health services while a decrease in the working age population will decrease revenues for health. To contain spending will require improving both quality and efficiency. This objective was supported by the ERDPL2 and monitored total reduction in public accrued health spending. The CPS foresaw a drop of 0.5 percent of GDP in health spending on an accrual basis, which was surpassed as public accrual spending was at 6.6 percent in 2016 (reduced by 1.0 percent).[56] This objective was supported through the *Public Finance Review*, making recommendations on health spending efficiency. The consolidation of service network and merger of facilities was taken up by the Government and included in the 2017 NRP. Implementation is supported under the ongoing *Health PforR* operation.

As part of the implementation of the Hospital Masterplan, supported with the *PforR* operation, progress was made since PLR and the total number of acute care beds was reduced by 23 percent from 15,930 (2012) to 12,161 (2017). This was achieved through cost rationalization in care delivery by increasing the number of elective surgeries performed as outpatient surgeries, notably to more than 61 percent. After a setback and policy reversals, with WBG support, the Government has relaunched joint procurement (initiated under *ERDPL2*). In 2018, the Ministry of Health has updated its National Hospital Plan, which aims to address the problem of hospital care delivery, and hospital functional integration – as reinforced through 2017 NRP and supported by the *PforR*. The Bank continues to monitor the level of overall health spending and has contributed with policy advice and recommendations related to hospital arrears (regional work, completed FY18), which is likely to continue into the CPF period. [57]

OBJECTIVE 4: Contributing to the coherence and implementation of strategic plans in railway and energy sectors, and improvements in airport infrastructure

The CPS supported public enterprise restructuring, primarily on transport, with a smaller engagement in the energy sector in renewables. In the railways, the WBG has been working jointly with EBRD and EU on the financial and operational restructuring of the three railway companies and a medium-term sector strategy. After delays, progress is being made on this objective and the Transport Development Strategy (TDS) 2017-2030 was adopted in 2017[58] and approved by the EC as the ex-ante conditionality[59] required for EU funding, thus enabling the financing of about 20 projects, worth EUR 2 billion in total. The medium-term contract for Passenger Service has been in place since 2017, and in line with the TDS, with further adjustment ongoing,

56 The drafting of the indicator has been revised to keep the original target of a .5 percent of GDP decrease, regardless of the baseline, given the impact of national account revisions on benchmarks and targets.

57 In 2018, the MoH has requested the Bank support for capacity building through RAS engagement.

58 TDS adopted: https://vlada.gov.hr/UserDocsImages//Sjednice/2017/08%20kolovoz/53%20sjednica%20VRH//53%20-%205.pdf

59 *Ex-ante conditionalities*, key elements introduced in 2014-20 Cohesion Policy reform for 2014-20, were to ensure the conditions for the effective use of ESI Funds. Notably, sound policy and strategic frameworks (to ensure that the strategic documents at national and regional level which underpin ESI Funds investments are of high quality and in line with standards agreed at EU level), regulatory frameworks (to ensure that ESI Funds operations comply with the EU acquis) and sufficient administrative and institutional capacity of public administration and stakeholders implementing the ESI Funds.

as supported by the *Railway Project*. Similarly, the medium-term contract for Infrastructure Management is in place and consistent with the Transport Strategy. The Government is stepping up the commitment to the restructuring of the railway companies by raising this agenda under the 2018 NRP, adopted in April 2018. This effort has been more recently supported through the *Railways policy update*, which will inform government work on the proposed Sector Policy Letter for the railways, replicating a successful approach under the *Roads project*.

IBRD analytical work has informed the sector institutional reform and the Government's work on feed-in tariffs for renewable energy resources. This dimension of the objective 4 was achieved at the time of the PLR. Although this remained a smaller intervention, the work contributed to an Action plan for feed-in tariffs for renewable energy resources and for improving the efficiency of the district heating (DH) sector, as adopted in 2013, with amendments in 2014 and 2015. Through its work on the *Energy System Review* (FY14), the WBG took stock of the methodology for feed-in tariffs, especially for the district heating sector, and provided recommendations to HERA – Croatian Energy Regulating Agency. The Bank's recommendations were translated in the new tariff system, for the DH. This included decoupling of establishing prices for DH – to be market-oriented and not to be government-influenced. As described in PLR, the government pursued regulatory improvements on feed-in tariffs on its own. A *Note on Energy Vulnerability* and ways how to mitigate the impact of potentially rising energy prices on the energy-vulnerable group was delivered in 2018. The Government pursued these efforts on its own and in April 2018, a new tariff methodology for renewable energy resources was adopted, representing a major step up leading to full market liberalization.

Improvement in airport infrastructure. This dimension of the CPS objective #4 was also achieved. In air transport, IFC has invested US$73 million in the Zagreb airport, aiming to expand the airport capacity by about 35 percent by the end of the CPS period, hence contributing to the development of the tourism sector, one of the major drivers of Croatia's GDP and employment. The indicator proposed under PLR refers to the number of unique users at the Zagreb airport and has been considered achieved. In 2017, the number of passengers reached 3.1 million, which means 0.59 million unique users, whereas the increase in traffic in 2017 and the first part of 2018 of 11 percent indicate that 3.45 million passengers or 0.66 million unique users might be reached in 2018.[60] The IFC has also provided an advisory work contributing to this objective by carrying out the market sounding related to Croatia Airlines privatization.

PILLAR II INNOVATION AND TRADE COMPETITIVENESS FOR GROWTH AND SHARED PROSPERITY

Progress made under this pillar, pursuing to strengthen the competitiveness performance and business environment, as well as support the private sector growth – critical given the long recession – has been achieved to a good extent. The objectives under this pillar benefited from a coordinated work of IFC and IBRD. Significant progress was reflected in improving the judiciary-related objectives and safeguarding exports of the private sector.

60 2018 data are not yet available.

OBJECTIVE 5: Improving efficiency and reducing arrears in the judicial system

Croatia has made good progress in improving the efficiency of judiciary and has significantly decreased the case backlog. Backlog cases[61] have been reduced from a baseline of around 437,892 in 2012 to 349,051 by April 2016,[62] which exceeds the target in the project document of 394,103.[63] Croatian courts now perform at a level comparable to the average for the other EU Member States on several efficiency indicators tracked by the EU Justice Scoreboard. Disposition times for cases have shortened and clearance rate is consistently over 100 percent or higher (per quarterly data published by MoJ), which indicates a continued positive trend and ability of the judicial system to handle the inflow of cases. The *Justice Sector Support Project* significantly contributed to this improving trend and quality of work in courts, by supporting automating and streamlining case processing as enabled with upgraded Integrated Case Management System (ICMS), rolled out to all courts,[64] whereas the Case Tracking System (CTS) was rolled out in State Attorney Offices (SAO).

Modernization of judicial information systems directly contributed to reducing time required for case disposal, reduced costs of litigation, and increased confidence in and access to the judicial system, helping lower the cost of doing business and help reduce administrative corruption. The *Integrated Land Administration System Project* also contributed to improving the efficiency of judiciary.[65] Significant progress has been made in reducing transaction processing times in land registry and cadaster: from 46 to 12 days for land registries; and from 30 to 8 days for cadaster, which has helped clear the case backlog.[66] *ERDPL2* has supported the reform of business registration and construction permitting, and Croatia's Doing Business ranking improved from 111 to 59.

OBJECTIVE 6. Contribute to diversity and security of energy supply by financing energy efficiency and renewable energy projects

IFC supported Croatia's climate change objective by investing in renewable energy projects. Specifically, IFC invested $25 million and mobilized $31 million from other financial institutions to finance three Wind Power Plants (WPP) in Sibenik, Jelinak and Rudine, which have been commissioned in 2014, 2013 and 2016 respectively. This brings the total wind power generation capacity installed with IFC's support—through its three active portfolio projects—to 108 MW, which constitutes a 50 percent increase in Croatia's total wind power capacity since 2012. These IFC projects also contribute to the reduction of greenhouse gas (GHG) emissions with estimated 75,000 tCO2 avoided every year. This target has been downsized at PLR compared to the original CPS target because an anticipated US$75 million sustainable energy finance project with a Croatian bank focused on renewable energy, did not materialize.

61 Croatia does not have a legal definition of a backlog case but applies this category to the cases older than ten years.

62 Latest data available for 2016, including in the 2018 CEPEJ reports given that Croatia does not have a formal definition of a case backlog.

63 The figures in the CPS Results Framework were not consistent with those in the Project. For assessing progress, the correct baseline, target and status figures have been used.

64 ICMS was only not applied to misdemeanor courts, which have seen a significant decrease in the number of cases and which have consequently been abolished in 2018.

65 Land registration in Croatia is located with courts and under the supervision of the Ministry of Justice.

66 A backlog case in land registry means a case that has not been processed in 90 days.

OBJECTIVE 7. Supporting competitive local companies to expand in the region and increase exports.

This objective is mostly achieved. The WBG has been supporting successfully the financing of exports. Under the *Export Finance Intermediation Loan (EFIL)*, the volume of medium-to long-term lending to firms under the project increased, and it achieved the final targets by the closing date in August 2016. The level of exports of beneficiary companies under the EFIL rose by 18.9 percent in the context of the protracted recession, and uncertainty in both global and local markets. The Government prioritized sustaining financial stability and supporting private sector activity for growth, which was a needed intervention amidst the risk-averse banking sector (reduced investments and increased savings preference) not conducive to recovery. The Government was determined to provide the incentives by starting its own investment cycle. HBOR was given a central role to achieve this goal. Against this background the CEFIL Project provided access to long-term finance for Croatian exporters for increasing their exports, competitiveness and employment.[67] About 60 percent of the exporters created additional employment while 7 percent of the firms kept their initial level of employment (against Croatia unemployment level at 17 percent at the peak of the crisis). In total 964 new jobs were created under the project which translates in to a 4.8 percent employment growth for the beneficiary exporters during the project. Firms that preserved (kept the same employment level throughout the project) employed 806 employees. For every Euro 153,000 disbursed to an exporter, one job was created.

IFC supported competitive local companies through investments in the financial sector, agribusiness and retail, and this dimension of the objective 7 is mostly achieved. In the financial sector, IFC has been implementing its strategic approach to support banks to expand on-lending to SMEs. IFC provided US$68 million long-term finance to one of Croatia's systemic banks to help target largely underserved markets such as the agri-sector and micro, small and medium enterprises (MSMEs). Through this bank, IFC has reached 5,400 MSMEs, which as of the end of 2014 had an outstanding balance of loans totaling to US$370 million; the relevant indicator was added to the results matrix. In 2016, IFC reached 5,125 MSME loans through its client Société Générale/Splitska banka. Although the number was expected to grow due to a change in market conditions and decrease in demand for financing, the client bank cancelled the engagement and prepaid. IFC has not seen opportunities for local currency finance as the Croatian economy remained heavily euro-ized. In agribusiness, through the portfolio project committed during the previous CPS period, IFC continued supporting one of the leading domestic producers of food and personal care products and a leading distributor of consumer goods in South-Eastern Europe. IFC's investment contributed to the company increasing its turnover by 8% in the CPS period. In retail, IFC supported the regional expansion of one of the leading German retailers to Croatia. Both companies procure about 50 percent of their domestic purchases from MSMEs, which totaled about US$200 million in 2014.

67 IBRD Croatian Export Financing Guarantee supported HBOR with additional EUR40 million, utilized to raise EUR50 million on the international commercial loan market and on lend through six sub loans to export companies.

PILLAR III HELPING MAXIMIZE THE ECONOMIC BENEFITS OF BECOMING AN EU MEMBER STATE

The third pillar is rated satisfactory. It reinforces the first two pillars because stronger national strategies contribute to fiscal consolidation, which in turn presents a solid basis for competitiveness of the private sector as an engine of growth. The achievement of the two objectives, coherent policy documents and prepared pool of projects for EU funding was essential given the EC's 2015-2017 estimate that in Croatia the Cohesion policy funding makes the 2nd largest share of public investments among the Member States (MS)—at about 80 percent.[68] This achievement is also relevant considering that all new MSs have faced problems with management and absorption of EU funds, and Croatia is no exception. Designing the pillar to include support to consistency of strategic documents and supporting the project pipeline allowed for a stronger synergy of various levels of capacity building for EU funds management – at a policy and reform level by supporting the annual NRPs; at strategic level – by contributing to fulfillment of ex-ante conditionalities, i.e. key strategies; and at project level – through helping build project pipeline, which included proper criteria applied for selection of project investments.

OBJECTIVE 8. Improving coherence and credibility of national strategic and policy documents needed for the EU funds absorption and management

This objective has been achieved. The CPS program, supported formulation of key sector strategies linked with the use of EU Funds. The work on the strategies contributed to the credibility of national documents through sound analyses and evidence-based policy-making. Most strategies were completed at the time of the PLR. Sector strategies prepared with contribution of the WBG program include:

- **(i)** National Education, Science and Technology Strategy – supported under the *Second Science and Technology Project (STP2)* and adopted by the Government and the Parliament in October 2014 – this is an ex-ante conditionality[69] for the use of EU funds and was one of the very few accepted by the European Commission as compliant with the Common Provisions Regulation[70] criteria;
- **(ii)** National Innovation Strategy - prepared with contribution under STP2 and adopted in December 2014 - responding to the Europe 2020 Strategy, which sets clear targets for EU Member States for innovation agenda;
- **(iii)** Research and Innovation Strategy for Smart Specialization (S3), prepared with contribution from STP2 as key ex-ante conditionality for the use of EU funds in R&D sector; the Bank's detailed analytical work on various industries enabled the credibility of the further conclusions of the Strategy;[71]
- **(iv)** National Research Infrastructure Roadmap – prepared with contribution from STP2 as an input to the Smart Specialization Strategy and an ex-ante conditionality *per se* for the use of EU funds for building public research infrastructures was updated to ensure coherence with S3, while also the sound planning of the infrastructure development including the budgeting were key in fulfilling the *ex-ante conditionality*;

68 EC estimated that Portugal has the largest share. European Structural Investment Funds – Open Data Portal https://cohesiondata.ec.europa.eu/Other/-of-cohesion-policy-funding-in-public-investment-p/7bw6-2dw3

69 The EU has set 25 ex-ante conditionalities under Croatia's OPCC 2014-2020, of which some have proven very challenging for the administration and were met as late as in 2017.

70 Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013R1303

71 P154855 Croatia Smart Specialization https://openknowledge.worldbank.org/bitstream/handle/10986/22024/9781464804588.pdf;sequence=1

(v) Policy advice/recommendations provided under the *EU Preparedness TA* in the areas of public administration, irrigation, rural development, transport, SME and water/environment sector. This included peer review / analysis of the coherence of the Partnership Agreement with the EU and Operational Program Cohesion and Competitiveness 2014-20;

(vi) National Technical and Economic Study for Management of Wastewater Treatment Sludge - prepared under the *Coastal Cities Pollution Control Project 2*, a requirement under the EU Landfill Directive and the Sludge Waste Directive, adopted in 2014.

(vii) Inputs for a draft National Waste and Leachate Management Plan, a requirement under the EU Waste Management Directive, were prepared under the Regional *GEF Adriatic project*.

(viii) Under the *National Reform Plan Technical Assistance*, the Bank assisted in reviewing and providing recommendations for strengthening the policy coordination and thus improving the credibility and coherence of policy measures under the European Semester, designing reform proposals for strengthening social benefits targeting, as well as assessing fiscal, economic and social impacts of the national reform plans.

OBJECTIVE 9. Contributing to Croatia's readiness and capacity to build the project pipeline for absorbing EU Funds in selected sectors

This objective is achieved. The indicator monitored development of a pipeline of projects for EU financing and the CLR reports an EU funds pipeline of ready projects worth over EUR700 million, exceeding the target of EUR100 million. The WBG program contributed to the country's capacity to use EU fund through supporting the administrative capacity building in line ministries and implementation agencies (in environment and R&D sectors) by financing training in specific areas such as state aid, project development and ex-ante project appraisal procedures, including those for major projects. Project readiness and quality of documentation are one of the key elements to a successful EU programs absorption and management, due to a limited timespan for the programs' physical and financial implementation. The project pipeline developed include EUR180 million worth projects in R&D and innovation, under the Second Science and Technology Project, of which EUR110 million is in various stages of implementation or procurement. This will bring Croatia's R&D investments to over 1 percent of GDP for the first time in ten years, and close to Croatia's R&D target under Europe 2020 Targets.[72] In nature protection, 32 projects worth EUR213 million have been prepared to date under *EU Natura 2000 Integration*, of which all are in implementation supporting sustainable management and educational activities in 18 national and nature parks. The *Justice Sector Support Project* prepared EUR11 million worth technical documentation for ICT projects and courthouse designs for the rehabilitation of four courthouses in Croatia lagging regions. *Under Coastal Cities 2* Project, five projects design were prepared for around EUR230 million, and in the transport sector, four project applications were prepared for funding under Connecting Europe Facility (CEF) under *Rijeka Gateway Project 2*, worth EUR86 million – of which two are in implementation and two in procurement stage. The project preparation activity equally contributed to the capacity building of project promotors, beneficiaries and local and national authorities, in public investment management and project management, as well as in the relevant field of sectorial policies.

72 Implementation of these projects will help better integrate public research organizations into the European Research Area and with financing of the EUR72 million "Open Scientific Infrastructural Platforms for Innovative Application in the Economy and Society (O-ZIP)", the largest research institution in Croatia, Rudjer Boskovic Institute, will undergo restructuring and orientation towards economy.

III. WORLD BANK GROUP PERFORMANCE

The performance of the WBG in designing and implementing the CPS program is rated as *Good*. The program was well aligned to country objectives, remained relevant by addressing main development challenges and was flexible. The design incorporated critical considerations for a new Member State, in terms of the EU's fiscal and other policy issues, the major increase of EU funds allocations and the need to engage in capacity building to strengthen institutions. The CPS program delivered the planned financial operations, except for the new policy lending operation, still envisaged at the time of the PLR which did not materialize. The risk of reform slowdown was anticipated, albeit the EU monitoring framework was not a sufficient mitigation tool to protect from reform reversals, including in the health and social sectors. The Bank's program remained flexible and able to promptly respond to the government's request to assist with the *Spending review*[73] required under the CSR and support the most critical issues under the NRP TA to underpin the government policy coordination under the European Semester. Most importantly, the WBG was able to respond to the imminent urgency related to unsustainable debt level of the roads public companies and mobilized resources under the *Roads project* for urgent debt refinancing. Finally, WBG closely worked with the EC to make sure the program would be fully aligned with EU policies and goals.

DESIGN

The CPS focus on addressing fiscal consolidation was justified by the country's prolonged recession. The chosen instrument was appropriate to achieve short-term and medium-term measures. The financing provided by ERDPL2 was modest, amounting to only 2 percent of the overall financing needs of the economy in 2014.[74] In 2014, Croatia had external reserves of about $12 billion amounting to about 8 months of imports. Throughout the recession, Croatia retained access to the commercial borrowing (albeit at much higher cost), and the real value of the operation was not only in terms of the financing, but in the accompanying rigorous analysis and policy advice. The project was recognized as a signal of commitment to structural policies when Croatia presented its reform efforts to the IMF, EU and approached the market for commercial loans and bonds. In 2017, the Bank sought to pursue a DPL with the current administration, but the fragile majority and Agrokor crisis were not conducive to support major multi-sector reform efforts. However, a preliminary set of policy measures discussed has informed the Government's 2017 NRP, adopted by the Commission And some are now being implemented.

There was a strong complementarity of interventions under the WBG financing, analytical and advisory programs. In the social sectors, *ERDPL2* was addressing the policy issues, planned to be taken further by the *Health PforR* and *Social Protection project* – contributing to the fiscal adjustment pillar. The *Macro-fiscal dialogue* (FY17) addressed issues in the labor market duality informing the government how to prevent further labor market segmentation (per CSR), whereas the *Social Protection project* included a component to strengthen the effectiveness and reach of active market policy measures by supporting the administrative capacity of the public employment services. The guarantee used in the *roads operation* made a positive impact, even without being drawn, as it was an important signal to the creditors and helped the government to improve the financial sustainability and performance of the road sector, contributing to the

73 Carried out following the Country Specific Recommendations, under the Miscellaneous Reimbursable Arrangement.

74 Total financing requirements include current account deficit, principle repayments and a provision for increase in official reserves.

competitiveness pillar. In other areas, the Bank has combined well various instruments, supporting regulatory and business environment and broad competitiveness agenda through *ERDPL2*, various Bank-funded analytical work (e.g. *DB Reform Memorandum, FY15*), the support funded by the EU's SRSS for reforms of buisenss regulations, and specific areas such as judiciary through investments under the *Justice project and Land Administration project*. Interventions of IBRD and IFC providing support to the companies were timely and well targeted measures in the context of the crisis and the need to preserve competitiveness.

The CPS program envisaged advisory services and analytics to inform the reform and Program implementation, that should be increasingly financed under reimbursable basis. Although this shift did not fully materialize, what the ASA program delivered was relevant and complementary. The NRP TA, *Regular Economic Report* (RER), the *Macro-structural dialogue* and the analytical pieces[75] prepared under *ERDPL2*, were effectively supporting the lending program, while also providing strategic policy advice. This work included pressing issues related to labor market duality,[76] relevant for the country's human capital, whereas the RER focused on Services Directive resulted in Government's commitment to tackle the occupation regulation reform, later financed through a Trust Fund support by the EU's Structural Reform Support Services. The two IFC advisory activities were complementing the investments, such as that related to the Croatia Airlines privatization. The other IFC advisory activity helped develop the corporate governance manual for Zagreb Stock Exchange, which contributed to supporting competitive local companies to expand in the region. With the financing program frontloaded during the first part of the CPS, the RAS pipeline was building up slowly. Partly because the EU funds became available belatedly,[77] and partly due to limited understading by the conterparts of the benefits of accessing EU funds for financing the RAS program. It took time for the counterpart institutions, accustomed to the Bank's traditional role as financier, to adopt a new engagement model. However, the three RAS agreements worth EUR5.7 million in total, signed between May 2015 and April 2016, created the foundations to further expand the RAS engagement.

The results matrix included objectives highly relevant for the country challenges, albeit some weaknesses persist. There was a mix of objectives that were set beyond the project outcomes, with quantitative indicators to the extent possible, and reflecting interventions of IBRD and IFC. Problems with tracking were encountered though and some revisions were made at PLR to adjust to changes in interventions; however, some data are still difficult to quantify – because the counterpart institutions have changed methodology or policy and are no longer tracking the same indicators.[78]

75 This work covered expenditure-based consolidation and investment climates, including among other 2014 Public Finance Review, EU *Regular Economic Report* and specific policy notes.

76 Analysis indicated that a high share of temporary employment among youth and highly educated professionals (15 percent) adversely affect the productivity growth and may be harmful for skill utilization. Almost 50 percent of university educated young workers (aged 20-29) have temporary contracts, which is a worrisome pattern in the context of increasing outmigration.

77 Application of EU Procurement Directives and availability of EU funds determined the use of RAS instrument. The first RAS for *Higher Education Finance Reform*, signed in May 2015, was financed from EU perspective 2007-13, under the former EU Procurement Directive. The EU funds 2014-17, under the Operational Program Competitiveness and Cohesion (OPCC), became available in 2015; however, there was no clarity on the application of the EU Procurement Directive until early 2016. Once this was resolved, the other two RAS Agreements were promptly signed in April 2016 because these were in preparation since 2014.

78 For instance, there are several tax gap methodologies, but the trend could not be established, or the baseline is missing.

Close cooperation with the EC and alignment with the country's EU policies was maintained during the CPS program. It ranged through all financing instruments - from *ERDPL2* built upon the Government's National Reform Program, through investment projects, with explicit development objectives linked to the EU agenda, to results-based disbursement instruments in the sectors directly specified in the CSRs. The knowledge partnership envisaged cooperation in advisory services and analytics, with close links to the country's Partnership Agreement and Operational Programs. The Bank closely coordinated with the SRSS on a series of small but highly valued operations in the business environment area, including trough Subnational Doing Bussiness activity for several EU member states (FY19). One of the topics with strong strong convergence relates business environment and poverty where the cooperation resulted in a poverty maps analysis carried out by the Bank for several EU Member States.[79] In Croatia, this led to a tailor-made RAS *Spatial Analysis of Policies and Poverty*, which became strategic for addressing the lagging regions, due to its analysis of small areas and corroboration of effectiveness of social protection policies in the context of prolonged crisis. It led to a government request for engaging the Bank in tackling the complex issues of the Slavonia region. It can represent knowledge spillover in other countries given the innovation of the policy analysis and methodology of the Index of Multiple Deprivation.[80]

Safeguards and fiduciary aspects of the program were satisfactory. Environmental safeguards performance was satisfactory. The program included categories A, B, Fi and C, and regular trainings were organized to strengthen capacity of project implementation units to build capacity for implementation of projects and corresponding reporting. There were no major environmental non-compliances during the CPS period. Social safeguard performance was satisfactory. The Bank's Operational Policy (OP) 4.12 on Involuntary Resettlement was not triggered as the nature of the projects required no land acquisition. The projects did not support any activities which might have caused involuntary taking of land or any kind of physical or economic displacement. The fiduciary requirements complied, with audit reports submitted and disclosed in line with Bank policies. The novelty of introducing the single treasury account, at the Government's initiative, was implemented without major disruptions. The fiduciary reporting continued to rely on country systems.

The WBG was actively seeking to restructure underperforming projects; however, this has not proven possible in operations with strong institutional reform components. The Bank has been systematically addressing the underperformance of the portfolio through restructuring and cancellations, raised in annual joint portfolio reviews with the Ministry of Finance and in regular reviews. The proactivity proved successful for many projects, including under the challenging *Health PforR*. However, several projects closed with unsatisfactory rating, which reflects institutional and governance issues. Projects with major institutional and system reforms require systemic stakeholder assessments to help overcome disruptions at times of political changes. This is essential for complex projects such as the *Revenue Administration project* and *Social Protection project*.[81] The first struggled with internal institutional reforms but did not manage to internalize the change management approach and the other faced a major policy shift - as the consol-

79 This activity was financed through the Part II Europe 2020 Programmatic TF facility.

80 The index of multiple deprivation consists of 30 indicators spanning over a range of services and indicators that can point the policy makers towards tailor-made interventions of targeted deprived areas and alleviating poverty.

81 *For Social Protection*, project restructuring modalities were discussed with the Government sworn in January 2016, and very intensively with the Government endorsed in October 2016, including at 2017 Joint Portfolio Review, with a Government Conclusion adopted in April 2017 mandating the line Ministry to prepare the restructuring package.

idation of social protection benefits was to ensure a more fair and transparent system but would jeopardize the traditional approach of categorical benefits.[82] A lesson noted in the ICR and the ICRR for the *Social Protection* project highlights that operations with strong reform components should be based on changes initiated before the start of project implementation, to avoid the risk of reform reversal after political changes

The WBG was using lessons learned in responding to changing circumstances. Under the *Roads operation*, the Bank has successfully used the Sector Policy Letter (SPL) to anchor the challenging operational restructuring of the public roads companies. The same approach has been launched for the restructuring of the public railway companies under the ongoing *Railways project*. In addition, a *Railways Policy update (FY18)* was prepared to inform the Government and the companies in the preparation of the SPL and ensure the high-level endorsement for the implementation of the restructuring plans. Under the *Venture Capital project*, although the operation was cancelled,[83] the Bank supported the authorities to address the existing regulatory constraints related to tax regime by carrying out a detailed assessment of the venture capital taxation regime in Croatia and reviewing the Alternative Investment Funds Act for its compliance with EU Directive.[84] This work contributed to the Government's alignment of the legislation with the Directive in January 2018,[85] which has opened the way to establishing the venture capital funds in Croatia that is tax transparent and conducive to investors.

IFC's program focused on financing projects that were faced with challenging structuring issues, mainly in power and transport. These were project which were first of its kind on the market and IFC played a key role in closing the financing gap with financing instruments which were not available through other banks. IFC also played a catalysts role by supporting financing institutions in underserved sectors, such as MSME and agribusiness and by mobilizing financing in cases where the risk perception was high for other financiers. IFC also introduced some innovative financing, such as mezzanine financing, to the market to overcome discrepancies between the tenure of the contracts and the financing. IFC also continued to support market leaders in their efforts to expand into other markets where IFC's market presence and knowledge played a key role.

During the CPS period, MIGA has had no active guarantees in Croatia. The lack of demand for both political risk insurance and credit enhancement guarantees reflects a variety of factors, including a broadly favorable perception by foreign investors of Croatia's political and credit risks.

The CPS program continued to include operations that are gender-informed. Projects that include financing components to beneficiaries monitor the gender indicator, such as *STP2* and *EFIL*. Under *ILAS*, the Joint Information System provides an opportunity to follow gender information for property registration. The Venture *Capital project* also envisaged to monitor the gender indicator. The WBG program did not envisage operations where targeting gender-related objectives would be applicable in Croatia. With respect to the *Social Protection project*, the government did not see the need to have specific gender-related targets; hence the project envisaged collecting and monitoring gender-disaggregated data related to deinstitutionalization activity.[86]

82 This remains relevant and in line with the 2014 CSR seeking improved effectiveness and transparency of the system through benefits consolidation, unified eligibility criteria and linking data from all levels and government entities in the One-stop-shop.

83 Note on Cancelled Operations approved July 2018. Croatia has not fully transposed the EU Directive, so the envisaged VC fund would be subject to taxation, which was considered suboptimal.

84 EU Directive 2011/61/EU on Alternative Investment Fund Managers.

85 Official Gazette NN 21/18.

86 For children deprived of parental care and adults and children with development disabilities who would be de-institutionalized and provided with family-type living arrangements.

. **The WBG program continues to ensure that citizen engagement improves the relevance and impact of Bank financed activity**. Lending operations approved in the CPF period have taken forward the citizen engagement corporate requirement and projects now require feedback from users during implementation and upon completion – to enhance lessons. In the past, the quality of citizen engagement mechanisms incorporated in projects was low compared to ECA countries. Since FY17, projects have more actively engaged beneficiaries, including under Trust Funded operations. The *Integrated Land Administration System Project* conducted several customer satisfaction surveys in which customers expressed high satisfaction with land administration services. Under RAS *Competitiveness Clusters Initiative*, the methodology included interviews with firms to obtain feedback on effectiveness of the public administration and business regulatory framework and the information informed the RAS recommendations. The *RAS for Spatial Analysis of Poverty and Policies* adopted a satisfaction survey in five Slavonia counties to obtain feedback on user perception of service delivery, based on the European quality of governance index (EQI), which assesses quality, impartiality and corruption in three basic services: education, health and law enforcement. The survey raised awareness of policy makers as to how citizens perceive the weak state of public service provision. The *Second Science and Technology Project* envisages an impact evaluation that will include all final beneficiaries of R&D programs and provides an opportunity to provide in-depth feedback.

The WBG institutions worked together and the IFC was well integrated into the results framework. There has been good cooperation among the institutions, which was at the beginning facilitated by WB-IFC Joint Business Plan (September 2014). The institutions worked well around renewable energy where there was a good coordination from the regulatory and investments side. IFC was undertaking a regional analysis to assess the potential for privatization of DH companies, including Croatia, working on a review of the regulatory framework from the private sector perspective, collecting technical and financial data for district heating (DH) companies, and interviewing DH companies and other stakeholders. Joint missions of IFC and IBRD took place in 2014 as part of this work. IBRD-informed feed-in-tariffs system legislation was the prerequisite for IFC windfarm investments. Also, in transport, both institutions exchanged notes and rationale for private sector involvement in the various transport areas. IFC and IBRD also worked together on regulations pertaining to financial institutions and new financial products. Complementary financial intermediation support also included support to individual HBOR clients under EFIL, which were able to benefit from IFC's trade finance program guaranteeing trade-related payment obligations. However, more could be done about collaboration to set the stage for the next CPF including opportunity for MFD. This could include an enhanced coordination and work to improve the regulatory environment in select sectors.

IV. ALIGNMENT WITH CORPORATE GOALS

The CPS was aligned with corporate goals, notably supporting shared prosperity. Preservation of jobs at the onset of the crisis and protracted recession was supported through *EFIL* and *IFC* interventions. About 60 percent of the exporters created additional employment while 7 percent of the firms kept their initial level of employment. *ERDPL2* supported measures to improve the targeting of social benefits program to the most vulnerable; whereas the *NRP TA* prepared simulations of means-testing of the child allowance program that could strengthen effectiveness of social benefits program and improve its coverage.[87] *Energy vulnerability note* provided options to tailor policy responses for vulnerable households to cope with price increase reaching the poor with means-tested social assistance. *Distributional Impact of Fiscal Policy* confirmed that Croatian direct tax and transfer system is redistributive, with progressive and inequality-reducing direct taxes and transfers, in line with other European countries. The 2017 tax reform was found to make both direct and indirect taxes more progressive in 2017 compared to 2014, albeit with most of the tax relief accrued to the top of the income distribution. However, the impact of lower VAT on electricity and utility bills is expected to reduce poverty.

The CPS program delivered *RAS Spatial Analysis of Poverty and Policies*, providing data on the disparities across the country. This work has produced detailed geo-referenced database with estimates of poverty data at the level of counties, cities and municipalities.[88] The poverty profiles analysis and the Index of Multiple Deprivation for small areas have been used by the Ministry of Regional Development and EU Funds to select eight cities with distinct deprivation profiles to create new Integrated Physical, Economic and Social Regeneration Program,[89] which will be financed from EU funds 2014-20. The work is also used to propose new NUTS2 statistical regions to the EC, which would allow better regional development policy and EU funds distribution to most vulnerable regions. This evidence has helped the Government to focus on lagging regions, which informed the engagement area of the new CPF on supporting the Slavonia region.

V. LESSONS LEARNED

Croatia values the WBG as a strategic partner, particularly in complex areas where it can bring global knowledge and experience to bear. The Bank program has evolved since CPS approval in FY14, including a very recent increase in reimbursable advisory services, and a general downward trend in terms of approval of lending operations. It has also evolved to concentrate in areas of long term engagement where development challenges are complex, and outcomes take time to materialize, but where the WBG program has a comparative advantage to bring a positive development impact. This work includes, for instance, the land administration, where the Bank and the Government has recently launched the third-generation project, and which has leveraged funds from EU IPA and ESIF. The SOEs restructuring is an example of a complex area where the Bank can provide its value proposition as in the case of the *Modernization and Restructuring of the Road Sector loan and guarantee*, which has helped the government to restructure over 60 percent of the debt. This is also an example of Maximizing Finance for Development

87 The assessment of this program suggests that around half of the program gets allocated to the two richest quintiles of the population. At the same time, only 10 percent of the 3.8 percent of GDP that the government currently spends on social benefit programs is subject to means-testing targeting procedures.

88 The database and all reports with finding have been made publicly available at the Ministry's website. https://razvoj.gov.hr/UserDocsImages/3585

89 Eight cities selected are predominantly in Slavonia - Pleternica, Nova Gradiska, Slatina, Garesnica, Novska, Dakovo and Popovaca – except Imotski https://strukturnifondovi.hr/wp-content/uploads/2018/11/Odluka-18.07.2018.pdf

(MFD), whereby the World Bank used EUR22 million of its balance sheet to solve a EUR5.2 billion problem by focusing on sectoral reforms to put the companies on a financially sustainable path.

Keep a focus on results but be flexible on the use of instruments. The implementation of the CPS has demonstrated that the WBG can deliver results through a variety of lending and advisory services, having included policy lending, results-based financing, traditional investment loans and guarantees, and its advisory instruments. A significant growth in its RAS program, towards multi-year engagements that help build capacity, spurred in FY2018. The proposed CPF should learn from implementation challenges to design and combine RAS and lending best suited to addressing institutional weaknesses and providing implementation support.

The WBG is providing implementation support that could help with efficient management of EC resources in the post 2020 programming period. The CPS was closely aligned with Croatia's efforts to implement the EU Cohesion policy, with two objectives dedicated to improving the country's capacity to absorb and manage sizable EU funds. This approach should be embedded across all areas of engagement in the new CPF to help position Croatia to use the potential of EC resources and support strategic long-term planning and prioritization for better impact. WBG engagement can provide concrete implementation support, increasingly through RAS-supported TA, in areas where its financing is limited but where it can serve as a catalyst including to leverage other development partners. The ongoing work in Slavonia and the engagement in the agriculture, logistics and innovation sectors is a good example of where the WBG brings a unique value proposition.

It is critical to consider the potential impact of political change on governance and institutional setup in project design. Experience during the implementation of the CPS has demonstrated the resilience of smaller-sized operations in areas of long-standing WBG engagement, or that are embedded in a government-funded program.[90] These operations had development impact and withstood challenges of political volatility by building implementation capacity through models that could be scaled-up or serve as demonstration. For example, under STP2, R&D programs were tested under the previous loan and then brought to scale. In the case of the two judiciary projects, they were scaled-up or upgraded the information systems put in place under previous operations.[91] A lesson embedded in the proposed CPF is to design interventions in areas where the WBG has a tested model that can complement or leverage the activities of other development partners. Sustained WBG engagement can broaden stakeholder support for policy or reforms and help sustain development impact.

The WBG has a role in policy design and process underpinning the reforms in the public sector. A careful consideration is needed in the design of instruments aimed at addressing the reforms in the public sector. Implementation problems encountered under the *Health sector program and the Social protection project*, have been difficult to address without appropriate TA components, which would enable capacity building and an active policy dialogue and continued engagement with all stakeholder groups in the sectors, which are heavy, which might be unsuccessful and/or reluctant to do reforms. This lesson is also confirmed by the client survey (2016). While in 2012, more than half of the participants had seen the Bank's greatest value in financing, in 2016, most of them have seen it in supporting policy formulation.

90 For example, the EU Natura 2000 Integration Project, Second Science and Technology Project (STP2), Land Administration and Justice Sector projects are successful follow up operations.

91 Under Land Administration project it was Joint Information System (developed and piloted under the Real Property Registration and Cadaster), and in the Justice Sector Support it was Integrated Case Management System, designed and piloted under the old Court and Bankruptcy Loan.

For EU member countries, where funds and financing are abundant, even in situations of severe financial distress, IFC's role and additionality play an important part in the success of a project. During the CPS period Croatia was mostly in recession, but it also benefited from the ECB's quantitative easing program. As a result, the market was highly liquid, but projects were not ready for financing. Many financial institutions struggled to deploy their funds, which resulted in a lot of cancelled lines through commercial banks. In such an environment, IFC continued to play a role in projects where: (i) longer term financing which was not available on the market, was essential for the project success; (ii) an alternative financial instrument (i.e. mezzanine) was needed to close the financing gap; (iii) the financial structure was a novelty on the market and financing institutions did not have the know how; (iv) companies expanded outside of their comfort zone, in new markets and they needed IFC's market presence and know-how and (v) IFC support underserved segments of the market (MSME, agri companies, etc.).

CPS Objectives and Indicators	Status and Evaluation Summary
PILLAR I: Fiscal Adjustment through Reforms at the Sector Level	
1. Improving sustainability of revenue enhancing policy as indicated by: – Improved tax gap as a percentage of total GDP *Baseline:* 0.8% (2011) [92] *Target:* 0.9% (2013) *Country Goal: Increasing tax revenues while decreasing fiscal expenditures*	**Mostly Achieved** – *CPS/PLR Indicator - not verified.* CPS used RAMP-specific method to measure tax gap, which could not be monitored after project closed. IOTA methodology, used to validate data as approximation (per RAMP ICR), showed positive trend at PLR, but was not adopted by the Croatian Tax Administration (CTA). – **Alternative indicator: Achieved - VAT Gap estimates** per "Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report", TAXUD/2015/CC/131, with financing of DG Taxation and Customs Union.[2] VAT Gap is defined as the difference between the VAT Total Tax Liability (VTTL), or the estimated tax liability according to the law, and the amount of VAT collected. In the 2014-2016 period VTTL increased by 7 percent mainly on the account of household consumption recovery after a prolonged recession. In the same period, however, the amount of VAT revenues collected rose by close to 9 percent, reflecting among other things measures taken to improve the tax collection. This has resulted in a significant drop in VAT gap, from 3% in 2014 to 1% in 2016. – This decline in the VAT gap is consistent with the RAMP activities completed by CTA in 2016, related to the RAMP-supported Compliance Risk Management System (CRMS). CRMS provides massive data sets allowing the CTA to analyze risk of non-compliance and improve tax revenues.[93] In the process of developing the CRMS, the CTA identified over 400 risks using 30 data sources, including from other government agencies and third-party information, and involved staff across the different CTA functions. CRMS includes automation of risk management in one place; using limited resources to focus on high-risk taxpayers and specific risk areas, classification of taxpayers in risk categories based on their behavior; transparency in selecting taxpayers for audit; and automation of VAT refund processing. CTA is now finalizing the implementing general audit support (GAS), and an integration solution for GAS as part of CRMS that will enable carrying out most of the audit of medium and large taxpayers through the information systems. – ERDPL2 focused on achieving more sustainable fiscal policy by strengthening the role and independence of the Fiscal Board. PFR provided analysis of options for fiscal consolidation, whereas *Spending review* had an impact on the dialogue with respect to Excessive Deficit Procedures (which Croatia exited in June 2017), and laid foundations for future spending review efforts.
2. Improving the targeting of social assistance programs as indicated by: – Means-tested programs as a share of all social assistance programs increased *Baseline:* 16% (2012) *Target:* 20% (2017) *Country Goal: Ensuring sustainability of social spending*	**Not Achieved** – *Indicator – not achieved.* The share of means-tested social programs in overall central government social spending increased from 16.1 percent in 2012 to 17.1% in 2016. (Source: WBG calculations based on data provided by MoF.) Efforts to consolidate some cash transfer programs and improve targeting have been legislated in a new Social Welfare Law adopted in 2013. The law introduced a new Guaranteed Minimum Benefit (GMB), which consolidated four different social assistance benefits (the social allowance program, the extended unemployment benefit, the homeland war veterans' benefit and the disabled World War II support allowance) and applied means-testing with changed equivalence scale to protect the most vulnerable (single elderly and single parents). In November 2017, the new law on homeland war veterans introduced policy changes and new war veteran benefits that are no longer part of the social protection system.

92 New Source: IOTA data introduced per ICR for Revenue Administration Modernization Project (reference PLR)

[2] Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report https://ec.europa.eu/taxation_customs/sites/taxation/files/2018_vat_gap_report_en.pdf

93 Strategy of Croatian Tax Administration for 2016-2020 https://www.porezna-uprava.hr/HR_o_nama/Strategije/Strategija-PorezneUprave2016_2020%20FINALNO.pdf

Instruments and Partner	Lessons Learned
Lending - Closed – Economic Recovery DPL 2 (ERDPL 2) (FY15); ICR: MS – Revenue Administration Modernization Project (RAMP) (FY15); ICR: MU **Additional lending - ongoing** – Modernization and Restructuring of the Road Sector Project (FY17); ISR: S/MS **ASA/RAS** – Macro-Fiscal Structural Dialogue (FY16) – Regular Economic Report (programmatic FY14-17) – Spending Review TA (FY15) **Activities not materialized** – DPL (dropped) – Debt Advisory **Partners** – EC Macro-Monitoring – IMF Article IV	– This objective was highly relevant for Croatia's recession context, albeit it was risky to rely on a complex tax administration project with a history of implementation problems to achieve it. Still, an anticipation that CRMS will transform the business model of the CTA was realistic given its design was carefully crafted, as it indeed turned out. The Bank's convening power that brought around the best practices through involving the IMF experts and Irish Tax Administration was acknowledged in Borrower's ICR. – Indicators designed under operations per special methodology and which are not standard sector indicators are not practical to track CPS objectives as these might not be internalized by implementing agencies beyond projects.
Lending - Closed – ERDPL2 (FY15); ICR: MS – Social Protection System Modernization Project (FY18); ICR: U *ASA/RAS* – Activation TA (reg. FY14) – Public Finance Review (PFR) (FY14) – National Reform Program (NRP) TA (FY14) – Spending Review TA (FY15) – Regular Economic Report (programmatic FY14-17) – Distributional Impact of Fiscal Policy (FY17) – RAS Spatial Analysis of Poverty and Policies (FY18)	– Achieving this objective would have required a government commitment to move away from predominantly categorical benefits and establishing an elaborate system to support means-tested programs. None of the three administrations resolved to challenge the current situation. Such system would also require strong, transparent and impartial institutions, which would require changes in governance and a change management component.

CPS Objectives and Indicators	Status and Evaluation Summary
	– Bank support has been through *ERDPL2* and *Social Protection System Modernization Project*. *ERDPL2* contributed to reduction of social benefit spending by supporting the introduction of a management information system for social welfare and targeting social benefits using means-testing. Although below the expected outcome, real expenditure fell 0.8 percent at the end of *ERDPL2*. – *PFR* (social assistance chapter), *NRP TA* and *ERDPL2* were analyzing and supporting parametric reforms that aim to increase the share of social protection programs that are means-tested. *Social Protection project* would have expanded the impact of the parametric reforms, such as through introduction of the OSS - helping prevent erroneous claims. A simulation of the introduction of means-tests for the child allowance program indicated a possible reduction of beneficiaries by 17 percent, and about half of these savings would be due to improved program compliance. Although key reform has been legislated (2013), the implementation was put on hold when OSS was first postponed in 2015. The project did not get traction in 2016, and the subsequent government decided in 2017 to close the project and cancel the funds.
3. Introducing cost rationalization and efficiency measures in the health sector as indicated by:[94] – Total public accrual health spending reduced by .5 percent of GDP between 2012 and 2017 *Baseline: 7.6% (2012)* *Target: 7.1% (2017)* – Further rationalization and reorganization of hospital system - reduction in the total number of acute care beds by 20 percent *Baseline: 15,930 (2012)* *Target: 12,800 (2017)* *Country Goal: Improving efficiency of the health system*	**Achieved** – *Public Accrual Indicator – achieved.* Public accrual spending is at 6.6 percent in 2016 (at 6.9 percent in 2014), reduced by 1.0 percent, surpassing the target. (Source: WBG calculations based on data provided by MoF.) *ERDPL2* contributed to this by rationalizing health expenditures through national implementation of e-prescriptions (bylaw on Criteria for Distribution of Pharmaceuticals and Prescription Issuance), standardized medical technology and orthopedic devices (enactment of the Criteria for Inclusion of Orthopedic and Other Medical Devices on the List of Supplies of the Croatian Health Insurance Fund – HZZO) and centralized procurement (Ministry of Health's Decisions on the Mandatory Implementation of Central Procurement by Public Institutions). – PFR made recommendations for health spending efficiency, among which some have been taken up (consolidate service network and merge facilities – ongoing through hospital reshaping, in NRP), expand e-health systems, enforce clinical guidelines), which led to Government's request for Bank's support in Spending review (SR), which included health sector as one of five critical areas. The Bank helped with methodology and was guiding the SR working groups. Although the immediate impact of SR was limited, this has paved the foundations for the fiscal policies the MoF has progressively been implementing in the following three years, with positive results emerging as of 2017. – Under Health PforR, several achieved DLIs supported cost rationalization and efficiency, such as DLI 4 with increased number of surgeries included in the elective surgeries list performed as outpatient surgeries; and DLI 9 with increased number of primary health care doctors working in group practices providing broader care services and reducing secondary care referrals. – *Acute Care Beds indicator - Achieved.* The total number of acute care beds was reduced by 23 percent from 15,930 (2012) to 12,161 (February 2017), surpassing the target, under Health PforR. (Source: ISR, Implementation Support Documents.)

94 The objective reworded to add efficiency measure (reference PLR). Original indicator on hospital rationalization was not tracked so it was replaced with Program for Results DLI on acute care beds reduction. The baseline number for accrual health spending has been revised to align fully with an accrual method accounting.

	Instruments and Partner	Lessons Learned
	Activities not materialized – DPL (dropped) **Partners:** – EC	– This objective was supported under the previous CPS where implementation was only partially successful, clearly pointing that a different engagement approach is needed.
	Lending - Ongoing – Improving Quality and Efficiency of Health Services PforR (FY14); ISR: MS/MS **Lending - Closed** – ERDPL2 (FY15); ICR: MS – Development of Emergency Medical Services and Investment Planning (FY14); ICR: S **ASA/RAS** – Public Finance Review (FY14) – Spending Review TA (FY15) – Regular Economic Report (programmatic FY14-17) – Health Sector Arrears Study (regional; FY18) – Strengthening Integrated Care (regional; delivery due FY18) **Activities not materialized** – DPL (dropped) **Partners:** – EC – CEB	– Health PforR envisaged to contribute to clearing hospital arrears, which would directly support this objective. However, this has proven overly challenging to address through a DLI mode of operation, and in the absence of strong reform preconditions, consisting of Government policy orientation and experienced team of policy makers. This points to the need of envisaging support for capacity building and TA engagement.

CPS Objectives and Indicators	Status and Evaluation Summary
4. Contributing to the coherence and implementation of strategic plans in railway and energy sectors, and improvements in airport infrastructure as indicated by:[95] – Implementation of restructuring plans for railway sector companies and medium-term strategy for the rail sector consistent with the EU 2014-20 funding period – Implementation of Croatia Energy Strategy 2009-20 related to the renewable energy and district heating – Accommodate existing and future air traffic[96] *Baseline:* – Revised restructuring plans of railway companies – Energy Strategy in place (2012) – 0.44 million unique users in 2013 *Target:* – Railway Modal Strategy 2014-2020 and medium-term contracts in place for Passenger Services and Infrastructure Management consistent with the strategy – Action plan adopted for feed-in tariffs for renewable energy resources and for improving the efficiency of the district heating sector – 0.60 million unique users in 2017 *Country Goal: Enhancing the capacity of public enterprises, in railway and energy sectors, to enable faster convergence towards operational and financial performance of EU 27 countries*	**Achieved** – *Railway Indicator - Achieved.* Transport Development Strategy (TDS) 2017-2030 has been adopted in 2017 and approved by the EC as part of ex-ante conditionality for the use of EU funds. TDS assesses and defines future measures (infrastructure, operation and organization) in the transport sector, for all transport segments. The medium-term contracts for Pubic Services Obligation (PSO) in HZ Passenger (HZP) consistent with the strategy were in place since 2017. These interim/annual contracts defined more detailed annual operational plans, including the national budget components for EU funds projects, to further improve service delivery and monitoring, and were required under the Budget Law in October 2017. This work is supported under the Bank-funded Railways project, including modifications that led to signing of a multi-annual PSO contract for 2019-2028,[97] fully aligned with EU Directives and enforcing appropriate methodologies for calculation of the cost on each section and calculation of HZPP revenues, and enabling long-term planning of passenger transport and investment. The medium-term contract for Infrastructure Management consistent with the strategy is in place and a second phase multiannual contract is in preparation, as supported by SUCRE. – *Energy Indicator – Achieved.* Action plan adopted for feed-in tariffs for renewable energy resources and for improving the efficiency of the district heating (DH) sector. The feed-in tariff (FIT) system for RER and DH was adopted in 2013, with amendments in 2014 and 2015.[98] The Bank contributed by reviewing the methodology for feed-in tariffs, especially for district heating sector, and provided recommendation to HERA – Croatian Energy Regulating Agency, some of which accepted and adopted in the new tariff system, notably for the DH. The recommendations included a methodology of establishing prices for DH – to be market-oriented rather than government influenced, and such FIT system led to over 500 megawatts of new wind farms in Croatia. Government pursued this objective on its own and the FIT has now been replaced by the new tariff methodology, which will further liberalize the electricity market. – *IFC Indicator – Mostly Achieved.* The number of passengers in 2017 reached 3.1 million, meaning that there were 0.59 million unique users in 2017, slightly falling short of target. IFC financing for Zagreb Airport expansion and modernization has been complex to launch, but it is on target and expected to reach in 2018 0.66 million unique users (or 3.45 million passengers) based on the increase in the number of passengers in 2017[99] and the first two months of 2018 by 11 percent.

95 Moved to Pillar I (reference PLR)

96 IFC added new indicator - unique users supported (reference PLR)

97 http://www.hzpp.hr/potpisan-10-godisnji-pso?p=578&r=294&mp=294

98 https://narodne-novine.nn.hr/clanci/sluzbeni/2015_09_100_1937.html; https://narodne-novine.nn.hr/clanci/sluzbeni/2013_10_128_2778.html

99 Zagreb Airport website: http://www.zagreb-airport.hr/poslovni/b2b-223/statistika/statistika-za-2017-godinu/381

Instruments and Partner	Lessons Learned
IBRD Lending - Ongoing – Sustainable Railways in Europe Project (FY15); ISR: MU **IFC financing – Ongoing** – Financing for Zagreb Airport expansion and modernization (loan, equity) **ASA/RAS** – Railway Policy Note (FY13) – Croatia Energy Sector Review (FY14) – EU Preparedness TA (FY15) – Energy Affordability (FY15) – Spending Review TA (FY15) – IFC Advisory on Croatian Airline Privatization **Activities not materialized:** – TA for Public Enterprise Reform (dropped) **Partners:** – EBRD – EC	– Building the momentum for railways restructuring remains as challenging as back in 2005 (earlier Railway project), as evident in delays, and requires concerted approach. This is now pursued though developing the Sector Policy Letter, envisaged to be adopted by the government and supported by Bank's TA engagement (ongoing Railways Policy Note initiated in 2017). – The Bank's engagement in helping design the feed-in-tariffs was modest in its scope but it helped the government step up the agenda of energy efficiency and renewable energy resources, and ultimately led to installment of greater capacity in wind farm, which in turn resulted in Government's commitment to advance the tariffs methodology into a market-oriented system in 2018. IBRD and IFC efficiently worked on this topic, which remains highly relevant as set in the European Council's 2030 Framework for Climate and Energy.

CPS Objectives and Indicators	Status and Evaluation Summary
PILLAR II: Innovation and Trade Competitiveness for growth and Shared Prosperity	
5. Improving efficiency and reducing arrears in the judicial system as indicated by: – Case backlog in judiciary decreased *Baseline: 437,892 (2012)*[100] *Target: 394,103 (2017)* *Country Goal: Strengthening the effectiveness of judiciary as to promote enabling environment for doing business*	**Achieved** – *Indicator – Achieved.* As of April, 2016,[101] there are 349,051 backlogged cases in the courts monitored under the *Justice Sector Support Project (JSSP)*. This is a reduction by 20 percent, down from 437,892 in 2010. This represents a continued reduction in backlog because of interventions supported under JSSP, notably the Integrated Case Management System (ICMS), which has been rolled out in all courts except the misdemeanor courts (which have a different system). A complementary indicator reflecting the efficiency of judiciary, the clearance rate, continues to show the trend of handling inflow of cases and backlog reduction. The clearance rate indicator for civil and commercial court cases per 2018 CEPEJ Report improved to 148% (2016) compared to 123% (2014). – The Integrated Land Administration System (ILAS) project has made additional contributions by reducing times to registering property and reducing corresponding backlogs. Average mortgage and registration times in Land Registration Offices (LROs) have decreased from 46 days to 12.7 days, and in Cadaster Offices (COs) from 30 to 8 days, which improved Croatia's Doing Business rank in the ease of registering properties from 111 to 59. Various e-services have been introduced in 2017 and the percentage of requests lodged online has increased to 5.2 percent. 28 ministries and government agencies are sharing spatial data with the State Geodetic Administration and MoJ and the implementing agencies have maintained customers' satisfaction above 4.5.
6. Contributing to diversity and security of energy supply by financing energy efficiency and renewable energy projects as indicated by: – Additional renewable energy generation capacity installed[103] *Target:* 108 MW (2017) – GHG emission avoided per year *Target:* 75,000 tCO2 equivalent (2017) *Country Goal: Increasing use of renewable sources and promoting energy efficiency – in line with Europe 2020 Strategy*	**Achieved** *Indicator – Achieved.* IFC has been supporting investments in the energy sector, which has increased the renewable energy installed capacity by 107.9 MW and contributed to the reduction of the annual GHG emissions of 78,300 tCO2 equivalent (calculated as per IFC standard methodology and capacity installed). This has helped Croatia diversify and improve security of its energy provision as it becomes less reliant on imports. Data on power market capacity showing renewables capacity to a large extent introduced after IFC investments available at HROTE[104] website: https://www.hrote.hr/izvjestaji This was achieved through three wind power plants: – Sibenik wind power plant (WPP), managed by RP Global Danilo d.o.o. and commissioned in June 2014, has capacity of 43.7 MW, and it is the largest WPP in Croatia producing about 100 gWh yearly, sufficient for about 22,000 households. It reduces Croatia's carbon footprint by 33,300 tons of CO2–equivalent per year; – WPP Jelinak (company Acciona), near Trogir, has capacity of 30 MW, it was commissioned in Sept. 2013 and can produce electricity for about 30,000 households. It provides a reduction in greenhouse gas emissions of approximately 21,000 tons per year; – WPP Rudine (near Slano, Dubrovnik, also by RP Global) has capacity of 34.2 MW, commissioned in April 2016. Its commissioning results in decrease in emission of GHG of 24,000 tCO2 equivalent/year.

100 The baseline and target numbers were not correct and were adjusted to reflect the number in the JSSP ICR document (reference PLR).

101 CLR does not report the result for 2017 given that the methodology applied currently in the Croatian judicial system is not comparable with how this was tracked under the Justice Project. However, the Ministry of Justice reports based on ICMS that there are 22 percent less unresolved cases older than ten years (the length of a case applied in practice in categorizing a case as backlog) in 2017, compared to 2016.

102 The LGAF is a diagnostic instrument to assess the state of land governance at the national or sub-national level.

103 IFC revised the indicators (reference PLR), as well as corresponding baseline and target numbers, because its $75 million project in the PBZ bank, with a focus on renewable energy, was not disbursed.

104 HROTE stands for Croatian Operator of Energy Market.

Instruments and Partner	Lessons Learned
Lending - Ongoing – Integrated Land Administration System Project (FY12); ISR: MS **Lending - Closed** – Justice Sector Support Project (FY16); ICR: S – ERDPL2 (FY15); ICR: MS **ASA/RAS** – Justice Sector Public Expenditure & Institutional Review (FY14) – Croatia: A Chronicle of Selected Justice Reforms (FY14) – Doing Business Reform Memorandum (FY15) – Land Governance Assessment Framework - LGAF (FY16)[102] **Activities not materialized** – TA on Public Administration – DPL (dropped) – RAS Judiciary (created FY16, dropped) **Partners:** – EC – The Netherlands – Norway	– This objective – although set at project outcome – addresses key country's challenge as judiciary is seen as main factor to investment decisions. However, the focus on backlog is overly narrow. Judicial efficiency should go beyond to include reforms that promote transparency, quality and integrity of justice. At a strategy level, a change management aspect would be useful to embed a culture of change and support the transition within the judiciary. – The financing instruments were well aligned; however, the analytical work missed the opportunity to make an impact. A discussion of RAS engagement in 2016 although not materialized has helped with prioritization of projects for EU financing.
IFC Financing - Closed – Financing to support renewable energy projects (wind power plants) **Activities not materialized** – IFC financing for energy efficiency projects through financial intermediaries **Partners:** – EBRD – EC	– In Croatia, the IFC interventions are limited to investment services, which makes the areas for cooperation with the IBRD limited. Another constraint in the past was the reluctance of the governments to open the economy for private sector participation thus making it difficult for joint interventions where typically IFC and IBRD cooperate (e.g. infrastructure). However, this area benefited from joint work and it was appropriate to reflect it in the results matrix given its relevance for the country's goals.

CPS Objectives and Indicators	Status and Evaluation Summary
7. Supporting competitive local companies to expand in the region and increase exports as indicated by: – Level of exports of beneficiary companies *Baseline:* HRK 4.35 billion (2011) *Target:* At least preserve the level of exports (2017) – Number of outstanding MSME loans in the portfolio IFC's client banks[105] *Baseline:* 6,000 (2011) Target: At least preserve the same level (2016) *Country Goal: Improving growth through support to the private sector, primarily SMEs and FDI*	**Mostly Achieved** – *IBRD Indicator – Achieved.* The level of exports of beneficiary firms has increased by 18.9 percent collectively under the support of the Export Finance Intermediation Loan (P116080). Median growth rate was 25 percent. Overall beneficiary exporters increased their exports by Euro 225 million during the project. This is an impressive growth considering 3.3 percent average export growth for Croatia between 2008 and 2015. – *IFC Indicator - Mostly Achieved.* In 2016, IFC reached 5,125 MSME loans through its client bank Société Générale/Splitska banka, under the project signed in 2012. The number was expected to grow; however, due to a change of market conditions and decrease in demand for financing, the client bank decided to cancel the engagement and proceed with prepayment ahead of time. Hence the final number of loans to MSME represent about 85 percent of the set target. (Source: IFC supervision reports.)
PILLAR III: Helping Maximize the Economic Benefits of Becoming an EU Member State	
8. Improving coherence and credibility of national strategic and policy documents needed for the EU funds absorption and management as indicated by: – National strategic and policy documents, including sector specific strategies, needed for the use of EU Funds, adopted by relevant authorities *Baseline:* no documents in place (2012) *Target:* Sector strategies adopted: (i) National Education, Science and Technology Strategy; (ii) National Innovation Strategy; (iii) Research and Innovation Strategy for Smart Specialization; (iv) Policy advice/ recommendations in the areas of irrigation, rural development, transport, SME and water/ environment sector;	Achieved – *Indicator – Achieved.* National Innovation Strategy has been prepared with contribution from *Second Science and Technology Project (STP2)* and adopted December 2014 in line with Europe 2020 Strategy. – Preparation of the National Education, Science and Technology Strategy, an ex-ante-conditionality for EU funds, has been supported under *STP2*, and adopted by the Parliament unanimously in December 2014. Guided by this Strategy, comprehensive curricular reform was prepared by February 2016, which the Government started to pilot in 2018 with EC financial support. – National Research Infrastructure Roadmap was prepared under *STP2* as an input for Smart Specialization Strategy (S3), as part of EU funds requirements; revised per the final version of S3, which the Government adopted in March 2016. Bank supported the S3 under the analytical piece *Smart Specialization*. – Policy advice in the areas of irrigation, rural development, transport, SME and water/environment sector has been provided through *EU Preparedness TA* throughout three years. Peer reviewing also included the Partnership Agreement between the EC and Croatia, and OP Cohesion and Competitiveness – the primary strategic documents for EU funds 2014-20 financial perspective. – National Technical and Economic Study for Management of Wastewater Treatment Sludge addressed a EU requirement and was prepared in 2016 under the *Coastal Cities Pollution Control Project 2*. Inputs prepared for National Waste and Leachate Management Plan under the *GEF Adriatic project* to meet requirements under the EU waste management Directive.

105 FC added new indicator (reference PLR)

106 Road to Europe Program of Accounting Reforms and Institutional Strengthening

107 Croatia became a EU member in July 2013 and needed to program Structural Funds for the last six months of the perspective 2007-13 and a seven-year perspective 2014-20, while finishing the implementation of the EU pre-accession funds, operated under different procedures.

	Instruments and Partner	Lessons Learned
	IBRD Financing - Ongoing – Croatia Export Financing Guarantee Project (FY13); ISR: MU **IFC Financing – Closed** – IFC financing to export oriented companies, SMEs, private sector infrastructure investments, FDIs and regional initiatives – IFC Investments in agribusiness and retail companies (Atlantic group, Lidl Croatia, CIOS) – IFC investments in financial intermediaries for on-lending to SMEs (Société Générale Croatia) **IBRD Financing - Closed** – Export Finance Intermediation Loan (FY17); ICR: S **ASA/RAS** – REPARIS[106] **Partners:** – EIB – CEB – KfW	– Support to the private sector to improve growth prospects was means to respond to country's recession context and market conditions. With the crisis leaving many people jobless, access to favorable medium-term finance enabled most of the companies to preserve the current workforce and create new jobs.
	Lending – Ongoing – Integrated Land Administration System Project (FY12); ISR: MS/MS – Science and Technology 2 (FY13); ISR: S/S – Sustainable Railways in Europe Project (FY15); ISR: MS/MU – Modernization and Restructuring of the Road Sector Project (FY17); ISR: S/MS – GEF Regional Adriatic Sea Environmental Pollution Control Project (FY15); ISR: MU/MU **Lending - Closed** – Justice Sector Support Project (FY16); ICR: S – EU Natura 2000 Integration (FY17); ICR: S – Coastal Cities Pollution Control Project 2 (FY16); ICR: S **ASA/RAS** – EU Preparedness TA (FY – Public Finance Review (FY14) – National Reform Program TA (FY14) – Smart Specialization (FY15) – RAS Spatial Analysis of Poverty and Policies (FY18) **Activities not materialized:** – EU Water sector compliance Project (dropped) **Partners: EC**	– The context of the first full programming period for Croatia, a ten-fold increase in funding compared to pre-accession funds, parallel programming for two periods and political volatility between 2015-17, could be characterized as transitional. With more than 150 strategies that Croatia prepared and weak administrative capacity, the Bank interventions that include implementation support, analysis and advisory work have proven strategic to ensure coherence among various policy documents in the sector with large EU funds allocations, such as transport, water and environment and R&D. This work has helped achieve ex-ante conditionalities and give the credibility to NRPs, which met the EC approval.

CPS Objectives and Indicators	Status and Evaluation Summary
(v) National Technical and Economic Study for Management of Wastewater Treatment Sludge (2017) *Country Goal: Preparing National Reform Program for effective use of EU Funds*	
9. Contributing to Croatia's readiness and capacity to build the project pipeline for absorbing EU Funds in selected sectors as indicated by: – Number and value of project applications prepared and/or submitted for financing from EU Funds in research and innovation and nature protection *Baseline:* no project proposals (2012) *Target:* (i) At least 6 project applications for financing in research, development and innovation sector, for the total value of projects amounting to EUR 50 million; (ii) At least 25 project applications for financing in the nature protection sector, for the total value of projects amounting to EUR 50 million (2017) *Country Goal: Strengthening capacity of public sector for the absorption of EU Structural Funds*	**Achieved** – *Indicator – Achieved.* WBG has supported administrative and technical capacity building of public sector institutions and the preparation of applications for absorption of EU funds estimated at over EUR 700 million. This contributed to improved capacity of project beneficiaries and stakeholders in public investment management, project management and monitoring and evaluation methodologies, mandatory for management of EU funds. – Under the *Second Science and Technology Project (STP2),* 6 project applications with technical documentations were prepared estimated to around EUR180 million. Of these, 5 are in the implementation and/or procurement stage for EU financing. The largest project, EUR72 million O-Zip[108] project is undergoing review by Jaspers.[109] – Under *EU Natura 2000 Integration Project* the target is far exceeded by preparing project proposals worth over EUR213 million for 32 projects. All the proposals have been approved for financing under the OPCC 2014-20 and are in various implementation stages.[110] – Under *Coastal Cities 2 Project*, technical design for five projects were prepared for around EUR 230 million for Pula, Opatija, Dugi Rat, Metkovic and Dubrovnik. These projects cover larger agglomerations requiring detailed environmental studies, often needing changes of physical plans, and other complex documentation[111] as part of project preparation before Jaspers' review and approval. This process is under way for Opatija, Pula, Dugi Rat and Dubrovnik (e.g. environmental study for a EUR78 million Dubrovnik agglomeration finalized in 2018 as a prerequisite for the feasibility study). All documents for EUR48 million Metkovic agglomeration were completed Dec. 2018 and award of EU funds is expected in 2019). – Under *Rijeka Gateway 2 Project*, four EU project applications under EU Connecting Europe Facility worth EUR86 million have been prepared, funds awarded and in implementation.[112] These investments will sustain the outcomes of Bank-funded project through supporting infrastructure and enable concessioning the Zagreb Container Terminal built under *Rijeka Gateway 2*. – Under the *Justice Sector Support Project*, the Bank supported the preparation of two project applications for EUR 11 million, which have already been implemented.

108 "Open Scientific Infrastructural Platforms for innovative Applications in the Economy and Society (O-ZIP)" – a project of Rudjer Boskovic Institute, the largest research institute in Croatia.

109 Jaspers is a technical assistance partnership between the EC, EIB and EBRD, which provides independent advice to beneficiary countries to help prepare high quality major projects to be co-financed by the ESI Funds. A project proposal must reflect Jaspers' recommendations and Jasper's completion note is a de facto approval of project financing.

110 Data are published at an individual project level. E.g. June 2018 contract signing information about a EUR12 million "Project on Sea Habitat Mapping" https://strukturnifondovi.hr/potpisan-ugovor-o-dodjeli-bespovratnih-sredstava-za-projekt-kartiranje-obalnih-i-pridnenih-morskih-stanista-na-podrucju-jadranskog-mora-pod-nacionalnom-jurisdikcijom/ or July 2017 contract signing on a EUR25 million "Project of Development of the Natura 2000 Ecological Network Management Framework" https://www.mzoip.hr/hr/ministarstvo/vijesti/osigurano-186-milijuna-kuna-za-izradu-planova-upravljanja-natura-2000-podrucjima.html or a EUR10 million "Papuk UNESCO Global Geopark Project" in implementation since October 2017 http://pp-papuk.hr/projekt-geoprice-unesco-geoparka/

111 In additional to technical designs, separate tender documentation and permit issuing, water waste treatment agglomerations require environmental and feasibility studies, cost-benefit analysis to ensure maintenance costs are tenable for municipalities' fiscal capacity, EU application forms, monitoring of quantity and quality of waters and resolution of all land/property issues.

112 Zagreb intermodal yard works: https://www.portauthority.hr/wp-content/uploads/2018/11/EK-letak-Zagreb-Deep-Sea.pdf; Brajdica intermodal yard works https://www.portauthority.hr/wp-content/uploads/2018/11/EK-letak-AGCT.pdf

113 These updates also included health and social sectors.

Instruments and Partner	Lessons Learned
Lending – Ongoing – Integrated Land Administration System Project (FY12); ISR: MS/MS – Science and Technology 2 (FY13); ISR: S/S – Sustainable Railways in Europe Project (FY15); ISR: MS/MU – GEF Regional Adriatic Sea Environmental Pollution Control Project (FY15); ISR: MU/MU – Rijeka Gateway 2 (FY09); ISR: MU/MS – Modernization and Restructuring of the Road Sector Project (FY17); ISR: S/MS **Lending - Closed** – Justice Sector Support Project (FY16); ICR: S – EU Natura 2000 Integration (FY17); ICR: S – Coastal Cities Pollution Control Project 2 (FY16); ICR: S – GEF Neretva and Trebisnjica Management Project (FY15); ICR: MS **ASA/RAS** – EU Preparedness TA (FY15) – Public Finance Review (FY14) – National Reform Program TA (FY14) – Smart Specialization (FY15) – RAS Spatial Analysis of Poverty and Policies (FY18) – Activities not materialized: – EU Water sector compliance Project (dropped) **Partners - EC** – EU Water sector compliance Project (dropped) **Partners** - EC	– Close coordination with the EC was critical to achieve this. The ESI Funds project pipeline under the OPCC included major projects (worth EUR50 million or more) that required elaborate, sequenced development of project documentation – from preliminary project proposal, through detailed design or blueprints, cost-benefit studies and feasibility studies, including completion note from Jaspers. To make sure that these complex requirements are met timely, the Bank and the EC held quarterly review meetings at the level of REGIO E4 Head of Unit/Zagreb country office, sectorial meetings/exchanges between officers, and exchanged the status updates in following sectors: transport, water, environment and science and innovation.[113] In some instances (e.g. for large R&D infrastructure projects), the meetings would gather all stakeholders – including beneficiaries and Jaspers team to overcome issues.

ANNEX 2: PLANNED AND ACTUAL LENDING

ID	Operation *	FY planned	FY actual	US$ m
	Policy Support			
P127665	Second Economic Recovery Development Policy Loan	2013	2014	206.8
P161661	Public Finance and Competitiveness DPL	2018	*Dropped 2018*	
	Program Support			
P144871	Health System Quality and Efficiency Improvement *(Program for Results)*	2014-15	2014	103.5
P145171	Social Protection System Modernization Project *(IPF with results-based disbursement)*	2014-15	2015	95.55
	Project Support			
P147499	Sustainable Croatian Railways in Europe	2014-15	2015	183.4
P152130	Croatia Innovation and Entrepreneurship Venture Capital Project	2014-15	2016	21.92
P065416	GEF Adriatic Sea Environmental Pollution Control Project (1) *(Croatia and Bosnia and Herzegovina project)*	2014-15	2014	4.3
P155842	Modernization and Restructuring of the Road Sector	2017	2017	23.3
		Total		**638.8**
	Guarantees			
P133471	Croatian Export Financing Guarantee Project	2013	2013	256.4
P155842	Modernization and Restructuring of the Road Sector	2017	2017	370.7
		Total		**627.1**

* Operations planned and not listed in Croatia CPS Table 4 (Indicative lending FY14-15) include:
- Venture Capital loan referenced in paragraph 71
- GEF Adriatic Sea project listed in paragraph 85
- Croatian Export Financing Guarantee Project (PCG) in paragraph 71; approved with CPS

ANNEX 3: CROATIA PORTFOLIO[114] AND PROJECT PERFORMANCE RATINGS DURING CPS PERIOD AND KEY INDICATORS

ID	Project name	Amount (US$m)	Approval date	Closing date	FY closing	Outcome Rating ICR	IEG
P086669	Development of Emergency Medical Services and Investment Planning Project	28.3	30-Sept-2008	31-Dec-2013	FY14	S	MS
P127665	Second Economic Recovery Development Policy Loan	206.8	11-Jul-2014	31-Aug-2014	FY15	MS	MS
P102778	Revenue Administration Modernization	68.0	28-Jun-2007	30-Jun-2015	FY15	MU	MU
P084608	Neretva & Trebisnjica River Basin Management Project (GEF)	2.0	29-May-2008	30-June-2015	FY15	MS	MS
P102732	Coastal Cities Pollution Control 2 (IBRD loan)	87.5	4-Jun-2009	31-Dec-2015	FY16	S	S
P102395	Coastal Cities Pollution Control 2 (GEF grant)	6.4	4-June-2009	31-May-2016	FY16	-	-
P093767	Trade & Transport Integration*	142.2	14-Nov-2006	31-May-2016	FY16	MS	U
P104749	Justice Sector Support	36.3	6-April-2010	30-Jun-2016	FY16	S	MS
P116080	Export Finance Intermediation Loan*	202.6	4-Aug-2009	31-Aug-2016	FY17	S	S
P111205	EU Natura 2000 Integration	28.8	10-Feb-2011	30-Apr-2017	FY17	S	S
P145171	Social Protection System Modernization Project	95.5	19-Sep-2014	30-Nov-2017	FY18	U	HU
P152130	Croatia Innovation and Entrepreneurship Venture Capital Project	21.9	06-Oct-2015	31-Dec-2017	FY18	U	n/a
P133471	Croatian Export Financing Guarantee	256.4	27-Jun-2013	1-Oct-2018	FY19	MU	n/a
P102365	Rijeka Gateway 2	122.5	11-Dec-2008	31-Dec-2018	FY19	MU	n/a

* AF TTI $ 66.9 million Aug. 4, 2011
AF EFIL $ 61.4 million Sept. 20, 2012

Key Portfolio Indicators

Indicators / FY	FY14	FY15	FY16	FY17	FY18
Net Commitment Amount ($m)	999.5	1,039.7	808.1	600.2	482.7
Disbursement in FY ($m)	96.0	287.5	155.9	75.4	48.8
Disbursement. Ratio in FY	22.5%	25.3%	25.4%	21.6%	25.9%
% Projects at Risk	27%	18.2%	11.1%	25.0%	33.3%
% Commitments at Risk	29%	14.1%	15.2%	19.6%	59.4%

114 In additional to GEF, several smaller Trust Funded activities were active during CPS: P144257 PEFA Study for Local Governments in Croatia (TF14174; EUR75,912 for Labin and Crikvenica, and TF14177; $79,500 for Sisak and Koprivnica); and P131562 Croatia SAFE TF Modernizing Treasury Systems in Croatia ($215,000).

ANNEX 4: IBRD NON-LENDING ACTIVITIES

IBRD Advisory Services and Analytics		
ID	Project Name	FY
P145233	Croatia Venture Capital Technical Assistance	FY14
P129039	Croatia: A Chronicle of Selected Justice Reforms	FY14
P122054	Justice Sector Public Expenditure & Institutional Review	FY14
P144564	Croatia Energy Sector Review	FY14
P147844	National Reform Program (NRP) TA *(Means-Testing the Child Allowance Program - Simulated Impact April 2014; Macroeconomic Impact Assessment of NRP 2014 – April 2014)*	FY14
P127662	Public Finance Review	FY14
P153715 P153528	National Reform Program (NRP) TA *(DB Reform Memorandum May 2015; Macroeconomic Impact Assessment of NRP 2015; Review of Draft Law on Personal Insolvency February 2015; Assessment of Public Investment Management Framework, September 2015)*	FY15
P150385	Croatia Energy Affordability and EU 11 Programmatic Energy Affordability (P147497)	FY15
P131000	EU Preparedness TA – Summary Report[115]	FY15
P154855	Croatia Smart Specialization: Inputs from Trade, Innovation and Productivity Analysis	FY15
P156355	Tax Treatment of NPL resolution	FY16
P156959	Croatia Policy Notes February 2016	FY16
P156273	Croatia Macro-Fiscal Structural Dialogue *(Addressing Labor Market Duality in Croatia – A Single Employment Contract; Restructuring Public Finance for Stability and Growth)*	FY17
P160376	Croatia - Distributional impact of Fiscal Policy and Inputs to Regional Flagship	FY17
P156355	Tax considerations for Non-Performing Loan Resolution in Croatia	FY17
P163660	Assessing financial gap for implementation of Waste Management Plan of Croatia	FY17
P157668	Croatia business environment reform	FY18
P165787	Benchmarking and initial diagnostics of growth opportunities in Slavonija, Baranja and Srijem	FY18

RAS /MRA Agreements signed during CPS			
Project ID	RAS Task name / value	Signing date	Closing date
P153133	Higher Education Finance Reform *(EUR250,000)*	May 21, 2015	October 3, 2016
P159627	Spatial Analysis of Poverty and Policies *(EUR511,108)*	April 11, 2016	March 31, 2018
P160276[116]	Clusters Competitiveness Initiative *(EUR4,928,797)*	April 15, 2016	April 30, 2019
	Miscellaneous Reimbursable Arrangements		
P149740	Money Laundering and Terrorist Financing National Risk Assessment of Croatia	Delivery FY15	
P154273	Spending Review TA	Delivery FY15	

115 Summary Report reflects key issues and recommendations prepared during 2013 as part of various analytical pieces, which included, among other, a note on Challenges in Preparing Croatan Transport Sector for EU 2014-20 Financial Perspective, a note on Public Investment in Irrigation and Drainage Infrastructures: Reflection in EU-funded Programs Across Member States and Lessons for Croatia, and a note on Public Investment in Small and Medium Enterprises: Reflections in EU-funded Programs Across Member States and Lessons for Croatia.

116 Subtask ID numbers: P161105, P161106 and P154353.

RAS Agreements signed FY2018			
ID	**RAS Task name / value**	**Signing date**	**Closing date**
P166354	Establishing the System for Strategic Planning and the Preparation of the National Develop. Strategy 2030 *(EUR4,339,210)*	May 11, 2018	July 11, 2020
P167067	Growth and Jobs in Slavonia, Baranja and Srijem *(EUR6,200,000)*	July 20, 2018	July 20, 2021
P167852	Strategic Transformation in Agriculture and Rural Space *(EUR2,500,000)*	Oct. 11, 2018	Nov. 12, 2020

Trust Funded Activities – supported by EU's Structural Reform Support Services			
ID	**Task name**	**Signing date**	**Closing date**
P163649	Croatia Business Environment Reform Project *(EUR298,501)*	May 8, 2017	Sept. 28, 2018
P165139	Croatia Occupational Regulation Reform *(EUR450,000)*	Nov. 30, 2017	June 28, 2019

Regional Activities with significant focus on Croatia		
ID	**Project Name**	**FY**
P143280	Croatia Country Gender Diagnostic- EU Equity and Gender TA - EU Accession Countries	FY14
P143351	Technical Assistance of ECCU5 Activation and Skills for Employability and Protection	FY14
P146139	Danube Water Program State of the Sector	FY15
n/a	Assessment of the venture capital taxation regime in Croatia (EU-funded TA; EDIF platform (http://www.wbedif.eu/about-wb-edif/) Review of the Croatia Alternative Investment Funds Act (AIFA); January 2016	FY16
P159888	Health Sector Arrears Study in selected countries of Europe	FY18
P158168	Strengthening Integrated Care in the EU	FY18
P156970	TF Subnational Doing Business in Selected EU Member States (regional)	FY19
	Programmatic tasks	
P151668 P161638	EU RER - Modest Recovery, Global Risk (June 2015) EU RER 2 - Sustaining Recovery, Improving Living Standards (Fall 2015) EU RER 3 - Growth, jobs and integration: Services to the rescue (Fall 2016) EU Regular Economic Report (RER) 4: Sharing Prosperity in the EU: Agricultural Matter	FY18

ASA Initiated FY18		
ID	**Project Name**	**FY**
P165911	Productive Inclusion for Agriculture Competitiveness in Croatia (completed)	FY19
P166331	Croatian Railways Policy Update	FY19
P165593	Croatia: Forest Sector Note (completed)	FY19
P166022	EU Croatia - Identification of Supports for Energy Sector (completed)	FY19
P166456	Optimizing the Croatian Waste Management Plan Financing and Implementation (completed)	FY19

Dropped Activities		
ID	**Project Name**	**FY**
P161820	Proposed RAS - Support to Public Sector Reform	FY17
P163262	Proposed RAS - Improving Efficiency of Judicial Administration in Croatia	FY17

ANNEX 5: IFC INVESTMENTS (US$M)

Investments Committed in FY14-17									
Project ID	Project Short Name	Institution Number	Cmt FY	Project Status	Primary Sector Name	Project Size	Original Commitment Loan	Original Commitment - Equity	Original Commitment Total
34079	Rudine WPP	771251	2015	Active	Electric Power	61.3	24.6	-	24.6
31969	Zagreb Airport	737730	2014	Active	Transportation and Warehousing	173.8	72.6	15.8	72.1
32317	SocGenCroa_ AGRI	732564	2014	Closed	Finance & Insurance	65.0	68.0	-	68.0
34380	Zagreb Air Hedge	737730	2014	Active	Transportation and Warehousing	1.2	1.2	-	1.2
					Sub-Total	**301.3**	**166.5**	**15.8**	**166.0**

Investments Commited pre-FY14 but active during FY14-17									
Project ID	Project Short Name	Institution Number	CMT FY	Project Status	Primary Sector Name	Project Size	Original Commitment Loan	Original Commitment - Equity	Original Commitment Total
32218	Jelinak	733242	2013	Active	Electric Power	57.5	20.0	-	20.1
32454	Atlantic Group	737339	2013	Active	Food & Beverages	339.2	20.5	-	20.5
33394	Lidl Croatia II	518995	2013	Active	Wholesale and Retail Trade	67.8	38.5	-	38.5
31606	Sibenik WPP	710966	2012	Active	Electric Power	74.0	24.8	-	24.8
					Sub-Total	**538.5**	**103.8**	**-**	**103.9**

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CROATIA

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- ○ SELECTED CITIES AND TOWNS
- ⊙ COUNTY (ŽUPANIJA) CAPITALS
- ⊛ NATIONAL CAPITAL
- RIVERS
- MAIN ROADS
- RAILROADS
- COUNTY (ŽUPANIJA) BOUNDARIES
- INTERNATIONAL BOUNDARIES

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NOTES

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