

Fair Market Conditions for Competitiveness in the Adriatic Region

Croatia Country Profile



Acknowledgements

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Background and Context

In the South East Europe (SEE) region, businesses continue to identify corruption and lack of transparency as a key constraint to economic growth and competitiveness. Similarly, the OECD Competitiveness Outlook for South East Europe from 2018 and 2021, the *OECD Investment Policy Review of Croatia* from 2019, and the *OECD Review of the Corporate Governance of State-Owned Enterprises in Croatia* from 2021¹ found a number of policy shortcomings in this regard. These range from limited awareness about whistle-blower protection mechanisms and the occurrence of conflicts of interest in public procurement procedures to risks of politicisation of state-owned enterprises' SOEs governing boards.

To address these findings, the OECD is implementing the *Fair Market Conditions for Competitiveness in the Adriatic Region Project* (the Project) which is funded by the Siemens Integrity Initiative and provides the context for this report. The Project aims to support the creation of a level playing field in three pilot countries from the SEE region (Bosnia and Herzegovina, Croatia, and Serbia) to enhance competitiveness and integrity in a sustainable and inclusive way. Having a level playing field means that the same rules regarding financial, regulatory and fiscal treatment, as well as public procurement, apply consistently to public, state-owned and private companies. This ensures that no entity operating in the market is subject to undue competitive advantages or disadvantages, and that every actor has equal market access (OECD, 2012^[1]). Levelling the competitive playing field can help boost productivity, efficiency, output quality and innovation. Eventually, a level playing field increases a country's level of competition and economic development as well as the economic well-being of its citizens. In this context, the Project's first key objective is to raise awareness about integrity standards and good practices among government officials, businesses and civil society. The second objective is to build capacity and to foster the implementation of recommendations on transparency and efficiency of anti-corruption and competition authorities. The third objective is to promote the latest knowledge on international standards and practices on anti-corruption and integrity in academic curricula, as academia plays a major role in educating future public and private actors.

By building on an extensive set of OECD analyses² and good practices – particularly the *OECD Review of the Corporate Governance of State-Owned Enterprises in Croatia* from 2021 – as well as input from external experts and stakeholders, this document aims to support the Project's second objective. To this end, this country profile maps existing legal and institutional frameworks, key achievements, and persistent policy challenges and provides actionable policy recommendations in the areas of **anti-corruption, competition and state-owned enterprises (SOEs)** which are considered particularly relevant for creating fair market conditions. As these areas are interconnected, reforms in one policy domain may influence policy settings in the others (OECD, 2015^[2]). For instance, the unjust allocation of power and resources as a result of corrupt practices, can create unfair market conditions by diminishing regulation and antitrust enforcement intended to correct market imperfections and by creating barriers to market entry. Moreover, bribery can direct companies' efforts towards rent-seeking instead of focusing on generating customer benefit. Corruption can also harm competition in public procurement by excluding potential competitors or by favouring others (OECD, 2010^[3]). Inversely, high levels of competition and sound competition policies reduce opportunities and incentives for corrupt behaviour. Lastly, SOE and competition policies are often intertwined as they both influence the rules that apply to a specific type of market actor.

¹ *OECD Investment Policy Reviews: Croatia* (OECD, 2019^[41]); *OECD Review of the Corporate Governance of State-Owned Enterprises: Croatia* (OECD, 2021^[18]).

² E.g. the publications *OECD Investment Policy Reviews: Croatia* (OECD, 2019^[41]) and the *OECD Review of the Corporate Governance of State-Owned Enterprises: Croatia* (OECD, 2021^[18]).

In this profile, a focus is set on the energy and industry sectors for several reasons: Firstly, given their significant contribution to GDP and employment in the Croatian economy they are important to the country's social and economic development³ (see Box 1 and Box 2). Secondly, ensuring a level playing field is particularly vital in these sectors. Since they are very capital-intensive, there are usually higher market entry barriers and a higher market concentration. This market dominance can attract more anti-competitive and corrupt behaviour to increase profit margins. Thirdly, in the energy and industry sectors there is a strong prevalence of SOEs since these sectors require considerable administration due to their size and indispensability for the population (IMF, 2019^[4]). As governments make in some circumstances deliberate decisions to pursue non-neutral practices in the favour of SOEs (OECD, 2012^[1]), a disruption of the level playing field may occur more likely in sectors with a high number of SOEs. Lastly, meeting specific standards in these sectors is also relevant for OECD accession which Croatia is pursuing.

Box 1: The Industry Sector in Croatia

The **industry sector** plays an important role in Croatia's economy by contributing to 20.2% of its GDP (Statista, 2019^[5]), 24.8% of gross value added (Eurostat, 2019^[6]) and 28.1% of employment (Eurostat, 2019^[7]). The most prominent forms of industrial production are manufacturing, the petrochemical industry and shipbuilding, with significant production in the construction and energy sectors as well (Miroslav Krleža Institute of Lexicography, 2021^[8]). The industry sector attracts Foreign Direct Investment (FDI) mainly in petroleum production (3.6%), pharmaceutical production (3.3%) and construction of buildings (3.2%) (Croatian Chamber of Economy, 2021^[9]). The subsectors of the industry sector on which this document focuses are manufacturing, construction, transportation and water resources management.

The **manufacturing** sector accounts for 12.3% of GDP and employs 17.2% of the working population. The most important exports are pharmaceutical products (7.8%); petroleum products (7.0%); timber (3.0%); cereals (2.2%), ships and other floating objects (2.1%), and electrical equipment-generators, engines, and transformers (2.0%)⁴ (Ministry of Economy and Sustainable Development, 2021^[10]).

The **construction sector**, including the creation, renovation, or extension of fixed assets of infrastructure, accounts for 4.6% of GDP (Croatian Bureau of Statistics, 2019^[11]) and employs 7.6% of the working population (Croatian Bureau of Statistics, 2020^[12]). Until the 2009 crisis, construction had been one of the most dynamic sectors, especially in road building, housing and commercial construction (Miroslav Krleža Institute of Lexicography, 2021^[8]). Out of the 21 biggest construction

³ The industry sector contributes to 20.2% of GDP (Statista, 2019^[5]) and 28.1% of employment (European Commission, 2019^[79]); the energy sector contributes to 3.5% of GDP (Croatian Bureau of Statistics, 2019^[11]) and 1.5% of employment (Croatian Bureau of Statistics, 2020^[12]).

⁴ The ten largest manufacturing companies by revenue are: 1) INA (manufactured petroleum products; headquartered in Zagreb); 2) Pliva (pharmaceutical products; headquartered in Zagreb); 3) Vindija (dairy products; headquartered in Varaždin, Northern Croatia); 4) Podravka (food products; headquartered in Koprivnica, Northern Croatia); 5) Petrokemija (fertilizer production; headquartered in Kutina, Central Croatia); 6) M San Grupa (information technology; headquartered in Zagreb); 7) Dukat (milk and dairy products; headquartered in Zagreb); 8) Ericsson Nikola Tesla (telecommunications equipment; headquartered in Zagreb); 9) PIK Vrbovec (meat industry; headquartered in Vrbovec, Zagreb county); 10) Mesna industrija Braća Pivac (meat industry; headquartered in Vrgorac, Split-Dalmatia county) (Ministry of Economy and Sustainable Development, 2021^[83]).

companies by revenue, 16 are private and 5 state-owned⁵ (Ministry of Economy and Sustainable Development, 2021_[13]).

The **transportation sector** relates to the operation, construction and maintenance of transport networks such as rail, road and air transport. It accounts for 3.9% of GDP (Croatian Bureau of Statistics, 2019_[11]) and employs 5.4% of the working population (Croatian Bureau of Statistics, 2020_[12]). The railway market is dominated by three SOEs: the Croatian Railways Infrastructure, Croatian Railways Cargo and the Croatian Railways Passenger Transport. The European Commission underscored the importance of modernisation and upgrading of the rail network to improve competitiveness of the railway sector. It called for removing regulatory restrictions and facilitating cooperation between SOEs, private operators and infrastructure managers (European Commission, 2020_[14]). For road transport, the most important company is the SOE Croatian Roads (Hrvatske Ceste) in charge of the management, construction and maintenance of state roads. For air transport, the most important company is the national flag carrier Croatia Airlines, an SOE majority owned by the central government.

The **water resources management sector** relates to water supply. It accounts for 1.1% of GDP (Croatian Bureau of Statistics, 2019_[11]) and employs 1.9% of the working population (Croatian Bureau of Statistics, 2020_[12])⁶. The use of water by the country's manufacturing sector is almost equal to the one by households (Eurostat, 2021_[15]). Bodies responsible for water management at the central level are the Ministry of Economy and Sustainable Development and the SOE Croatian Waters (Hrvatske Vode), counties at the regional level, and municipalities and cities at the local level. The company Croatian Waters, fully owned by the state, is headquartered in Zagreb and has 1 000 employees.

Box 2: The Energy Sector in Croatia

The **energy sector** is a strategic industry for Croatia with significant weight in its economy. It comprises the totality of the value chain involved in the production and supply of energy from the extraction of primary energy sources such as oil, coal and gas over refining energy carriers, to the production and distribution of energy such as electricity or heat.

The energy sector accounts for 3.5% of GDP, i.e., electricity, gas, and steam supply accounted for 2.2%, manufacture of coke and fine petroleum products for 1.0%, and mining and quarrying for 0.3% (Croatian Bureau of Statistics, 2019_[11]). It employs 1.5% of the working population in legal entities, i.e. 1.1% work in electricity, gas, steam and air conditioning supply; 0.3% in mining and quarrying; and 0.1% in manufacture of coke and fine petroleum products (Croatian Bureau of

⁵ The biggest five are: 1) The SOE Croatian Motorways (Hrvatske Autoceste), which is responsible for the construction and management of motorways. It operates under a legal monopoly in the country, it is headquartered in Zagreb and employs around 2 700 people; 2) The private company Kamgrad which deals primarily with residential building construction. It is headquartered in Zagreb, employs more than 730 people and operates also in Bosnia and Herzegovina, Serbia, Germany, and Sweden; 3) The company Dalekovod is active in electrical engineering and civil engineering sectors. Formerly an SOE, it was transformed into a shareholding company in 1993. It is headquartered in Zagreb, has 1 500 employees; 4) The company China Road and Bridge Corporation: Main Branch Zagreb is constructing the Pelješac Bridge, currently the biggest infrastructure project in Croatia; 5) The private company Strabag which is headquartered in Zagreb and active in building construction, civil engineering, transport routes and tunnelling.

⁶ This estimate includes also sewerage, waste management and remediation alongside water supply.

Statistics, 2020^[12]). The total energy supply (TES)⁷ amounts to 8 591 ktoe which corresponds approximately to 2.9% of Germany's energy supply (Eurostat, 2021^[16])

Primary energy production stems from firewood and biomass (31.3%), hydropower (25.7%), natural gas (18.0%), crude oil (15.0%), and renewable energy sources and ambient heat (10.0%). Yet energy production from renewable sources increased by 20.4% in 2019 compared to 2018. Regarding import of energy, oil derivatives account for 34.5% of total import, followed by crude oil (26.0%), natural gas (21.1%), electricity (10.0%), coal and coke (6.9%), and wood and biomass (1.5%). Energy export is dominated by petroleum products (75.5%), followed by electricity (8.9%), biomass (8.6%), crude oil (4.3%), natural gas (2.1%), and coal and coke (0.6%) (Ministry of Economy and Sustainable Development, 2019^[17]).

Several of the largest energy companies by revenue are state-owned, followed by privately owned ones. The multinational oil company INA Group is minority-owned by the state. Fully state-owned is the energy company HEP Group (Hrvatska Elektroprivreda) that has daughter companies managed by subsidiaries: electricity and thermal energy producer HEP-Production, the HEP-Distribution System Operator and the energy supplier HEP ELEKTRA (OECD, 2021^[18]). The natural gas supplier Gradska plinara Zagreb – Opskrba is owned by the City of Zagreb. PPD (Prvo plinarsko društvo) is a private gas supplier, GEN-I Hrvatska a private multinational company for electricity trading, and E.ON Energija a private multinational gas and electricity supplier (Croatian Chamber of Economy, 2021^[19]). The most prominent energy company by revenue is the INA Group (INA-Industrija Nafta d.d.), a multinational company and minority SOE with headquarters in Zagreb operating in oil and gas exploration and production, as well as in refining and marketing of oil products. Its largest shareholders are the Hungarian national oil company MOL (49.0%) and the Republic of Croatia (44.8%). Apart from Croatia, INA has operations in Angola and Egypt, and runs a network of 489 petrol stations in Croatia, Bosnia and Herzegovina, Slovenia, and Montenegro. INA is the largest individual SOE employer in the oil sector with 10 800 employees and also one of the most profitable Croatian SOEs in general (OECD, 2021^[18]). The second largest energy company is the HEP Group, a state-owned energy supplier also headquartered in Zagreb with a strong presence across the entire energy value chain. The HEP group is the dominant electricity producer, accounting for 83.5% of the production capacity and 79.8% of generated electricity (Croatian Energy Regulatory Agency, 2020^[20]). With 11 500 employees, it is also the largest individual SOE employer in the electricity sector (HEP Group, 2019^[21]). The third largest company in the energy sector is the privately owned company PDD (Prvo plinarsko društvo) based in Vukovar in Eastern Croatia. The company conducts business in trade, import, sale and supply of natural gas. In addition, PPD is the largest natural gas importing company in Croatia that also runs its business from companies it owns in Hungary, Switzerland, Italy, Slovenia, and Bosnia and Herzegovina (PPD, 2021^[22]).

When it comes to electricity demand, final consumption stems from households (50.7%); other sectors like services, agriculture and construction (25.2%); industry (21.9%); and transport (2.0%) (Ministry of Economy and Sustainable Development, 2019^[17]). Electricity prices for household consumers in the second half of 2020 were lower than the EU average (-39.0%) (Eurostat, 2021^[23]). Regarding gas, final consumption stems from households (66.6%), industry (22.5%), other sectors (10.3%) and transport (0.4%) (Ministry of Economy and Sustainable Development, 2019^[17]). Natural gas prices for household consumers in the second half of 2020 was also lower than the EU average (-46.0%) (Eurostat, 2021^[24]). Consumption of oil and petroleum products on the other hand stems from transport (78.5%), other sectors including households (14.9%) and industry (6.5%) (Ministry of Economy and Sustainable Development, 2019^[17]).

⁷ Total Energy Supply (TES) is the evaluation of energy supplied by fuels in their primary form, prior to any conversions such as coal to electricity.

The following three subchapters on the areas of anti-corruption, competition and SOEs are each structured into policy issues which are fundamental for policy frameworks that effectively foster fair market conditions, ensure a level playing field and tackle corruption.

1. Anti-Corruption Policy: Fostering Integrity in the Public and Private Sector

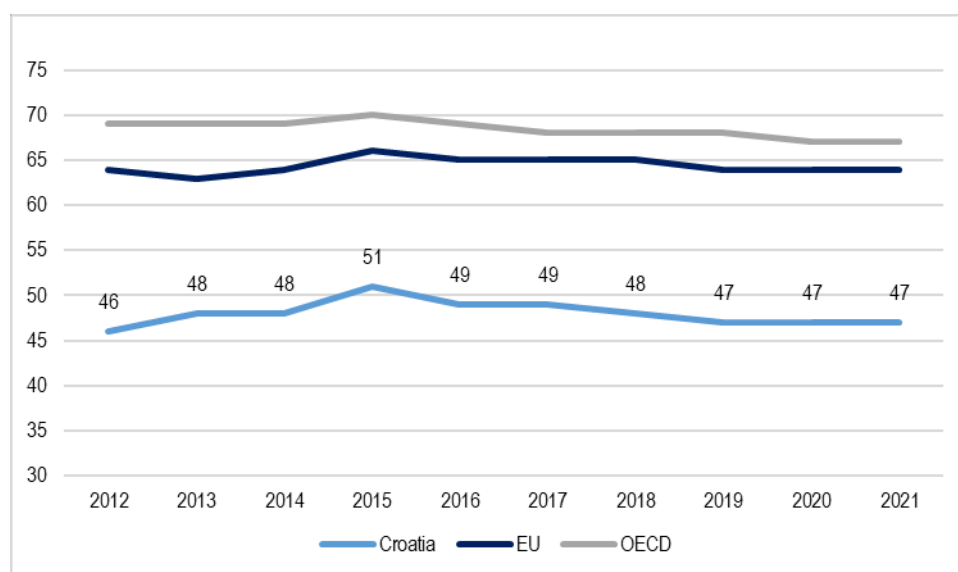
Why Anti-Corruption Policies Matter

Corruption has negative effects on numerous areas that are crucial for a country's economic and social development such as investment, competition, entrepreneurship, government efficiency and human-capital formation (OECD, 2015^[2]). Having well-designed standards on public integrity and anti-corruption is a prerequisite for tackling the consequences of corruption such as resource misallocation, price distortion, reduced quality or scarcity of goods and services, distorted competition, decreasing growth and innovation, unfair allocation of benefits and a loss of trust in the government and public authorities.

Perceptions of Corruption in Croatia

According to the 2021 Transparency International's Corruption Perception Index (CPI), Croatia ranks 63th out of 180 evaluated economies (Transparency International, 2022^[25]), leaving behind only Romania (rank 66), Hungary (rank 73) and Bulgaria (rank 78) and performing significantly lower than the EU average (see Figure 1). Croatia's score has been decreasing over the last six years. The 2020 Eurobarometer survey also showed that 97% of Croatian citizens believe corruption to be widespread while the EU average is 71%. Moreover, 54% of them feel personally affected by it in their everyday lives whereas the EU average stands at 26% (Eurobarometer, 2020^[26]). Besides, according to the 2019 Flash Eurobarometer on businesses' attitudes towards corruption in the EU, 91% of respondents operating in Croatia described corruption as widespread while the EU-28 average stood at 63% (Flash Eurobarometer, 2019^[27]).

Figure 1: Transparency International Corruption Perception Index: Croatia's Scores in Comparison (2012-2021)



Note: The scores of the CPI range from 0 (“highly corrupt”) to 100 (“very clean”). The vertical axis shows a limited range of the scores for better visualisation of the yearly score changes. The scores are shown for the last nine years since Transparency International started to use an improved methodology from 2012 on which is still used today.

Source: Transparency International Corruption Perception Index from 2012 to 2021.

OECD Findings on Anti-Corruption Policies

Croatia has made important efforts in reducing opportunities for corruption and limiting discretion in public decision-making. At the central level, certain standards of integrity are in place and obligations for public officials to report personal assets and interests are the rule. The transparency and control of public procurement have been enhanced, efficiency of law enforcement agencies has been strengthened and a track record of effective corruption prosecution has been established. However, some elements of a functioning anti-corruption framework are still missing: for instance, a code of conduct for persons with top executive functions as well as comprehensive codes of conduct for elected officials at regional and local level, a framework regulating lobbying, an operational whistleblower protection system, and innovative mechanisms to facilitate the use of out-of-court dispute resolution. Further efforts are also needed to defuse concerns by businesses and the public in general about the prevalent level of corruption.

The Role of Anti-Corruption Policies in the Energy and Industry Sector

Comprehensive anti-corruption policies are indispensable in particular in the industry and energy sectors⁸, where large-scale investments have been made to modernise and expand the energy, transport, and water infrastructures in Croatia. For instance, when it comes to European Union (EU) funds available, in the 2014-2020 financial period the country had at its disposal EUR 10.7 billion from the European Structural and Investment Funds (ESIF). It also used funding from the structural instruments of the 2007-2013 financial perspective, Instrument for Pre-accession Assistance (IPA) and European Union Programmes (Ministry of Regional Development and EU Funds, 2021_[28]). In addition, as part of the Next Generation EU programme, the Croatian 2021-26 National Recovery and Resilience Plan contains 77 reforms and 152 investments amounting to EUR 6.3 billion (12.0% of GDP, the EU average being 3.7% of GDP). The government plans to distribute the investments as follows: economy (54%); education, science, and research (15%); renovation of buildings (12%); public administration, rule of law, and state assets (10%); health (5%); labour market and social protection (4%). Regarding economy, the government plans to invest, among others, in the field of energy transition, water and waste management, energy-sustainable transport system, and food supply chain strengthening (Government of the Republic of Croatia, 2021_[29]). In addition, in the period 2010-2020 foreign direct investment from China and Russia have amounted to EUR 118.3 million and EUR 344.6 million respectively which was mainly directed towards sectors such as energy and transport (Croatian National Bank, 2021_[30]). In such circumstances, where investments are high but where the prevalent policy and legal frameworks do not sufficiently address corruption, the risk of anti-competitive behaviour usually grows significantly. Therefore, the anti-corruption policies mentioned in this subchapter also apply to the industry and energy sectors.

1.1. Prevention of Corruption

A generally advanced legal framework for the prevention of corruption and a network of authorities that contribute to policy-making and preventing corruption is in place across all branches of power.

⁸See Box 1 and 2.

The **Council for the Prevention of Corruption** is a governmental advisory body responsible for developing and monitoring national anti-corruption documents, composed of all relevant stakeholders, including civil society, and presided by a Ministry of Justice and Public Administration representative. The Council enjoys expert and administrative support by the Anti-Corruption Sector of the Ministry of Justice and Public Administration that is in charge of coordinating the overall development, implementation and monitoring of national anti-corruption documents. At the parliamentary level, the **National Council for Monitoring the Implementation of the Strategy for Combating Corruption**, is headed by an opposition representative.

Having clear rules on **conflict of interest** is crucial to ensure that public officials do not favour private interests over their position's responsibilities to the public, that they remain unbiased in their actions and do not misuse their power or influence (OECD, 2003^[31]). The **Commission for the Resolution of Conflicts of Interest** is the competent body for initiating conflict of interest proceedings and rendering decisions on infringements, checking declaration of assets of public officials, drawing up guidelines on conflicts of interest, conducting training on conflicts of interest and on submitting declarations of assets. It is composed of five non-partisan members elected by the parliament, following a public call for candidates, and it can recommend changes in the conflict-of-interest system (Council of Europe, 2020^[32]). Besides, the Protection of Reporters of Irregularities Act (Whistle-blowers Act) envisages the possibility of external reporting to the Ombudsman, who is in charge of protecting human rights and freedoms and the rule of law either ex officio or on the basis of complaints on unlawful practices and irregularities in the work of public authorities. In addition, the Information Commissioner is an independent body which reports to the parliament on the implementation of the Law on the Right of Access to Information and acts as a second instance for complaints as well, following appeals to the head of the public authority in question against a rejection of a request for information (Council of Europe, 2020^[32]). Finally, the State Commission for the Supervision of Public Procurement Procedures that controls procurement by the state, the State Election Commission that monitors financing of political activities and the State Audit Office as the highest audit instance also contribute to preventing corruption.

Regarding the legal framework for **preventing corruption**, the **Prevention of Conflicts of Interest Act** regulates the exercise of public office by high-level elected and appointed public officials at both the central and local level, high-level public servants appointed by the Government, as well as presidents and board members of majority state-owned enterprises. According to the Prevention of Conflicts of Interest Act conflict of interest arises when officials' private interests are contrary to the public interest, and particularly when they affect his or her impartiality or when there is a founded opinion that they affect or may affect his or her impartiality in exercising public office. International observers have considered the provision of the Act forbidding officials to accept employment in the private sector for a period of 12 months after the end of the public service as too short (European Commission, 2021^[33]). However, the new Prevention of Conflicts of Interest Act from December 2021 foresees the application of a prolonged cooling off period of 18 months only in relation to management positions in companies with whom the official's previous public employer had a business relationship (Official Gazette, 2021^[34]) The Act is implemented by the Commission for the Resolution of Conflicts of Interest that can apply administrative sanctions of warning and suspend the official's salary. In 2020, the staff of the Commission has been reinforced and the Commission's budget has been increased. However, this capacity-strengthening effort needs to continue, in view of the Commission's statutory competencies and scope of work (Council of Europe, 2021^[35]).

In addition, the central government level still lacks a **code of conduct** for persons with top executive functions, who are not familiarised enough with standards on integrity. The Commission for the Resolution of Conflicts of Interest conducted proceedings under Article 5 of the Prevention of Conflicts of Interest Act that dealt with integrity of public officials. However, in 2019 and 2020 these decisions were annulled by the High Administrative Court and lower administrative courts because, according

to them, the Act did not prescribe sanctions, i.e., the Commission did not have a legal basis for establishing its violation (European Commission, 2021_[33]). The Commission criticized the new Prevention of Conflicts of Interest Act from December 2021 for not making any progress in this regard and for preventing it to render declaratory decisions on the violation of ethical principles of public office. In October 2021, the Ministry of Justice and Public Administration established a working group responsible for the drafting of a code of conduct for persons with top executive functions, in accordance with the new Anti-Corruption Strategy 2021-2030. Likewise, there are no rules that regulate contacts of persons with top executive functions with lobbyists (Council of Europe, 2020_[32]). In December 2021, the authorities reported that they plan to introduce a legal framework to regulate lobbying following the highest ethical standards, in accordance with the new Anti-Corruption Strategy 2021-2030. To this end, a working group was established and the drafting process was expected to last until the end of 2022 (Council of Europe, 2021_[35]). Furthermore, conflicts of interest remain of particular concern at the local level due to weaknesses in the integrity framework for local office-holders (European Commission, 2020_[36]). In this context, the new Anti-Corruption Strategy 2021-2030 foresees strengthening ethical standards of local, regional and central authorities.

Another vital tool to safeguard integrity in public service is **asset and interest disclosure** by public officials. It allows oversight institutions and the public to track the officials' assets and interests, to scrutinise whether variations in wealth are justified and to monitor their outside interests. Asset and interest disclosure is also governed by the Prevention of Conflicts of Interest Act. Public officials, including persons with top executive functions, submit declarations when taking office as well as every year during their period of service (Official Gazette, 2021_[34]). The Commission has an IT system at its disposal which performs checks of officials' property status by retrieving data from databases kept by various state bodies. However, the Commission criticised it as not enough efficient. Further improvements to this system are planned to allow for an automatic inclusion of data from available public sources already at the stage of filling in a declaration (Council of Europe, 2021_[35]). On the other hand, the Law on Local and Regional Self-Governance gives elected local officials considerable discretion in decision-making without subjecting them to asset declarations or other forms of oversight. The discretionary powers to decide on disposing of assets and finances of up to Croatian Kuna (HRK) 1 million and to appoint board members of public local companies create scope for corruption. Official statistics also show that a significant proportion of corruption offences are recorded at local level (European Commission, 2020_[14]).

The existing framework for **whistle-blower protection** – mechanisms that protect employees, who disclose information allegedly providing evidence of a legal, regulatory or ethical violation, from retaliation – is relatively advanced. The **Law on Protection of Persons who Report Irregularities** was adopted in 2019 as *lex specialis* combining all legal standards in one act and providing similar protection for people working in the private and in the public sector (Council of Europe, 2020_[32]). According to the authorities, when drafting the law, account was taken of the Council of Europe's Recommendation CM/Rec (2014)7 on the protection of whistle-blowers. Therefore the law provides for multiple whistle-blower protection measures. According to the law, all employers in the public and private sector with at least 50 employees have been required to set up internal reporting channels and appoint a "trusted person" for internal reporting of irregularities. The law likewise envisages the possibility of external reporting to the **Ombudsman** as well as public disclosure in case of an imminent threat (Council of Europe, 2020_[32]). In case of external reporting, the Ombudsman reports on whistleblowing to competent bodies (inspectorates, public prosecutors) that take action to protect whistle-blowers. The Ombudsman can participate in court proceedings in favour of the whistle-blower and file misdemeanour indictment proposals within its competences. The Ombudsman's Office is in charge of data collection on whistleblowing that is presented annually to the parliament and also publicly available. In order to fully harmonise the existing legal framework with the Directive (EU) 2019/1937 on the protection of persons who report breaches of EU law, according to the authorities a new draft proposal entered the legislative procedure in December 2021. The authorities also

envisage the development of promotional materials to raise awareness of the whistle-blower protection mechanism.

Additionally, the government has been engaged in **public awareness and education activities**. A number of activities is being organised for the general public, public officials, school pupils and university students, NGOs, media, business associations, and private companies. Educational materials have been produced as well, such as the guidelines for managing conflicts of interest of public sector employees; guidelines for the development of integrity strategies and integrity plans; guidelines for the implementation of corruption risk assessment; basic obligations and restrictions of officials regarding conflicts of interest; guidelines on the right of access to information, etc. Nonetheless, in the last ten years there has not been any evidence of broader campaigns. According to the new Anti-Corruption Strategy 2021-2030, the authorities plan to conduct a comprehensive anti-corruption campaign that will include media activities, conferences for central and local government officials, NGOs and journalists, as well as secondary education activities.

Box 3: Raising Awareness of Anti-Corruption Policies and Integrity in Academia

Raising awareness of anti-corruption policies and integrity in academia is especially important to harness young people's desire for fairness and equity, since they might become public or private actors in the future. A stocktaking analysis conducted in 2020 by the OECD in the context of the Project supported by the Siemens Integrity Initiative has shown that the majority of students in three Croatian pilot universities, i.e. the University of Zagreb, the University of Rijeka and the University of Split, does not have the option to attend anti-corruption and integrity courses throughout their studies. At the University of Zagreb, only the Faculty of Economics and Business, the Faculty of Law, and the Faculty of Political Science address these topics, giving only 29% of all students the opportunity to attend such courses. At the University of Split, the Faculties of Economics, Business and Tourism as well as the Faculty of Law integrate anti-corruption and integrity into their curricula so that only about 15% of all students can benefit from this offer. At the University of Rijeka anti-corruption and integrity topics are addressed in a limited number of courses at the Faculty of Law and the Faculty of Economics, resulting in 70% of students not being able to enrol in them. Thus, there is scope for universities to provide general and in-depth courses on these issues that are available to all students.

In the same stocktaking analysis, expert organisations fighting corruption claimed that it is common for leading professors to participate as speakers at government-led events and contribute to anti-corruption strategies. Nevertheless, universities themselves often do not take sufficient action yet against corruption within the faculties. For example, while the University of Zagreb and the University of Split both have a procedure to report corruption, students do not use it in practice. The University of Rijeka created a Whistle-blower Protection Guide, however, in early 2020 the service had not been used yet by students or the faculty. This shows that more could be done by universities to incentivise the reporting of corruption cases.

Therefore, there is still significant potential for improvement concerning visibility, awareness, and exchange about common principles and anti-corruption policies at universities but also across society in general. So far, an academic platform that brings the public, private and academic sector together does not yet exist in Croatia.

Key Recommendations:

The following key recommendations provide guidance for the way forward:

- Continue current reform efforts to develop comprehensive **codes of conduct** for persons with top executive functions as well as elected officials at regional and local level and ensure corresponding accountability tools and dissuasive sanctions for their potential violations. The **OECD Working Party of Senior Public Integrity Officials (SPIO)**, which promotes the design and implementation of integrity and anti-corruption policies, could assist Croatia in these efforts. Croatia might also consider to participate in the SPIO and broaden its engagement with the **OECD Anti-Corruption Network for Eastern Europe and Central Asia (OECD/ACN)**.
- Boost efforts to **raise awareness** against corruption. Promote a whole-of-society culture of public integrity, partnering with the private sector, civil society and individuals, in particular through carrying out campaigns to promote civic education on public integrity (OECD, 2017^[37]). The **OECD Public Integrity Handbook** and **OECD Education for Integrity** materials can provide guidance.
- Support the establishment of an **online academic platform**, which provides visibility of research, facilitates the exchange of good practices, stimulates discussions, and boosts awareness about common principles and recent anti-corruption reforms across various stakeholders, students and society. Such a platform would ensure that information is easily accessible for a broad audience and is collected sustainably in a long-term database.

1.2. Anti-Corruption Policy Framework

Croatia has already implemented several **anti-corruption strategies** and **associated action plans (APs)**. In October 2021, a new **Strategy for the Period 2021-2030** was adopted identifying the following priority areas for tackling corruption to be strengthened: the institutional and legal framework for the fight against corruption; transparency and openness of public administration bodies; the system of integrity and conflict of interest management in public administration; anti-corruption efforts in public procurement, as well as raising public awareness on the impact of corruption, necessity of reporting irregularities and reinforcement of transparency (The Croatian Parliament, 2021^[38]). In accordance with the new Anti-Corruption Strategy, at the end of 2021 the government established working groups for drafting a code of conduct for persons with top executive functions and for drafting a legal framework to regulate lobbying. In addition, the new Strategy foresees strengthening ethical standards of local, regional and central authorities as well as conducting a comprehensive anti-corruption campaign. According to authorities, the work on the first draft Action Plan for the implementation period 2022-2024 is underway. The budget allocated for the implementation of anti-corruption activities planned in each AP has increased over the last years (AP 2015-2016: EUR 2.3 million; AP 2017-2018: EUR 3.5 million; AP 2019-2020: EUR 9.0 million). According to the government analysis, the implementation rate of anti-corruption APs has also improved over time (2015-2016: 57%; 2017-2018: 83%; 2019-2020: 85%), even if no specific impact assessment has been conducted yet. Still, the authorities plan to externally evaluate the implementation of the new Strategy 2021-2030 and associated APs at the end of the implementing period. Preventing corruption on a smaller scale where it can go more easily unnoticed is crucial, too. In this context, 18 out of 20 counties established anti-corruption commissions and 10 adopted anti-corruption APs and codes of conduct for officials. Likewise, the Community of Counties published the “Anti-Corruption Guide for Local and Regional Government Officials and Employees”.

It should be positively highlighted that Croatia is also participating in **international anti-corruption frameworks**. For instance, it is a member of the OECD/ACN, a regional outreach programme of the OECD Working Group on Bribery that supports its member countries in their efforts to prevent and fight corruption. Moreover, Croatia participates in the Open Government Partnership (OGP). In the framework of this partnership, members have to co-create a two-year action plan with civil society that outlines concrete commitments to enhance transparency, accountability and public participation

in government. Croatia is currently implementing 15 commitments from its 2018-2020 action plan in areas such as open data and free access to information.

The **inclusion of civil society** in the drafting of the anti-corruption framework is crucial to take ownership, identify the root causes of corruption, define effective policy responses and prepare the monitoring of their implementation. In Croatia, civil society is involved in the development and monitoring of anti-corruption policy by means of participation in the Ministry of Justice’s coordination working groups on anti-corruption, the Government Council for the Prevention of Corruption and the Parliament National Council for Monitoring of the Implementation of the Anti-Corruption Strategy. The institutional “triangle” of the Government’s Office for Cooperation with NGOs, Council for the Civil Society Development and the National Foundation for Civil Society Development serves as a dialogue platform between civil society and the government. According to the authorities, civil society propositions get included in the anti-corruption legislation and explanations are provided for those that do not on the e-consultation web portal. However, the consultations are often lacking in quality and the uptake of comments remains low (European Commission, 2020_[36]). In general citizens’ involvement in decision-making remains relatively weak (European Commission, 2020_[14]). In addition, at an OECD event organised in the context of the Project in December 2021 civil society representatives criticised the existing institutional “triangle” for not communicating efficiently enough with the government in recent years. Moreover, there is no platform yet that allows for more regular exchange between civil society, public and private sector as well as academia who want to tackle corruption through collective action. Box 4 explains the benefits of using collective action community members would facilitate this endeavour.

Box 4: Using Collective Action to Counteract Corruption

In contexts that are vulnerable towards corruption, collective action has proven effective in promoting integrity and competition rules that actors will actively comply with (OECD, 2020_[39]). A widely accepted definition by the World Bank defines collective actions as follows: “A collaborative and sustained process of cooperation between stakeholders. It increases the impact and credibility of individual action, brings vulnerable individual players into an alliance of like-minded organisations and levels the playing field between competitors” (World Bank, 2008_[40]). The stakeholders can be representatives from the public and private sector, as well as from civil society and academia who want to define rules and standards to which they adhere globally and individually. Collective action can take many forms. It may involve a statement or declaration condemning corruption, an integrity pact, an initiative to develop common standards and principles, or a certification process (OECD, 2020_[39]). Collective action is a unique tool in advancing integrity and achieving a level playing field as it ensures that all participants, who co-operate and monitor each other, adopt the necessary standards at the same time.

However, it requires time, expertise and close collaboration to be sustainable and successful in the long term as its coordination, design and implementation are complex. Collective action does not involve a single, isolated event. In fact, a certain period of development and maturation is required, during which the various aspects of improving integrity can be addressed (OECD, 2020_[39]). The creation of a self-sustaining platform for interaction and dialogue between collective action community members is a way to ensure successful collective action. It allows for more regular communication, better coordination and easier exchange of good practices. Moreover, it enables the community members to proceed with and promote activities that raise awareness about anti-corruption practices in the public. Lastly, it helps to identify and boost champions for integrity that can take the position of role models.

Key Recommendation:

The following key recommendations provide guidance for the way forward:

- Boost the role of the institutional “triangle” for **civil society dialogue** with the government. Encourage stakeholders’ engagement at all stages of the political process, in particular through granting all stakeholders access in the development and implementation of public policies (OECD, 2017^[37]).
- Consider developing a **self-sustaining dialogue platform** to allow for more regular exchange between civil society, public and private sector as well as academia (i.e., establishing a collective action community). This can help increase overall NGO and business representation and public awareness about champions in the fight against corruption. Furthermore, such a platform could be used as a mechanism to monitor the implementation of national anti-corruption strategies and action plans.

1.3. Business Integrity and Corporate Liability

Business integrity refers to the commitment by businesses to consistently adhere to laws and regulations, certain ethical standards, and responsible core values. It is a prerequisite for a level playing field, as businesses can only compete fairly if none profits from unfair advantages resulting from corrupt practices. Business integrity is also an essential ingredient for sustainable and long-term business growth since having a good reputation is necessary to gain the trust of customers, suppliers, business partners and investors.

The **Companies Act**, the main legal act governing the corporate sector, establishes certain **corporate governance requirements** in regards to the rights and responsibilities of the shareholders, the rules of corporate management, as well as the rules on transparency, auditing and accountability. In addition, the principles of the **Corporate Governance Code**, which applies to joint-stock companies (JSCs) listed on the Zagreb Stock Exchange (ZSE), include ensuring transparent business operations, defining work procedures for boards of directors, avoiding conflicts of interest, and establishing internal controls and accountability mechanisms. The Code also includes provisions related to preventing and sanctioning bribery and corruption. Finally, a non-binding **Corporate Governance Code for SOEs** establishes business conduct principles with the view of establishing efficient and responsible governance of SOEs, even though there is currently no authority to monitor its implementation (OECD, 2021^[18]). However, until the adoption of a Whistle-blower Protection Act in 2019, corruption prevention in the corporate sector has been significantly lower on the government's reform agenda. The Whistle-blower Protection Act was an important step forward to improve awareness among companies of the need to adopt ethics programmes and measures for preventing and detecting irregularities. The development of internal channels for reporting became a statutory requirement for all employers with more than 50 employees. Nevertheless, the current situation leaves room for improvement in implementing internal whistle-blower mechanisms among businesses. According to the authorities, trainings on whistle-blower protection for SOE representatives are envisaged in the the Action Plan for the implementation of OECD recommendations for the improvement of corporate governance in legal entities owned by Croatia.

As another important step forward, in 2019 Croatia adhered to the **OECD Declaration on International Investment and Multinational Enterprises**, adopted the **OECD Guidelines for Multinational Enterprises for Responsible Business Conduct (RBC)** and established a National Contact Point (NCP) as a permanent mechanism for their promotion and implementation. The Guidelines for Multinational Enterprises provide recommendations on expected business behaviour in the areas in which business impacts people and the environment. They also deal with combating bribery, bribery solicitation and extortion. As a non-OECD member that adhered to the Declaration on International Investment and

Multinational Enterprises, Croatia participates as an associate in the Investment Committee meetings on issues relating to the Guidelines and in Working Party on Responsible Business Conduct (WPRBC) meetings.

While Croatian justice system has seen improvements in reducing length of proceedings and backlogs, the EU Justice Scoreboard shows that backlogs and the length of court proceedings still remain among the highest in the EU (European Commission, 2020^[14]). In that context, efforts to facilitate arbitration and mediation to unburden the judiciary are welcome, such as the Civil Arbitration Court that provides an alternative forum for the resolution of disputes related to small claims. There is still room for similar initiatives in business environments to facilitate the use of **out-of-court dispute resolution** such as a **business ombudsman** tailored specifically to businesses' needs who would help expedite the legal process and reduce the cost to businesses and citizens (OECD, 2019^[41]). Business ombudsman institutions are designed to supplement judicial and institutional responses to corruption by investigating claims of abuse of businesses' rights, resolving disputes as an impartial mediator between the involved parties and providing advocacy or advisory services (Danon and Savran, 2021^[42]). Some of them have also listed whistle-blower protection as their function (OECD, 2018^[43]). Ombudsman institutions are unique actors as they offer non-judicial ways of resolving suspicions of misconduct and they do not depend on the involvement of high-level authorities. Instead, they rely on their independence, neutrality, accessibility, transparency and expertise which results in high levels of trust among the society (Danon and Savran, 2021^[42]). Since business ombudsman institutions interact with businesses and their employees and oversee if their rights have been respected, they also monitor the implementation of policies for ensuring business integrity. In doing so, they can hold governments and businesses accountable and make recommendations for improvement (OECD, 2018^[43]). Such assessments are regularly included in reports that are submitted by business ombudsman institutions. Being a flexible tool that can fit local contexts, the institutions can either be part of a government, be based in business chambers or be independent bodies established by governments and business associations with the assistance of international partners.

Furthermore, the **Act on the Responsibility of Legal Persons for the Criminal Offences** establishes the **liability of legal persons** for criminal corruption offences. According to the Act, the responsible person is a natural person in charge of the operations of the legal person or entrusted with the tasks from the scope of operation of the legal person. The responsibility of a legal person is based on the guilt of a responsible person. The legal person shall be punished for a criminal offence of a responsible person if such offence violates the legal person's duties or if the legal person has derived illegal gain for itself or a third person. The liability of legal persons is autonomous, i.e., it is not restricted to cases where the natural person who perpetrated the offence is identified, prosecuted or convicted. The legal person shall also be punished for a criminal offence of the responsible person in case of existence of legal or actual obstacles for establishing of responsibility of a responsible person. The law envisages both fines and the termination of the legal entity as penalties, security measures as well as other legal consequences, e.g., a ban on obtaining subventions. According to the authorities, fines ranging from EUR 2 000 to EUR 1.3 million are not proportionate to the amount of the undue benefit.

With adopting the new **Anti-Money Laundering and Terrorist Financing Act** in 2017 and its amendments in 2019, the European regulation for anti-money laundering and terrorist financing has been implemented in the national legislation and the register of **beneficial owners** – natural persons who ultimately own or control a legal entity or arrangement – was introduced. State authorities and obliged entities have access to all information from the register while the broad public has free of charge access to beneficial owners' name, country of residence, date of birth, nationality, and the nature and extent of beneficial ownership. The Financial Agency oversees whether legal persons and trustees have completed the register while the Tax Administration verifies the accuracy of the information. The Anti-Money Laundering and Terrorist Financing Act prescribes sanctions for legal persons (EUR 660 to EUR 46 000, EUR 99 000 for the most severe misdemeanours), legal person's

responsible persons (EUR 660 to EUR 10 000, i.e. 13 000) and trustees (EUR 660 to EUR 10 000 i.e. 13 000 for the most severe misdemeanours) in case of a violation of legal provisions prescribing the obligation to keep accurate beneficial owner data, to enter and to update the data in the register.

Bribery of public officials is generally a common form of corruption practised by some businesses. The Criminal Code prescribes a series of corruptive criminal offences against official duty that are also in line with the catalogue of offences under Chapter 3 of the UN Convention against Corruption (UNCAC). Accordingly, criminal offenses against official duty are criminal offense of abuse of office and authority, unlawful facilitation, receiving bribery, giving bribery, influence trading, and of giving bribe for influence trading. The Criminal Code also prescribes corruptive offenses against the economy, namely, criminal offense of receiving and giving bribery in bankruptcy procedure, receiving bribery in business conduct, giving bribery in business conduct, and of abuse in the public procurement procedure. The aforementioned criminal offenses may also be committed within the criminal association. Criminal prosecution aims to seize unlawfully obtained material gain, in addition to imposing sanctions. In 2019, total property gain of EUR 2.7 million was confiscated in cases within the jurisdiction of the Office for the Suppression of Corruption and Organised Crime (USKOK), with EUR 1.3 million relating to confiscated property gain for corruption criminal offenses. The largest confiscation was due to the criminal offense of bribery for which EUR 801 632 was seized, while the amount of EUR 518 194 of the confiscated gain relates to the criminal offense of abuse of office and authority. With respect to temporary security measures (“freezing of assets”), in 2019 in corruption cases within the jurisdiction of USKOK, a forfeiture of property gain of EUR 480 509 was temporarily seized (Government of the Republic of Croatia, 2020^[44]). At the time of writing, Croatia and the OECD were conducting the EU-funded project “Raising Awareness and Standards of Fighting Bribery in International Business Transactions” in order to improve the legal and policy framework for fighting bribery and to support Croatia’s efforts to accede to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The Convention is the first and only international anti-corruption instrument focused on the “supply side” of the bribery transaction i.e. the person or entity offering, promising or giving a bribe. Countries that adopt the Convention commit to prevent, detect, prosecute and sanction bribery of foreign officials. The OECD Working Group on Bribery monitors parties’ compliance with the Convention and promotes better anti-bribery laws and enforcement (OECD, 2020^[45]). Still, the OECD project showed that there is little awareness of the risks of foreign bribery among businesses and the public. As part of the project, in October 2021 the Ministry of Justice and Public Administration, European Commission and the OECD organised a high-level conference “Fighting Transnational Bribery in Croatia: Impact of the OECD Anti-Bribery Convention and New Perspectives for Public and Private Stakeholders”. The project also includes a report assessing Croatia’s legal and policy framework for fighting foreign bribery, as well as workshops for stakeholders at all levels to present the OECD assessment and recommendations for Croatia.

Lobbying can provide decision-makers with valuable insights and data, as well as grant stakeholders – such as businesses – access to the development and implementation of public policies. However, it can also lead to undue influence, unfair competition and regulatory capture to the detriment of the public interest and effective public policies. A sound framework for transparency in lobbying is therefore crucial to safeguard the integrity of the public decision-making process (OECD, 2013^[46]). In Croatia, there are no detailed rules to regulate contacts of individuals in top executive functions with lobbyists and also no reporting or disclosure requirements applicable to those who seek to influence government actions and policies. Both the Government Programme for 2020-2024 and the new Anti-Corruption Strategy 2021-2030 envisage the adoption of a comprehensive regulation on lobbying. To this end, a working group was established and the drafting process was expected to last until the end of 2022 (Council of Europe, 2021^[35]).

Key Recommendations:

The following key recommendations provide guidance for the way forward:

- Expand awareness raising activities related to **whistle-blower protection** to include the private sector, in addition to envisaged trainings for SOEs. Awareness raising can help change the culture and language surrounding whistleblowing and ultimately break down the negative connotations associated with disclosing wrongdoing (OECD, 2016^[47]).
- Establish a **dispute avoidance mechanism**, tailored specifically to business needs, such as a **Business Ombudsman**. This would help to expedite the legal process and reduce the cost to businesses and citizens (OECD, 2019^[41]).
- Continue reform efforts to implement the OECD recommendations to improve the policy framework for fighting **bribery** and to accede to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Improve awareness among companies of the Convention through workshops and other forms of guidance.
- Continue efforts to develop a comprehensive regulation on **lobbying** (see Box 5). The Recommendation on Principles for Transparency and Integrity in Lobbying, which is the first international set of guidelines to address integrity risks related to lobbying practices, can provide guidance (OECD, 2010^[48]).

Box 5: Transparency on Lobbying Activities in Poland

In 2010, the OECD adopted the Recommendation on Principles for Transparency and Integrity in Lobbying – the first international instrument to address undue influence and inequities in the power of influence. The Lobbying Principles advocate for the disclosure of lobbying activities and for the provision of sufficient information on key aspects of lobbying activities to enable public scrutiny.

Poland, for example, provides transparency on lobbying activities through a register of entities performing professional lobbying, as well as lists of registered persons administered by the chambers of parliament. Lobbyists' registration is mandatory to conduct lobbying activities and to access parliamentary premises and hearings. Lobbyists must notify the authority responsible for maintaining the registers of any modification made to the data recorded in the register within seven days of the modification. Managers of public authorities must publish, once a year, information on interactions with lobbyists that they had. The information is published in the Public Information Bulletin. The oversight body for lobbying activities is the Ministry of Interior and Administration. It administers the register of professional lobbyists and enforces sanctions (fines or ban from lobbying activities). The register is available online.

Moreover, the Standing Orders of Lower House (Sejm) provide for the publication of proposals, expert opinions and legal opinions submitted by lobbyists to Committees working on a specific bill. The documents are made available on the Sejm's Information System. The Senate Regulations also specify that the rapporteur of a committee reporting on legislation must indicate when activities are performed by professional lobbyists in the course of committee work. They must also present the committee's position on the proposals presented by lobbyists.

The strength of this approach lies in the aspect that not only lobbyist themselves have to be registered but also the interaction with them has to be reported as well as the outcome of the lobbyists' activities. This allows for a thorough documentation of lobbying. Furthermore, the documentation is transparent as the information is published regularly online so that it is available for the public.

Source: (OECD, 2021^[49]), *Lobbying in the 21st Century: Transparency, Integrity and Access*, <https://doi.org/10.1787/c6d8eff8-en>.

1.4. Investigation and Prosecution

Anti-corruption frameworks can only be effective if there are well-functioning investigative and prosecutorial bodies and procedures which enforce them.

The **Office for the Suppression of Corruption and Organised Crime (USKOK)** is a special state attorney's office for **investigation and prosecution of corruption**, including high-level corruption. It was established in 2001 with country-wide responsibilities. USKOK has jurisdiction over criminal offences such as abuse in performing governmental duties; illegal intercession; accepting and offering a bribe, including in economic transactions; abuse of office and official authority; money laundering; evasion of taxes and other levies (OECD, 2019^[41]). The director of USKOK is appointed by the Chief State Attorney, with prior opinion from the Minister of Justice and Public Administration and the Board of the State Attorney's Office, for a four-year term with possibility of reappointment. In 2020, USKOK employed 33 prosecutors and 41 civil servants and employees. Corruption cases are presented in court by specialised anti-corruption prosecutors. All forms of influence against state attorneys and deputy state attorneys are prohibited. The Law on the Judicial Academy regulates professional training of judicial officials and civil servants, USKOK included.

Various sources of information, including financial intelligence units' reports and asset and interest disclosure, are routinely used for the **detection of high-level corruption**. USKOK investigates public allegations of high-level corruption and based on the results, makes decisions to open an investigation. On its website, it communicates to the public the progress of investigations, filing of indictments and rejections of criminal charges. Decisions on prohibition of holding public offices by persons convicted for high-level corruption are within the jurisdiction of courts and depend on the circumstances of each case. On its website, the State Attorney's Office (DORH) publishes annual reports on the work of every state attorneys' office, including USKOK, and also reports annually to the parliament. USKOK cooperates with civil society but there are no special mechanisms for civil society oversight. There have not been any allegations of corruption perpetrated by USKOK in the period 2017-2020. At first under-resourced and ineffective, meanwhile USKOK has been described by some observers as one of the world's most respected anti-corruption outfits, having prosecuted more than 2 000 defendants during its first ten years of existence and achieving in 2017 a conviction rate of roughly 90% (OECD, 2019^[41]). The positive trend on corruption investigations and prosecutions has continued until the present moment, including at local level. However, once the cases reach the courts, several high level corruption cases face lengthy procedure that delays court rulings. In order to address this issue, the new Anti-Corruption Strategy 2021-2030 sets the objective of improving the legal framework for the prosecution of corruption offences with the aim of speeding up judicial proceedings (European Commission, 2021^[33]).

Regarding **corruption cases in the industry and energy sectors**, in the period 2015-2021 USKOK handled 4 cases involving 35 persons from the energy sector (11 indictments; the investigation is still ongoing against 24 persons). In the same period USKOK handled 22 cases in the industry sector involving 143 persons (101 indictments; the investigation is ongoing against 42 persons). Even though USKOK does not keep special statistics on the share of high-level corruption cases, defendants have included a former prime minister and a former vice president, former ministers, mayors and other high officials. For example, in 2018 the first-instance verdict on war profiteering was issued convicting former Prime Minister Ivo Sanader of an offense for abuse of office and power and sentencing him to 2 years and 6 months in prison. Due to the criminal offence of abuse of office and authority in the so-

called “Planinska case”, in 2019 the Supreme Court upheld the first-instance conviction, increased the sentence and sentenced him to six years in prison. The defendant is currently serving his sentence. In addition, in 2019, the former Prime Minister was sentenced to six years in prison for bribery during the privatisation of oil and gas company INA, at present minority-owned by the state. In the same case, the head of a Hungarian oil company MOL was sentenced to two years of imprisonment for a bribery offense. The first-instance conviction in this case became final in 2021 (Government of the Republic of Croatia, 2020^[44]). At the time of writing, USKOK was conducting an investigation in the wind park case against former Minister of Regional Development and EU Funds Gabrijela Zalac and former State Secretary Josipa Rimac for supposed bribery and abuse of office and powers. USKOK suspected they had tried to influence members of the Croatian Bank for Reconstruction and Development’s supervisory board to give state loan to a company for a wind park project, regardless of required conditions⁹ (N1, 2021^[50]).

In addition to USKOK, there is the **National Police Office for the Suppression of Corruption and Organized Crime (PNUSKOK)** as an organisational unit of the Criminal Police Directorate responsible for conducting criminal investigations on organised crime and corruption. Regarding specialisation in corruption cases, county courts in Osijek, Rijeka, Split and Zagreb as well as municipal courts in Osijek, Rijeka, and Split, and the Municipal Criminal Court in Zagreb have **special court departments for criminal cases** under the USKOK Act.

Concerning **alternative and innovative sources of legal assistance**, an OECD stocktaking exercise¹⁰ showed that Croatian law faculties have **legal clinics** that operate within the framework of the Law on Free Legal Aid. They are authorised to provide primary legal aid, i.e., students who work there can give legal advice and general legal information, as well as provide help in drafting documents for administrative and other procedures, but they cannot represent clients before the court. For example, the University of Zagreb Faculty of legal clinic, founded in 2010, handled 2 159 cases in 2016, 2 132 in 2017 and 1 158 in 2018 (University of Zagreb, Faculty of Law, 2021^[51]). Moreover, following powerful earthquakes that hit Zagreb and the county Sisak-Moslavina in 2020 the legal clinic also provided legal aid to earthquake victims. The law faculties of the universities in Split and Osijek have legal clinics as well and the University of Rijeka established one in March 2021. Still, there are no specialised anti-corruption legal clinics that would provide explicit legal aid in corruption cases.

Key Recommendation:

The following key recommendation provides guidance for the way forward:

- Support universities in the endeavour to introduce **Anti-Corruption Legal Clinics**, which aim to provide free general consultation to companies and citizens regarding corruption issues and which equip students with comprehensive knowledge and hands-on experience (see Box 6).

Box 6: The Legal Clinic for Anti-Corruption at the University of Belgrade in Serbia

⁹ In November 2021 former EU Funds Minister Gabrijela Zalac was arrested on suspicion of corruption in relation to overpayment for a software contract, pursuant to a warrant by the European Public Prosecutor's Office (Balkan Investigative Reporting Network, 2021^[81]).

¹⁰ As part of the project *Fair Market Conditions for Competitiveness in the Adriatic Region*, the OECD carried out a stocktaking exercise in three pilot universities, the University of Zagreb, University of Rijeka and the University of Split, in order to measure the extent to which anti-corruption and integrity topics are part of their current curricula.

As an alternative and innovative source of legal assistance, the University of Belgrade has established a Legal Clinic for Anti-Corruption that is run by students and professors. The Legal Clinic provides a special form of education for 4th year undergraduate students consisting of a theoretical and a practical part which allows for gaining comprehensive knowledge and experience.

In the theoretical part, students learn about the notion of corruption, its impact on human rights and anti-corruption mechanisms. They are also educated about international and European anti-corruption approaches with a special focus on UNCAC and the Serbian normative and institutional framework. The practical part consists of work with clients at the Legal Clinic in the form of provision of legal information and advice. It further includes internships at, for example, the ACA/APC, the court, the Public Prosecution Office, Transparency Serbia or Pištaljka, a knowledge centre concerning whistleblowing policies. Moreover, students cooperate with NGOs by monitoring court cases and by providing legal analysis and free legal advice. Lastly, the practical part entails cooperation with international organisations like UNDP, USAID and OSCE which offer lectures by international practitioners and experts, and an essay competition where two students are awarded a trip to Italy to visit anti-corruption bodies.

Although the Legal Clinic does not provide any form of official legal aid, it supplies free general legal information, for example on existing legal remedies in a case of corruption. This is highly beneficial for companies and citizens who are looking for easy and quick access to this information. This model also benefits students who can attain not only theoretical but also practical, hands-on experience and it offers them the opportunity to get in contact with potential employers.

Source: OECD stocktaking exercise as part of the project *Fair Market Conditions for Competitiveness in the Adriatic Region*.

2. Competition Policy: Moving towards an Improved Business Environment

Why Competition Policies Matter

Competition has been recognised as a powerful driver of productivity growth and innovation. It gives businesses incentives to be more efficient and innovative, to lower their costs, to reduce their prices, and to better respond to customers' needs. Furthermore, it motivates them to supply internationally competitive products and services and to upgrade in global value chains. Thus, a competitive economic environment helps raise economic growth and increase living standards, thereby also helping to reduce inequality. High levels of competition are especially important for economies like Croatia which can substantially benefit from the sophistication of products and services for the domestic market and for boosting their exports. Higher levels of competition can be achieved by implementing well-designed competition policies and by fostering integrity, since there is an inverse relationship between competition and corruption: low levels of competition and high levels of corruption are correlated (OECD, 2015^[2]).

OECD Findings on Competition Policies

In general, the legislative framework on competition is broadly in line with international standards. The Croatian Competition Agency as well as sectoral regulatory bodies are visibly aligned to international best practices with regard to their scope of action and powers to fight anticompetitive behaviour. However, additional efforts would be highly beneficial with regard to improving cartel detection, bid rigging prevention, public procurement procedures and the promotion of competitive neutrality.

The Role of Competition Policies in the Energy and Industry Sector

Competition policies are particularly vital in the energy and industry sectors. As capital-intensive sectors, these are generally characterised by higher market concentration, as also seen in Croatia, and may attract more anti-competitive behaviour to increase profit margins. Moreover, a general strong prevalence of SOEs in these sectors increases opportunities for a disruption of the level playing field, meaning that SOEs may benefit from unfair advantages, due to their ownership structure. Additionally, in energy and industry projects, public procurement plays a major role – a process that sometimes attracts manipulation and rent-seeking attempts. For businesses in Croatia, issues of corruption and conflicts of interest remain widespread in public procurement (European Commission, 2020^[14]).

2.1. Scope of Action

The main body in charge of competition is the **Croatian Competition Agency (CCA)**. It is an independent legal entity with public authority established in 1995 and operative since 1997 that performs its duties in accordance with the **Competition Act**, adopted in 2009 and amended in 2013 and in 2021. As an independent regulatory body, the CCA does not receive binding directions from any state body in any area of its work. According to the CCA, the Competition Council and the experts exercise their powers free of political and any other influence, without prejudice to the powers of the government to adopt general policy rules not associated with sector inquires or procedures carried out or falling within CCA's powers. The CCA is accountable for the delivery of its objectives to the parliament, to which it submits annual reports. Apart from being a member of the International Competition Network and the European Competition Network, it also participates in the work of the OECD-GVH Regional Centre for Competition in Budapest and since 2016 has a participant status in the OECD Competition Committee. Regarding enforcement capacity, the CCA staff consisted of 52 employees in 2019. These data can be appreciated by comparison with the competition authorities that participated in the OECD Database on General Competition Statistics (OECD CompStats¹¹). Namely, in 2019 the average total staff of the 15 competition authorities in small countries (with a population lower than 7.5 million) was 114, of whom 43 were working on competition. The budget for competition law and policy of the CCA decreased from EUR 1.9 million in 2015 to EUR 1.5 million in 2017, but it started to rise with the introduction of a new competence (enforcing rules regarding unfair trading practices in the food supply chain) in 2017 to reach EUR 1.9 million in 2019¹². Still, in comparison with international standards, the annual budget of the CCA is rather low. Indeed, in 2019 the average financial resources of the 15 competition authorities in small countries that participated in OECD CompStats were EUR 5.4 million (OECD, 2020^[52]).

The provisions of the Competition Act apply to all legal and natural persons that perform economic activities in the country ensuring **competitive neutrality**. More precisely, state-controlled firms are not exempt from the application of competition law when conducting commercial activities in competition with private firms. Moreover, the CCA has already issued decisions on mergers and abuses of dominant position involving SOEs, such as the Croatian Post and certain railway companies (OECD, 2021^[18]). For example, in 2015 the CCA found that the SOE Croatian Post did not abuse a dominant position in the postal services market that was confirmed by the Arbitration Tribunal at the

¹¹ OECD CompStats is a database with general statistics about competition agencies, including data on enforcement and information on advocacy initiatives. It encompasses data from competition agencies in 56 jurisdictions, including 37 OECD countries (36 OECD countries and the European Union) (OECD, 2020^[80]). The database currently covers the period 2015-19 and data will be collected annually in the future.

¹² In 2018 the CCA budget increased also thanks to the EU funds for the implementation of an EU twinning project with the Montenegrin Agency for Protection of Competition.

International Centre for the Settlement of Investment Disputes in Washington (Croatian Competition Agency, 2016^[53]). In 2019, the CCA decided that there were no reasons to initiate proceedings against the railway company HŽ Infrastruktura since it did not put another railway company, HŽ Cargo, in a more favourable position than other rail freight carriers (Croatian Competition Agency, 2020^[54]). At the moment there are several proceedings involving SOEs – among others, forest and woodland management company Hrvatske šume (Croatian Woods).

Another vital aspect to the protection of competition is controlling **state aid** since this financial tool can distort the level playing field if it is not used with moderation or if only certain market players benefit from it. The government, through the Ministry of Finance, is authorised to issue state guarantees for SOE loans at the proposal of the competent ministry. For this purpose, a guarantee agreement is concluded between the Ministry of Finance and the borrower/SOE which defines the obligations of the SOE with regards to the use of credit funds. In line with EU rules, state guarantees of legal monopolies, such as the Croatian Motorways, Croatian Roads and the Croatian Railways Infrastructure, are not treated as state aid. Even though SOEs are not required to report on financial assistance received from the state, government guarantees are published by the Ministry of Finance and on the government's website. The decisions on guarantees issuance are also contained in government sessions' public records (OECD, 2021^[18]).

While the legal and institutional framework described above applies to the energy and industry sectors, there are also a number of independent **regulatory bodies** operating, amongst others, in the sectors of energy, railways and water services. It is important to mention that, unlike other regulators, the CCA carries *ex post* infringement proceedings in all sectors of the economy, despite the existence of a specific regulator in the market and the sector specific regulation. According to the authorities, sectoral regulators make independent decisions and treat private firms and SOEs equally. They also regularly monitor and publicise decisions on the SOEs (OECD, 2021^[18]).

In the energy sector, the **Croatian Energy Regulatory Agency (HERA)** regulates the electricity, gas and district heating sectors. It is an independent body with tasks and duties defined in legislation. Regarding independence in the decision-making process, HERA's decisions are directly applicable and do not need confirmation by another body. It also has the power to make recommendations or to issue opinions on draft legislation and/or policy documents as well as to supervise and carry out investigations and inspections. HERA's enforcement tools are: requesting information/data, accessing relevant documents, organising hearings, revoking licenses or certifications, and initiation of legal proceedings at a court. Procedures for appeal of HERA's decisions can only be overturned by courts. However, unlike other EU national regulatory agencies (NRAs), HERA has the legal power to request and set a deadline for the provision of information from regulated entities through a compulsory process. Also, unlike almost all EU NRAs who have sanctioning powers for imposing penalties for non-compliance, HERA is competent to request information from regulated entities, but it does not have sanctioning powers to impose penalties in cases of non-compliance. In that case, HERA can submit a motion to indict before the competent court for initiating misdemeanour proceedings. Regarding independence in resources, HERA has sufficient financial resources at its disposal. In recent years HERA's workload increased substantially and, according to the authorities, new personnel is needed to be able to regulate energy activities in a transparent and sustainable way. It is mainly staffed with civil servants and it experienced a constant growth in staff numbers in the period 2017 to 2019. Its permanent staff is not subject to any form of personnel restrictions nor cooling off period for those who pursue employment in sectors regulated by HERA. HERA is governed by the Board of Commissioners with five members appointed by the parliament. Regarding the employment of HERA's board members, there are no restrictions either. Candidates for the positions of board members are required to have at least ten years of work experience in the energy sector. The president of the board is required to have at least four years of work experience in management positions in the field of energy activities or another related field in the energy sector. Once in office, board members are not

allowed to hold other offices or appointments in the government/the regulated industry simultaneously. In regard to a subsequent position of board members in the relevant regulated sectors, they have to comply with rules to avoid conflicts of interest to accept the position. The competent ministry elaborates a financial plan for the energy sector, including HERA, that forms part of the state budget approved by the parliament. HERA is legally required to disclose all its respective decisions, resolutions and agreements as well as to carry out public consultations on relevant activities.

Regarding the industry sector, its subsectors' competition policies are not governed by a single regulatory sub-body but rather by several entities. For instance, each transport mode has its own regulatory body that is inter alia responsible for issues related to competition. The **Croatian Civil Aviation Agency** is an independent and non-profit legal entity whose activities include air traffic safety related tasks, especially certification, oversight and supervision. Since joining the EU in 2013, the Croatian Civil Aviation Agency acts as an extended arm of the EU Aviation Safety Agency in the implementation of Union legislation in the field of civil aviation. According to the Agency's annual report, there were 15 aircraft operators registered in the country in 2019 (Croatian Civil Aviation Agency, 2019^[55]). The national flag carrier Croatia Airlines, majority owned by the government, holds 36% of the market (Croatia Airlines, 2020^[56]). Even though it had undergone restructuring, Croatia Airlines has been operating at a loss for years and the National Reform Programme 2020 includes the objective of finding a strategic partner for the air transport company (Government of the Republic of Croatia, 2020^[57]).

The **Croatian Regulatory Authority for Network Industries (HAKOM)** is an independent national regulatory authority tasked with regulating the rail, telecommunications and the postal industries. It was established after the merger of three earlier regulatory agencies: the Croatian Telecommunications Agency, the Postal Services Council and the Rail Market Regulatory Agency. Regarding rail services market, HAKOM is responsible for the market regulation of rail services and the protection of end-user rights. It is financed by fees from the rail infrastructure manager, collected in turn from railway undertakings. Regarding the opening of the freight market, competitors' average market share in the EU27 rail freight market increased from 34% to 42% between 2015 and 2018 with Croatia reporting one of the highest growth rates (30%). When it comes to the opening of the passenger market, on average competitors had a 10% market share in national commercial passenger markets¹³ in the EU27 in 2018, while Croatia reported no competitors in commercial services with a market share of 1% or more for 2018 (European Commission, 2021^[58]). Indeed, there is only one railway infrastructure manager and operator present on the railway market, the SOE Croatian Railways Infrastructure. Although the Railway Act liberalised the rail passenger market, there was also only one passenger carrier present in 2019 in the country, the historical passenger carrier Croatian Railways Passenger Transport. On the other hand, freight services were operated by nine carriers in 2019, two more than in 2018 (Croatian Regulatory Authority for Network Industries, 2020^[59]).

The **Ministry of Sea, Transport and Infrastructure** is the competent authority for managing market access for international transport of goods and passengers by road (International Transport Forum, 2018^[60]). In managing the construction, maintenance and operations of the road network it relies on SOEs like the Croatian Roads and the Croatian Motorways that are financed through proceeds from fuel tax and a few other fees related to vehicle use. Despite restructuring efforts, these companies continue to generate losses and to rely on government support (OECD, 2021^[18]).

Key Recommendation:

¹³ Shares are measured in passenger kilometres, which are not served by the historic incumbent operator.

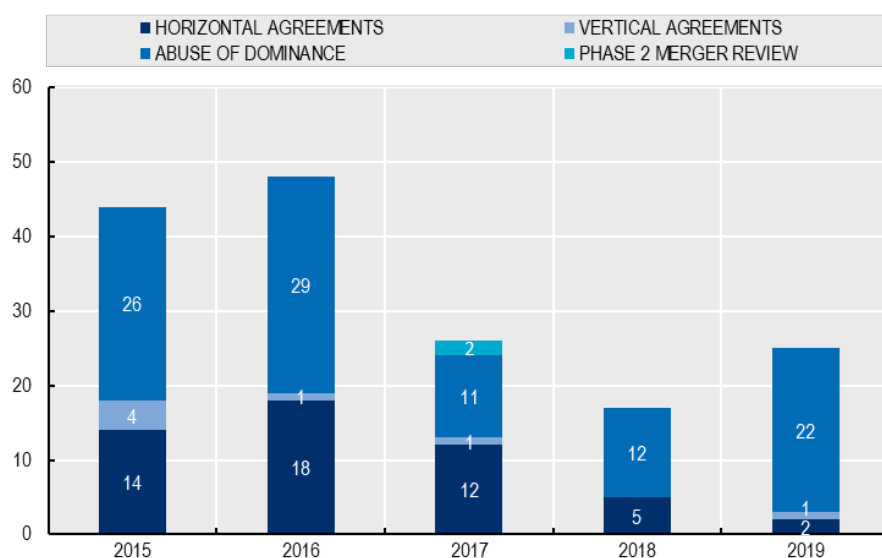
The following recommendations provide guidance for the way forward:

- Provide the CCA with adequate **financial resources** that would develop its full potential in terms of competition enforcement and advocacy.
- Remove remaining **regulatory barriers to competition** in the network industries. Public ownership of large network operators is still widespread and regulation in network industries could be better aligned with international best practice.

2.2. Fight against Anti-Competitive Behaviour

Even though the CCA has appropriate powers to investigate, sanction, or remedy possible **antitrust infringements**, there is room for improvement of its record of competition enforcement. Namely, according to OECD CompStats, 15 small economies included in the database (comparable to Croatia) made on average 60 competition decisions during the period 2015-2019, while Croatia made 45 (see Figure 2).

Figure 2: Competition Decisions in Croatia (2015-2019)



Note: The number of decisions on anti-competitive horizontal agreements (cartels) decreased from 14 and 18 in 2015 and 2016 to 5 and 2 in 2018 and 2019. By comparison, the average number of cartel decisions in Europe has been stable at around an average 5 decisions a year during the period 2015-2017, with a small drop in 2018 (4 decisions) (OECD, 2020^[52]). The number of decisions with a vertical element also decreased from 4 in 2015 to 1 or 0 in the following years. Although it rarely launched dawn raids for that purpose (1 in 2015, 1 in 2017 and 2 in 2018), the scores are in line with international standards, particularly for small non-OECD countries, because in 2018 the average number of dawn-raids for non-OECD jurisdictions was also 2.4. Namely, with the exception of leniency programmes, dawn raids are the most effective tool to obtain both direct evidence and supporting circumstantial evidence. The amount of monetary fines varied to a great extent from EUR 2.3 million in 2015 to EUR 0 and EUR 1 400 in 2017 and 2018. In comparison with the CompStats jurisdictions, the fines imposed by the CCA are very low. Namely, total average fines imposed by the Comp Stat competition authorities were EUR 96.4 million in 2015, EUR 134.1 million in 2016, EUR 127.4 million in 2017 and EUR 83.3 million in 2018 (OECD, 2020^[52]). With regard to abuse of dominance cases, the number of decisions was high in 2015 and 2016 (26 and 29) to fall in 2017 and 2018 (11 and 12) and then to rise again in 2019 (22).

Source: Data provided by the CCA.

The CCA has also a **leniency programme** that ensures immunity from sanctions to a cartel member that first informs the CCA on the existence of the cartel or that first submits evidence that enables the CCA to detect the cartel's existence. However, it appears that the program might not be efficient enough since there was only one application in the period between 2015 and 2019. By comparison, although the average number of leniency applications to each OECD CompStats competition authority has been decreasing from an average of 14 in 2015 to 7 in 2018, it is still higher than in Croatia. Looking specifically at the non-OECD jurisdictions, the average number was 11 in 2015 and 5 in 2018 (OECD, 2020^[39]).

Thorough **merger control**, meaning the procedures used for reviewing corporate mergers and acquisitions, is vital to avoid anti-competitive consequences of concentrations, e.g. like monopolisation, less choice and higher prices for customers. Like the majority of OECD CompStats jurisdictions, Croatia requires mandatory pre-merger notification for transactions that meet certain thresholds and the **Competition Act** provides for ex ante control of mergers. The CCA may compel merging firms and third parties to provide information to help it assess the merger. When assessing the merger, the CCA may conduct an economic analysis of the competitive effects of mergers and also consider whether the merger is likely to generate efficiencies. The CCA can clear a merger that raises anticompetitive concerns by negotiating/accepting remedies that address these concerns at an early stage and thus bring the case to a faster conclusion, avoiding a lengthy and detailed investigation. Furthermore, the CCA can impose sanctions on firms and/or individuals that do not comply with a decision on a merger. In the period between 2015 and 2019, the number of merger notifications more than doubled from 11 in 2015 to 24 in 2019. The number of Phase I clearances decreased from 18 in 2015 to 13 in 2019, none with remedies. In the period 2015-2019 the CCA conducted 4 Phase II clearances and 2 with remedies. In the period 2015-2019, the CCA did not prohibit any merger. In comparison, over 40% of OECD CompStats jurisdictions also did not prohibit a single merger during 2015-2018 (OECD, 2020^[39]).

Ensuring that **public procurement** is competitive, is a prerequisite to secure the best value for public money. The **State Commission for the Supervision of Public Procurement Procedures** is the main institution responsible for controlling state procurement. It decides on the legality of proceedings, acts, omissions and decisions adopted in the procurement procedure and can submit indictments for misdemeanour. The decisions of the Commission are public and they are used by the State Audit Office when directing audits. The Council of Europe commended the Commission's work and other features of the procurement system, such as a contract register and the possibility of submitting electronic complaints to the State Commission, as well as the advanced level of e-procurement (Council of Europe, 2019^[61]). However, insufficient regulation of the Commission members' status was identified as a corruption risk in the Anti-Corruption Strategy 2015-2020. To address this issue, the authorities amended the Law on the State Commission for the Control of Public Procurement Procedures in April 2021. Further strengthening of the Commission is planned by specifying work methods that follow strict ethical standards. In addition, the authorities plan to further enhance transparency of simple procurement procedures in order to meet corruption risks when planning and selecting bids. According to the authorities' report from December 2021, the Ministry of Economy and Sustainable Development initiated a procedure for amending the Public Procurement Act and proposed to introduce a mandatory e-complaint system to make the procedure more time-effective and transparent. Overall, 67% of businesses consider conflicts of interest in the evaluation of public procurement bids to be widespread and 71% consider tailor made specification for specific companies and collusive bidding to be common. Moreover, at the local level 74% consider corruption widespread in public procurement managed by regional or local authorities (European Commission, 2020^[14]). In September 2021, Croatian media reported on a suspicious public procurement case in the energy sector according to which the energy company HEP could have saved EUR 9 million on digitalisation by accepting a favourable procurement bid. Instead, HEP annulled the tender process and published a new request for tender. However, the State Commission for Supervision of Public Procurement

Procedures called off HEP's annulment of the first tender and, at the time of writing, it was deciding on HEP's new request for tender (Telegram, 2021_[62]).

In terms of measures against **anti-competitive behaviour in the energy sector**, energy reforms in accordance with EU commitments and national energy strategies have been implemented, which include adopting a regulated **third-party access** regime, establishing a power market and **unbundling** the transmission and distribution sub-sectors from power generation and supply. The electric and gas SOE HEP Group has undergone vertical unbundling and established separated entities for generation, transmission, distribution and supply. New companies have entered the electricity and gas supply business, and electricity and gas prices have been gradually deregulated. The electricity exchange CROPEX started operations in 2016, and in 2018 it coupled with the Slovenian exchange (World Bank, 2019_[63]). In 2020, two new members joined CROPEX Markets, both day-ahead¹⁴ and intraday¹⁵ markets (MFT Energy A/S from Denmark along with TrailStone Renewables GmbH from Germany). By the end of 2020, there were altogether 22 registered CROPEX members active on the day-ahead market, of which 15 were also active on the intraday market (CROPEX, 2020_[64]). In general, since joining the EU in 2013, Croatia has implemented many EU Directives aimed at opening its electricity sector to competition and integrating it into a single EU electricity market. However, competition in the electricity market is still limited, and inefficiencies affect the deployment of renewable energy sources, the environment and raise costs for consumers (European Commission, 2020_[14]). Competition in the country's gas wholesale markets is limited as well, wholesale gas prices are still highly regulated and discourage market entry and competition (European Commission, 2020_[14]).

Between 2002 and 2010, **state aid** volumes in Croatia were among the highest in the EU (1.2% vs. 0.5% of GDP in the EU-12), with a dominant share going to the shipbuilding and transport sectors. The amount of state aid has declined since the early 2000s, mainly due to the relaxing of support and restructuring of the shipbuilding industry as a condition for the accession to the EU. Still, state aid has increased in the past years again, becoming more concentrated in regional development and SME support policies: by 2017 33% of state aid was allocated for regional development (0.4% of GDP), 17% for SME support (0.2% of GDP) and 10% for culture (0.1% of GDP) (World Bank, 2019_[65]).

Key Recommendations:

The following recommendations provide guidance for the way forward:

- Give priority to boosting **cartel enforcement**. To that end, enable the CCA to have access to all types of electronic information and investigative techniques, train specialised staff and provide adequate hardware and software equipment (OECD, 2019_[66]).
- Set fines for anti-competitive behaviour high enough to ensure deterrence and to support the effectiveness of the **leniency programme**.
- Strengthen the capacity of existing **control mechanisms for public procurement** (see Box 7). The OECD Recommendation on Public Procurement and the OECD Public Procurement Toolbox can provide useful guidance. Implementing the OECD Recommendation on Bid Rigging in Public Procurement would also help to improve public procurement procedures.

Box 7: Crosschecking Data to Flag Conflicts of Interest in Public Procurement in Romania

¹⁴ The day-ahead market is a local auction to allow day-ahead trading within the single electricity market.

¹⁵ Intraday power trading refers to continuous buying and selling of power at a power exchange that takes place on the same day as the power delivery.

Data collected for state contractors, companies, beneficial ownership and financial disclosures of public officials can be used for detecting potential and preventing actual conflict of interest (COI) particularly through the identification of red flags in public processes that are at higher risk of COI. Public procurement is particularly vulnerable to COI.

Romania's "Prevent" programme is an integrated IT system aimed at preventing conflict of interest in public procurement. This system has enabled the National Integrity Agency (A.N.I.) to identify COIs ex-ante and prevent the award of contracts where a COI exists. The Romanian system performs an ex-ante analysis and automatically detects whether participants in the public bid are related or otherwise connected to the management of the contractor. The system predicts the likelihood of a potential COI with a risk rating for each tender; for this it uses relevant data on both sides of the equation: about the contracting authority and the bidder. These predictions are based on information about the individuals making decisions on the contracting authority's side and to the company data on each bidder's side.

A.N.I. performs data analysis of collected information, conduct crosschecks and generate relational maps. If applicable, it issues red flags that the system automatically translates into an integrity warning for the head of the contracting authority.

This example which makes use of e-procurement information represents a comprehensive approach to tackle conflict of interest as it allows ex-ante detection and it is based on detailed data that allows for useful mechanisms like individual risk ratings and automatic warnings.

Source: (OECD, 2020^[67]), *Preventing and Managing Conflicts of Interest in the Public Sector: Good Practices Guide*, <https://documents1.worldbank.org/curated/en/950091599837673013/pdf/Preventing-and-Managing-Conflicts-of-Interest-in-the-Public-Sector-Good-Practices-Guide.pdf>.

2.3. Advocacy

Promoting compliance with competition principles through advocacy is an important precondition for developing a stable competition culture in the long term.

The CCA has wide-ranging **advocacy powers**. It advocates competition at central, regional and local government levels, issues expert opinions on draft and existing laws affecting competition, and performs market studies. All new public policies that may have implications for competition are subject to a **competition assessment** by the CCA. The CCA issues expert opinions at the request of ministries and other state authorities, that may also be requested to communicate to the CCA draft legislation for the purpose of assessment and issuing expert opinions on their compliance with the Competition Act, if the CCA finds that they may raise competition concerns. The same applies for legislation proposed by regional and local government, professional, and other associations that pass subordinate legislation. According to the CCA, ensuring consistency of existing legislation with the Competition Act represents a challenge to them, for example, when professional associations rely on existing legislation to determine minimum prices. The CCA has a specialised unit in charge of competition assessment. Although expert opinions on draft legislation are not obligatory, according to the CCA most of recommendations and objections to draft laws are accepted. Since 2015 the CCA performed three to four **market studies** per year. If a study identifies an obstacle to competition caused by an existing public policy, the CCA cannot call for immediate action of state authorities, but may undertake further advocacy efforts in order to remedy the situation, or may initiate an enforcement action.

Within the framework of the Agreement on Cooperation with the State Commission for the Supervision of Public Procurement Procedures, the CCA has been regularly providing information to

public procurement officials on the prevention and detection of bid rigging in public procurement procedures. In 2016, it issued a guide for contracting authorities in detecting and tipping-off bid rigging cartels in public procurement, published on the CCA's website and distributed to authorities involved in public procurement. The guide complemented the adoption of the new Public Procurement Act in 2017. Moreover, the CCA developed a continuing **relationship with procurement bodies** so that – if preventive mechanisms fail to protect public funds from third-party collusion – those bodies will report the suspected collusion to the CCA and have the confidence that the CCA will help investigate and prosecute any potential anticompetitive conduct. However, the CCA does not provide specific training for procurement officials.

The CCA is engaged in promoting **competition culture**, such as the organisation of seminars and conferences. The CCA organised ten advocacy events in 2018 and five in 2019. The CCA also publishes monthly newsletters with updates on its activities and latest developments in competition practice. On its website, the CCA publishes its decisions, opinions, annual reports, experts' articles, press releases about opened and closed cases, ruling of competent courts regarding CCA's decisions, as well as market studies and guides, such as a compliance program guide. Likewise, the CCA shares its know-how on competition with potential candidate and candidate countries for EU accession, such as a twinning project with Montenegro in 2018-2019. However, the CCA has not been engaged in advocacy initiatives that relate to the economic impact of the current COVID-19 pandemic yet, just like most other national competition agencies so far.

Key Recommendations:

The following key recommendations provide guidance for the way forward:

- Continue advocating to oppose **restrictions to competition** in laws and regulations while embedding competition principles in draft legislative provisions. The OECD Competition Assessment Toolkit is a practical methodology that supports competition authorities in this task. Conducting an assessment of regulatory constraints on competition in certain sectors would also be beneficial (see Box 8).
- Provide support to procurement agencies to set up **specific training** for procurement officials, auditors and investigators on techniques for identifying suspicious behaviour which may indicate collusion (OECD, 2019^[68]).

Box 8: Competition Assessment Project in Romania

The OECD's Competition Assessment Toolkit helps governments to eliminate barriers to competition by providing a method for identifying unnecessary restraints on market activities and developing alternative, less restrictive measures that still achieve government policy objectives.

In 2014, the Romanian government asked the OECD to conduct an assessment of regulatory constraints on competition in three key sectors: construction, freight transport and food processing. Together, these three sectors account for over 12% of GDP and almost 10% of employment.

Making use of the methodology in the OECD Competition Assessment Toolkit, the project analysed legislation, assessed costs and benefits of regulations restricting competition in the designated sectors and proposed specific recommendations on legal provisions that should be amended or repealed. Another important work-stream of the project was to provide assistance in building the competition assessment capabilities of the Romania administration.

The key benefits of the Toolkit are its general applicability, its flexibility and its usability: It provides a general methodology so that it can be applied to various contexts; it is designed for use in a decentralised fashion across government at both national and sub-national levels; and it is made for use by officials with no specialised economics or competition policy training.

Source: (OECD, 2016^[69]), *OECD Competition Assessment Reviews: Romania*, <http://dx.doi.org/10.1787/9789264257450-en>.

3. State-Owned Enterprises (SOEs): Ensuring a Level Playing Field

Why SOE Policies Matter

The SOE sector plays an important role in the Croatian economy. With about 260 public enterprises per 1 million inhabitants, the Croatian SOE sector is one of the largest in the EU, as well as among Central and South Eastern European countries (IMF, 2019^[70]). The central government holds full or majority ownership in 59 SOEs (including 6 listed companies) and minority stakes in 10 listed companies. In addition, 938 enterprises are fully or majority owned by local governments. The SOE sector accounts for 5.9% of total employment at the national level (66 900 people). If Croatia was an OECD member country, this number would place it among the top-10 OECD countries with the largest central SOE sector (the OECD average is 2.2%) (OECD, 2017^[71]). When including the sub-national level, the sector employs 6.5% of the total workforce. To ensure that these SOEs operate for the common good and on an equal footing with private companies, well-designed ownership policies have to be in place. In sectors with a strong prevalence of SOEs, it is crucial to have sound transparency and accountability policies that ensure a level playing field. Such practices prevent SOEs from receiving favourable financial, regulatory and tax treatment. Unfair advantages granted only to SOEs but not to private companies create market distortions, lowers the level of competition and thereby decrease necessary innovation and productivity. Lastly, consistent policies for restructuring and privatising SOEs have to ensure that such major interventions are conducted in a transparent and structured manner.

OECD Findings on SOE Policies

The reforms in the country initially placed emphasis on the corporatisation, liberalisation and privatisation of SOEs, but the momentum diminished in the 2000s. Today SOEs still dominate the economy, especially the infrastructure sectors, including transport, energy, post and communication, and utilities. They also operate in competitive industries such as agribusiness and manufacturing. Even though in recent years Croatia has taken steps to improve the management and corporate governance of SOEs, the sector still suffers from “political interference, ineffective governance, poor management, and low efficiency” (OECD, 2019^[41]).

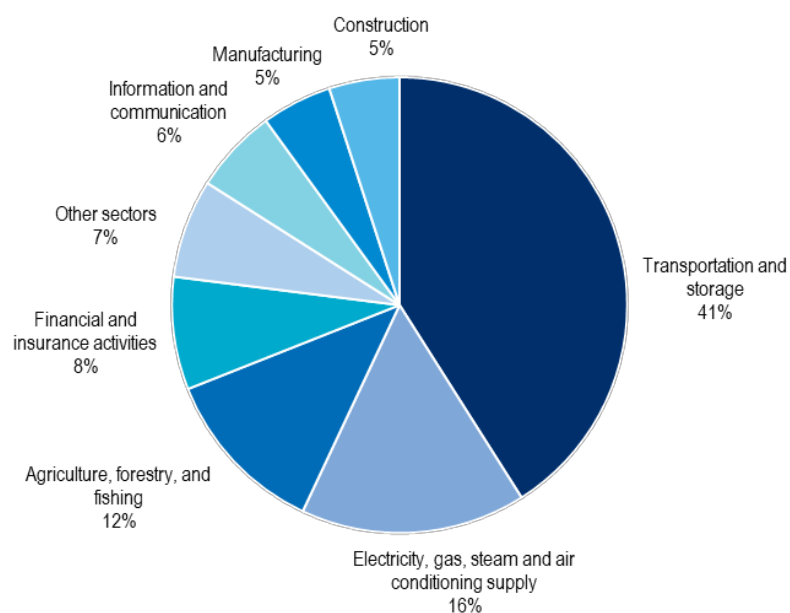
The Role of SOE Policies in the Energy and Industry Sector

With regard to sectors, transportation accounts for the largest number of SOEs at the national level, followed by other activities (which include tourism)¹⁶, finance and manufacturing. Transportation (41.0%) and electricity (16.0%) account for the highest share of employment (see Figure 3). However, when measured by value added, the major share goes to the construction sector (47.4%), followed by finance (16.2%) and electricity (14.3%). The situation is different at the subnational level where the water utilities make up for 55.6% of total employment and 93.0% of total value added. The largest

¹⁶ Other activities include SOEs operating in 1) Arts, entertainment and recreation; 2) Accommodation and food service activities; 3) Professional, scientific and technical activities; and 4) Wholesale and retail trade, repair of motor vehicles and motorcycles.

SOE employers are the energy company HEP group (11 500 employees), the oil multinational company INA Group (10 800 employees) and the Croatian Post (10 100 employees) (OECD, 2021^[18]). At national and sub-national level combined, in 2020 the energy sector accounted for 4.9% of all SOEs, i.e., electricity, gas, and steam supply accounted for 4.5%, manufacture of coke and fine petroleum products for 0%, and mining and quarrying for 0.4%. In the same year, SOEs in the energy sector employed 12.4% of the work force in SOEs, i.e. 12.3% in electricity, gas, steam, and air conditioning supply; 0.1% in mining and quarrying; and 0% in manufacture of coke and fine petroleum products. The subsectors of the industry sector on which this document focuses i.e. manufacturing, construction, transportation, and water resources management, accounted for 51.2% of all SOEs in 2020, i.e. manufacturing accounted for 3.3 %, construction for 5.3 %, transportation for 5.8 % and water resources management for 37.3 %. In the same year, SOEs in the four subsectors employed 49.6% of the work force in SOEs, i.e. 3.8% in manufacturing, 5.9% in construction, 27.5% in transportation and 23.4% in water resources management (Financial Agency FINA, 2020^[72]). SOEs generally have a strong presence in the energy and industry sectors since they require considerable administration due to their size and indispensability for the population¹⁷ (IMF, 2019^[4]).

Figure 3: Sectoral Distribution of SOEs by Employment (Central Level of Government)



Source: Calculations based on information provided by the Financial Agency.

3.1. Efficiency and Performance through Improved Governance

According to the OECD Guidelines on Corporate Governance of SOEs, the **exercise of ownership rights** over SOEs should be clearly identified within the state administration, preferably centralised in a single ownership entity or co-ordinated by a centralised body (OECD, 2015^[73]). In Croatia, however, there are two different ownership arrangements: The first being a mostly decentralised model applicable to 39 enterprises of special interest which operate in strategic sectors or in sectors where the government performs a price setting function (e.g. energy, transport and utilities). Here, eight line-ministries exercise state ownership functions together with the Ministry of Physical Planning, Construction and State Assets (MPPCSA). The number of SOEs under each ministry varies significantly:

¹⁷ See Box 1 and 2.

some have ownership rights over a large number of enterprises, such as the Ministry of the Sea, Transport and Infrastructure (22, including the Croatian Roads, the Croatian Motorways and the Croatian Railways) and the Ministry of Economy and Sustainable Development (17, including the electricity utility group HEP, the water management company Croatian Waters, and the energy companies INA and Janaf), while others are in charge of only one SOE, such as the Ministry of Interior. In practice, line ministries have more powers than the MPPCSA whose role focuses on monitoring SOE performance and management. The second being a centralised model applicable to the rest of (mostly minority-owned) SOEs whose ownership rights were vested in the Centre for Restructuring and Sale of State Assets (CERP) in view of their privatisation and restructuring. In addition, there is the Croatia Banka, which is owned by the State Agency for Deposit Insurance and Bank Resolution whose ownership rights are exercised by the Ministry of Finance and the MPPCSA, and the Croatian Radio-Television, whose ownership rights are directly exercised by the government. The complex ownership structure makes it difficult to exercise state ownership rights on a whole-of-government basis. The roles and responsibilities of line ministries towards SOEs are not clear nor uniform and there is a lack of communication and coordination between competent ministries.

The absence of a clear **state ownership policy** and unclear commercial and non-commercial objectives contribute to sub-optimal performance of SOEs. Between 2007 and 2017, return on equity (ROE) and sales growth were both generally lower for SOEs than for private companies. Besides, even when removing large and strategic SOEs which tend to drive up the performance of SOEs, more than 80% of non-strategic SOEs had an ROE below the industry median (OECD, 2021^[74]). However, the development of an ownership policy is foreseen within the MPPCSA's responsibilities and should be elaborated in the near future.

Boards of SOEs should have “the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management” (OECD, 2015^[73]). In Croatia SOE boards are mostly two-tiered and usually consist of a management team or a supervisory board. In most cases, SOEs have five members in their supervisory boards while the management boards consist of one or more persons. The board members are appointed by the line ministry, at the proposal of the government. There is no specific requirement in terms of gender, age, geographical, professional and/or educational background. Most boards include a mix of state and employee representatives as well as executives from related companies. Information on the 11 largest commercial SOEs shows that about 26% of board members are ‘independent’ although there is no clear definition and criteria of their independence. In general, boards of directors are not independent enough to fulfil their strategy-setting and corporate oversight roles. Nomination procedures do not adequately protect from political interference. Many SOEs also operate as extensions of their line ministries whose representatives are appointed by the state. However, in August 2021 Croatia adopted new guidelines on supervisory boards and audit committees. Drafted with the support of the European Bank for reconstruction and development (EBRD), new guidelines aim to improve current SOE boards' selection and appointment processes by making them more competitive and by setting criteria for candidates, including on independence. Still, the guidelines are not binding. In addition, at the time of writing the new law on SOEs has been developed in cooperation with the OECD in order to be adopted in 2024. It will also address SOE boards' selection and appointment processes to align them with related OECD recommendations on Croatian SOEs from 2021.

Key Recommendations:

The following recommendations provide guidance for the way forward:

- Establish an **ownership coordination unit**. The unit should be mandated to develop and monitor compliance with the state's governance and disclosure standards for SOEs,

monitoring the performance of SOEs and engaging in public reporting. It should also play a role in SOE board nominations (OECD, 2021^[18]).

- Develop an **ownership policy** clearly outlining the rationales and objectives for state ownership, whose scope should cover all SOEs fully or majority-owned at the national level. It should also define the responsibilities of the state bodies involved in its implementation (OECD, 2021^[18]).
- Define **financial and non-financial performance objectives** for SOEs, in line with the state's objectives as the owner, in order to remove present ambiguities and improve the performance of SOEs (OECD, 2021^[18]).
- Establish professional and independent **SOE boards**. The boards should be required to comprise a majority of independent directors. No state representatives should be considered as independent. Board members should be selected based on their professional qualifications in a transparent procedure (see Box 9) (OECD, 2021^[18]).

Box 9: Decision to Increase the Independence of SOE Boards in Lithuania

In 2015, the Lithuanian government prohibited politicians to be appointed or selected to SOE boards/supervisory boards, to increase their independence.

Independent candidates to the board or supervisory board must meet general, specific (settled by the authority representing the state) and independence requirements. The candidate must meet the general requirements, such as higher university education; and should not hold the shares of the SOE or municipality-owned enterprise of an affiliated company. Regarding independence criteria, the candidate, for example, cannot be the manager of the SOE or municipality-owned enterprise to which he applied or an affiliated company thereof nor have held such position for the last three years.

Consequently, in Lithuania, as of 2020, there were no politicians serving on SOE boards or supervisory boards and 56% of board members were independent. This was achieved through the vast and concrete independence criteria that are set up by the resolution that not only take into account the candidates' professional activities at the time of applying but also during the previous three to five years.

Source: (OECD, 2020^[75]), *Implementing the OECD Guidelines on Corporate Governance of State-Owned Enterprises: Review of Recent Developments*, <https://doi.org/10.1787/4caa0c3b-en>.

3.2. Transparency and Accountability Practices

Financial and non-financial reporting of SOEs are important transparency and accountability practices that give stakeholders an accurate depiction of SOEs' performance, operations, liquidity and use of finances. The Ministry of Finance supervises the application of regulations governing the material and financial operations of fully or majority-owned SOEs. They are required to submit a quarterly financial statement, annual plan, annual report, mid-term plan, mid-term report and other reports to the Ministry of Finance, MPPCSA and CERP. In addition, all companies, including SOEs, are required to submit their annual financial statements and consolidated financial statements report to the Finance Agency (FINA) for statistical purposes and public disclosure. However, annual aggregate reports cover only enterprises of special interest but not all SOEs fully or majority-owned at the central level of government. Moreover, disclosure standards are not harmonised across the SOE sector to ensure quality and credibility of corporate reporting.

Auditing, the examination of financial reports, increases the credibility of financial statements and gives the shareholders confidence that the accounts are true. Croatian SOEs are subject to several external and internal control mechanisms, including those undertaken by state bodies, internal units of the SOEs and independent external auditors. As the highest audit institution, the **State Audit Office** can conduct audits of legal entities founded by the central government or by the local community and legal entities in which the Republic of Croatia or the local community has shares or stakes. Special interest, listed and large SOEs, as well as statutory entities where of special interest, are subjects to annual external audit. In addition, all legal entities of special interest are required to have an audit committee, which are also mandatory for other SOEs exceeding the average number of 5 000 employees and with assets exceeding HRK 5 million (EUR 666 000). For example, the HEP Group has an internal audit department that carries out internal audits in line with the strategic plan and the department annual plan adopted by the management board with the consent of the audit committee, to which it is accountable. Another example is the minority-owned energy company INA that has an audit committee of three members, which is appointed by the supervisory board and confirmed by the general assembly. The law prescribes the independence of audit committee members, however, it does not proscribe the independence of the chair of the committee. For example, regarding Croatia Airlines, the one state representative on the supervisory board is also the chair of the audit committee, as well as advisor to the Minister of Sea, Transport and Infrastructure.

In the late 2000s, the **Anti-Corruption Program for SOEs** was adopted, which was not extended after its accession to the EU. Still, other anti-corruption measures have been implemented which also cover SOEs, such as the Whistle-blower Protection Act, disclosure of beneficial owners and the enforcement of criminal liability for corruption committed by legal persons. In 2019, a new Anti-Corruption Programme for Majority-owned SOEs for 2019-2020 was adopted with the focus detecting corruption risks and eliminating the remaining legislative and institutional shortcomings. It envisages new mechanisms, including the incorporation of a rule on the prevention of conflict of interests into the codes of ethics and internal acts of SOEs, the requirement for all SOEs to implement internal control of business operations as well as independent monitoring of sponsorship, donations and of public procurement procedures. It also recognises the role of employees in detecting and reporting evidence of bribery. To monitor the implementation of the programme, all majority-owned SOEs are required to prepare their own internal anti-corruption action plans. According to the authorities, 27 out of 39 SOEs within the competence of the MPPCSA adopted internal anti-corruption plans which are published on the SOEs' websites. In addition, all 19 SOEs in majority state ownership within the competence of CERP have adopted internal anti-corruption plans. The government also introduced a number of anti-corruption mechanisms in SOEs: a compliance monitoring function; integrated risk management systems to ensure the independence of internal and external audit; codes of ethics; a declaration of assets by key management of SOEs; and an anti-corruption focus of monitoring and audits. According to the authorities, 32 out of 39 SOEs within the competence of the MPPCSA have introduced compliance monitoring function. Out of 19 SOEs in majority state ownership within the competence of CERP, the compliance monitoring function has been introduced by 14 SOEs. In addition, there is also the anti-corruption programme for SOE's owned by local and regional government (for the period 2021-2022). Besides, sectoral strategies on state property management, judicial reform and public administration contain anti-corruption measures as well. However, according to the authorities, there is no specific training for compliance officers and specialists for anti-competitive practices in general yet. Establishing such education would be a crucial step to equip them with the full set of skills their tasks require. Also, according to the authorities, there is room for improvement of the understanding and implementation of the OECD Recommendation on Bid Rigging in Public Procurement and the OECD Guidelines on SOEs.

Key Recommendations:

The following recommendations provide guidance for the way forward:

- Extend the scope of the **aggregate report**. Develop annual aggregate reports on SOEs that cover not only enterprises of special interest but all SOEs fully or majority-owned at the central level of government. In addition to the current information, the aggregate report could also include an assessment of SOEs' compliance with the state's applicable governance and disclosure rules (see Box 10) (OECD, 2021_[18]).
- Improve **financial and non-financial disclosure**. Establish in a single policy document on what accounting, audit and disclosure standards are applicable to SOEs (see Box 10) (OECD, 2021_[18]).
- Increase the **independence of audit committees** in SOEs whose chairs are independent from the company and the state shareholder. No state representatives should serve as audit committee chair (OECD, 2021_[18]).
- Strengthen the effectiveness of SOEs' **internal control systems** by 1) ensuring the implementation of safeguards for independence of external auditors; 2) ensuring the effectiveness of specific control measures, particularly for whistle-blower channels and for the management of procurement; 3) continuing the implementation of mandatory compliance functions in majority-owned SOEs, for example, by providing training and peer-learning on whistle-blower protection and public procurement practices (OECD, 2021_[18]); 4) raising awareness of the OECD Guidelines on SOEs and the Recommendation on Bid Rigging in Public Procurement.

Box 10: Aggregate Disclosure in Lithuania

Since 2010, the Lithuanian authorities have published an annual report on the characteristics, operations and performance of the SOE portfolio. The report is produced by a central co-ordinating body, the Governance Co-ordination Centre, which is tasked with monitoring and reporting on SOEs' compliance with the state's policies and guidelines bearing on corporate governance and transparency. The report is available online and is produced in both Lithuanian and English. Among the main elements included in the report are the following:

State ownership policy. The report gives an overview of the Lithuanian state's ownership policy and disclosure requirements for SOEs, enshrined in two policy documents, Ownership Guidelines and Transparency Guidelines. It also references the key legal acts bearing on SOEs' operations. It furthermore communicates the state's overarching objectives for SOEs, based on sorting enterprises into three categories according to whether they are primarily commercially oriented, primarily public service oriented or a mixture of both.

Corporate governance index. The corporate governance index rates all SOEs according to the quality of their corporate governance in three dimensions: transparency, boards of directors, and strategic planning and implementation. This section of the report is also used to highlight significant recent developments or issues of concern, such as major changes in the functioning or composition of SOE boards of directors.

SOE executive remuneration. This section reports on the average remuneration of high-level SOE executives by sector and by corporate form.

SOEs' non-commercial objectives. This section reports on the costs associated with SOEs' non-commercial objectives ("special obligations" in national nomenclature), as well as their related funding arrangements. It provides a breakdown by individual enterprise, including any losses incurred for funding non-commercial objectives. The related information is requested annually from line ministries by a central co-ordinating agency.

Value and performance of SOEs. This section provides an overview of the value of SOEs, their annual aggregate financial performance and their contributions to national employment, all broken down by sector. It also reports on SOEs' rates of return and highlights significant related evolutions since the preceding year.

Reporting on individual SOEs. This section provides detailed reporting on recent financial and corporate governance developments in Lithuania's largest SOEs. It also provides information on their board composition, identifying which board members represent ministries and which are considered independent.

Lithuania's aggregate disclosure is comparatively on a high international level and is regarded as significant progress in the country's SOE reform.

Its strengths lie in the following components: it is comprehensive (e.g. it also includes reports about non-financial performance of SOEs) and detailed since it is produced by a central co-ordinating body; and it is easily accessible to both the Lithuanian and international public.

Source: (OECD, 2015^[76]), *Review of the Corporate Governance of State-Owned Enterprises: Lithuania*, www.oecd.org/daf/ca/Lithuania_SOE_Review.pdf.

3.3. Ensuring a Level Playing Field

Regarding **legal and regulatory** treatment, SOE's do not seem to benefit from any major exemptions from the laws and regulations applicable to private companies. They are covered by the same provisions of the Competition Act, the Public Procurement Act as well as sectorial regulations. However, some elements may distort the level-playing field between SOEs and private companies, like the partial corporatisation of some SOEs and the uneven application of public procurement rules. SOEs are primarily established as joint-stock companies (JSCs) or limited liability companies (LLCs). In addition, there are also SOEs that operate as statutory corporations, i.e. legal entities with public authority, established pursuant to a special law. Out of the 59 fully or majority-owned SOEs, 34 are LLCs, 18 are JSCs (6 of which are listed on the Zagreb Stock Exchange) and 7 are legal entities (i.e. statutory enterprises and quasi-corporations): CERP, Jadrolinija, the Financial Agency, the State Agency for Deposit Insurance and Bank Resolution (DAB), the Croatian Bank for Reconstruction and Development (HBOR), Croatian Waters, and the Croatian Radio-Television. Due to their specific legal status, some SOEs are protected from insolvency procedures, such as the Croatian Waters where the government assumes unlimited accountability for its liabilities. In addition, at the sub-national level 50 out of 938 public enterprises are statutory corporations or quasi-corporations (888 are majority-owned unlisted enterprises). In general, current partial corporatisation of commercially-oriented enterprises may distort the level playing field between SOEs and private competitors. When it comes to public procurement, some SOEs like the oil company Jadranski Naftovod and the Croatian Post, still enjoy certain exemptions when they act as procurers, even though they are covered by the same provisions of the Public Procurement Act. Financial audits of SOEs have also revealed irregularities in the area of public procurement, and as a result, the State Audit Office considers this to be an area of high risk.

Concerning **access to finance**, SOEs are allowed to use all available creditors in the market. They may also borrow from SOEs such as the HBOR and the Croatian Postal Bank (HPB) on the same conditions as private companies. According to the authorities, SOEs are also subject to a similar tax treatment as private companies. The government issues state guarantees for SOE loans in line with national law and the EU rules on **state aid**. All state aid proposals are communicated with the Ministry of Finance

and the European Commission. Such guarantees are provided mainly to companies that need to implement large infrastructure or restructuring programmes, often in the transport and shipbuilding sector. In line with EU rules, state guarantees of legal monopolies such as the Croatian Motorways, Croatian Roads and the Croatian Railways Infrastructure are not treated as state aid. However, according to the European Commission government debt rose between 2008 and 2015, namely because of “high government deficits and off-budget transactions including the rising net borrowing of SOEs and the take-up of debt by the state upon calls on guarantees to public corporations” (European Commission, 2017^[77]).

The outbreak of the **COVID-19 pandemic** has had a significant economic impact on Croatia which, like other countries, introduced support measures for the economy. In the period between April 2020 and April 2021, the government adopted state aid measures that were approved by the European Commission under EU State aid rules. In particular, the EU Temporary framework for state aid measures support the economy in the COVID-19 outbreak. For instance, it provides a EUR 80 million loan guarantee scheme for companies in the maritime, transport, travel and infrastructure sectors; EUR 1 billion schemes to support companies affected by coronavirus outbreak; and EUR 790 million guarantee scheme for companies with export activities affected by the outbreak. The pandemic has impacted SOEs as well. In that context, the government introduced several support measures such as a EUR 11.7 million grant in 2020 to compensate the national flag carrier Croatia Airlines, majority owned by the government, for damage caused by coronavirus outbreak (European Commission, 2021^[78]). During such an exceptional period, it is particularly important to ensure that allocation of state funds is conducted in a non-discriminatory and transparent way.

Key Recommendations:

The following recommendations provide guidance for the way forward:

- Streamline SOEs’ **legal and corporate forms**. Statutory SOEs (“legal entities”) that operate commercially should be incorporated as joint-stock companies, following a prior assessment of individual SOEs’ objectives (OECD, 2021^[18]).
- Strengthen the internal control systems for the **management of procurement**. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be transparent, competitive, non-discriminatory and safeguarded by appropriate standards of transparency and integrity (OECD, 2021^[18]).

3.4. Reforming and Privatising State-Owned Enterprises

In recent years, Croatia has taken steps to improve the management and corporate governance of SOEs. In particular, the five-year country strategy from 2017 should help establish a clearer reporting and monitoring system for SOEs as well as a comprehensive framework for the preparation and implementation of **restructuring plans** and Financial and Operational Performance Improvement Programmes (FOPIPs). Other measures include the adoption of an SOE Corporate Governance Code, the issuing of an aggregate report on SOEs of special interest and the introduction of an obligation for SOEs to set up a compliance monitoring function. The governance framework of majority owned SOEs has improved, but according to the European Commission progress with restructuring and privatisation of SOEs has been slow (European Commission, 2020^[14]).

At the moment, a number of projects take place in the SOE sector, for example, on increasing financial and operational effectiveness of SOEs and on enhancing the competences of their supervisory boards and audit committees. In 2020, a project on activating non-operating assets in SOEs was launched since many SOEs have a portfolio of non-operating assets, like construction sites. In addition, as part

of the ongoing legislative reforms within the ERM-II Accession Framework¹⁸, Croatia committed to improve **corporate governance of SOEs** through revising and aligning regulation and practices in accordance with the OECD Guidelines on Corporate Governance of SOEs. Therefore, the OECD conducted a review of the Croatian SOE sector against the OECD Guidelines on Corporate Governance of State-Owned Enterprises and issued tailor-made recommendations, which are also presented in this country note, with the aim of improving the overall governance of SOEs. According to the authorities, at present there is still little awareness of the OECD Guidelines on Corporate Governance of State-Owned Enterprises. However, the government is committed to implement the OECD recommendations. It has prepared an Action Plan and set up a Steering Group gathering experts from relevant ministries to work on the new law on state ownership and discuss political feasibility of OECD reform proposals. The government plans to adopt a comprehensive law on SOEs that would address most OECD recommendations by 2024.

Key Recommendations:

The following recommendation provides guidance for the way forward:

- Continue current **SOE reform efforts** to implement OECD recommendations and align the SOE framework with the SOE Guidelines on Corporate Governance of SOEs and best international standards and practices, with support of international experts.
- Increase awareness of the **OECD Guidelines on Corporate Governance of State-Owned Enterprises** to foster their implementation by organising tailor-made webinars for boards of directors on topics such as public procurement, compliance, reporting and integrity.

Conclusion

This country profile provides an updated picture of the framework, challenges, achievements and recommendations regarding anti-corruption, competition and SOE policies in Croatia with a focus on the energy and industry sectors. The key recommendations provided for each policy issue are based on the extensive research and analysis of the *OECD Investment Policy Review of Croatia* from 2019, the *OECD Review of the Corporate Governance of SOEs in Croatia* from 2021, several other OECD publications and tools, as well as input from external experts and stakeholders.

Overall, important progress in reducing opportunities for corruption and limiting discretion in decision-making has been made. However, some elements of a functioning anti-corruption framework are still missing and further efforts are needed to defuse concerns about the level of corruption by businesses and the public in general. For instance, the public's and businesses' trust in the government's efforts to combat corruption remains low despite the number of encouraging steps taken by the government. Furthermore, a code of conduct for persons with top executive functions as well as for elected officials at regional and local level is still lacking. In addition, the initiative to regulate lobbying still needs to be implemented. Even though the whistle-blower protection framework is relatively advanced, the current situation leaves room for expanding awareness raising activities related to whistle-blower protection mechanisms. Given the fact that businesses still perceive the

¹⁸ The EU's Exchange Rate Mechanism (ERM II) ensures that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market, and helps non-euro area countries to prepare themselves for participation in the euro area. In 2019, Croatia committed to putting in place policy measures to prepare for participating in ERM II. In 2020, the Commission and the European Central Bank provided positive assessments of the fulfilment of these commitments and the ERM II parties agreed to include the Croatian kuna in the ERM II mechanism (European Commission, 2020_[82]).

judiciary as one of the principal shortcomings when it comes to business conditions, there is room for new initiatives to facilitate the use of out-of-court dispute resolution such as a business ombudsman. There is also potential regarding the inclusion of civil society and academia in the design of anti-corruption policies.

In terms of competition policies, the legislative framework is broadly in line with international standards and the CCA is following best practices regarding its scope of action and powers to fight anticompetitive behaviour. Nevertheless, some important challenges still remain to be addressed. For example, in comparison with international standards the annual CCA budget is low while adequate financial resources would help the CCA to develop its full potential. Although the overall procurement system has been commended by relevant international institutions, businesses still consider conflicts of interest in the evaluation of public procurement bids to be widespread. In addition, the economic challenges brought about by the COVID-19 pandemic suggest the need to step up the CCA's advocacy efforts to ensure that the government is aware of the competition principles that need to be respected in order for markets to remain competitive following the crisis.

Like in most economies in the SEE region, ensuring that SOEs in Croatia operate efficiently, transparently and on a level playing field with private companies will necessitate reforms in multiple policy areas. At present, the responsibilities of line ministries towards SOEs are not clear and there is a lack of coordination between competent ministries. Moreover, the government has not yet defined a clear ownership policy as well as financial and non-financial performance objectives for SOEs which further contributes to their generally rather low performance. In addition, the boards of directors are not adequately protected from political interference and many SOEs operate as extensions of their line ministries. Annual aggregate reports on SOEs cover only enterprises of special interest but not all SOEs that are fully or majority-owned by the central government. Finally, auditing safeguards could be strengthened to limit the risk of conflict of interest. On a positive note, as part of the reforms within the ERM-II Accession Framework, Croatia is aligning regulation and practices with the OECD Guidelines on Corporate Governance of SOEs to improve the overall corporate governance of SOEs.

When taking into account the key recommendations made in this country profile, Croatia should pay particular attention to the energy and industry sectors. Due to their indispensability for public service delivery and their contributions to GDP and employment, having well-designed policy frameworks regarding anti-corruption, competition and SOEs in place in these sectors is vital for the social and economic development. To increase transparency and competitiveness in the energy and industry sectors, emphasis should be put on ensuring transparent public procurement procedures, further decreasing regulatory barriers that reduce competition and professionalising SOE management.

In essence, the present country profile provides a guidepost for reforms that authorities can use to enhance their policy efforts in the policy areas of anti-corruption, competition and SOEs. It has to be emphasised again that these policy areas are often interconnected so that reforms in one of them might influence processes in the others. Implementing the policy recommendations made in this country profile equips the authorities with additional and improved tools to fight corruption and to create fair market conditions. Eventually, this will help Croatia to establish a level playing field and to increase its competitiveness and economic growth.

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COUNTRY PROFILES

FAIR MARKET CONDITIONS FOR COMPETITIVENESS IN THE ADRIATIC REGION PROJECT

High levels of corruption and lack of transparency are key constraints to economic growth in many countries worldwide. This Country Profile for Croatia aims to map existing legal and institutional frameworks in the policy areas of anti-corruption, competition, and state-owned enterprises to identify policy challenges to a level playing field. It also provides actionable policy recommendations which draw on a broad set of OECD analysis, guidelines, legal instruments and good practices as well as on additional data collected for the report.

This Country Profile, along those for Bosnia and Herzegovina and Serbia, is one output of the three-year OECD project to promote fair market conditions for competitiveness in the Adriatic region, which is supported by the Siemens Integrity Initiative. Through Collective Action, government officials from the region as well as business leaders, anti-corruption experts and practitioners, civil society representatives and academics have engaged to jointly enhance integrity and transparency.

These efforts are part of the engagement of the OECD South East Europe Regional Programme, which collaborates with the region since 2000 to advance private sector development, improve the investment climate and raise living standards for an inclusive and sustainable future for the people of South East Europe.

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