



# **Peer Review on “Minimum income benefits – securing a life in dignity, enabling access to services and integration into the labour market”**

**Peer Country Comments Paper - Croatia**

**Germany, 15 – 16 November 2018**

## **Reaching for more: challenges of adequacy and coverage in Croatian Minimum Income system**

**DG Employment, Social Affairs and Inclusion**



**EUROPEAN COMMISSION**

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Unit C.1

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## 1 Introduction

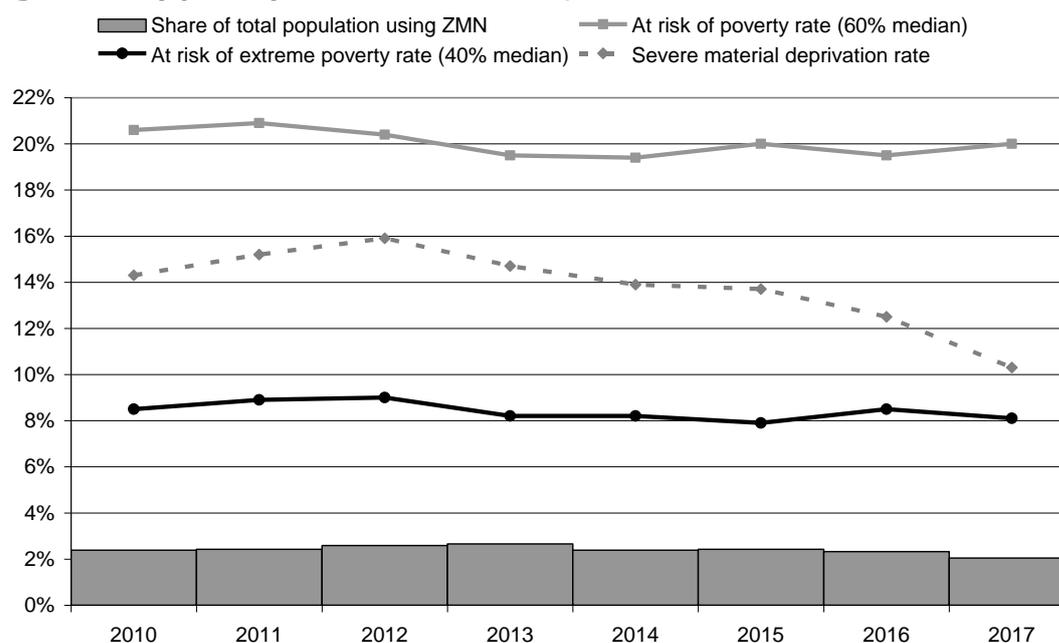
This paper has been prepared for the Peer Review on "Minimum income benefits – securing a life in dignity, enabling access to services and integration into the labour market". It provides a comparative assessment of the policy example of the Host Country Germany and the situation in Croatia. For information on the host country policy example, please refer to the Host Country Discussion Paper.

## 2 Situation in the peer country

### 2.1 Economic and labour market context

Croatia has been struggling with the aftermath of the 2008 recession for quite a long time, shedding 11.6% of GDP until 2014, and growth turning positive only in 2015, adding annually 2.4%-3.5% since. The crisis affected the labour market strongly, with the employment rate (15-64) dropping from 60.0% in 2008 down to 52.5% in 2013 and recovering since to 58.9% in 2017, while the unemployment rate doubled from 8.5% in 2008 to 17.3% in 2013 and 2014, then declining to 11.2% in 2017. In addition, having joined the EU on 1 July 2013, net migration turned strongly negative, with (likely underestimated) net registered migration flow towards EU countries during 2014 and 2017 being about 81 000 (about 2 %of total population), out of that about 65 000 towards Germany (CES, 2018). With respect to wage growth in legal entities, after largely stagnating up until 2014 (growing just 3.6% between 2010 and 2014), economic growth coupled with a shrinking labour market and the relaxation of income tax led to growth of disposable labour income in recent years. Average net wage in legal entities increased from 5594 HRK in 2015 to 5985 HRK in 2017 (7.0%), with 4.5% annual increase during January and August 2018 (CBS, 2018a). As for minimum wages, those were effectively fixed at 2251 HRK (300-309 EUR) between June 2009 and May 2013, then increased by 6% to 2388 HRK in 2013, and floated around this level (315-318 EUR) until 2015. However, during the 2016 to 2018 period, there were three consecutive minimum wage increases by 3%, 5% and 5%, setting the 2018 level at 2752 HRK (369 EUR). The current context has greatly improved since the peak of the crisis, but is way worse compared to the situation when Social Code Book II was passed in Germany.

**Figure 1: Key poverty indicators in Croatia, 2010-2017**



Sources: EU-SILC (tables *ilc\_mddd11*, *ilc\_li02*), MDOMSP (2010-2017) and CBS population estimates

## **2.2 Poverty trends and minimum income (MI) benefit coverage**

Within such a context, there was not much variation in the at-risk-of-poverty rate (AROP) since 2010 when EU-SILC was introduced in Croatia. At both, the 60% threshold and in particular at the 40% extreme poverty threshold (see Figure 1), the rate is high in the European context (cf. 16.1% and 4.4% in DE). Some decline in poverty rate seems to have happened about 2012-2013, only to remain stagnant afterwards. Yet the non-distributional severe material deprivation indicator seems to have broadly followed the course of crisis and recovery, its prevalence increasing to 16% of the population in 2012, then decreasing to 10% by 2017 (cf. 3.4% in DE).

The minimum income benefit was introduced in Croatia in 1998 and is provided under the name *Zajamčena minimalna naknada (ZMN)* since 2014. The number of recipients (end-year stock) in Croatia has historically hovered slightly above 2 % of population. The number of beneficiaries has not increased rapidly or greatly during the economic crisis: from 93 000 in 2008 to 113 000 at peak in 2013 (2.7 % of population). The implementation of new obligations and strict means testing in 2014, together with the start of economic recovery has brought the number of beneficiaries down to 101 000 at the end of 2014, and by end-2017 the number has reached a historical low of 85 000 (2.0 % of population). In 2017, however, ZMN covered only about 10% of the number of persons at risk of poverty. Considering that the number of persons at risk of extreme poverty is four times greater and the number of persons declaring severe material deprivation fivefold higher than the number of ZMN beneficiaries (see Figure 1 1), the coverage of minimum income benefits in Croatia is far from adequate (Stubbs and Zrinščak, 2015, Frazer and Marlier 2016, Šućur, 2018.).

## **3 Assessment of the policy measure**

### **3.1 Foundations and eligibility assessment**

Unlike the three systems for different groups of recipients existing in Germany, the Croatian Social Welfare Act (SWA) stipulates one comprehensive tax-funded, means-tested minimum income scheme, the '*Zajamčena minimalna naknada*' (ZMN). The ZMN includes provisions for both households headed by persons fit to work and those comprised of persons not able to work due to disability or old age<sup>1</sup>. Therefore, the Croatian system has been categorised within the 'simple and comprehensive' grouping in the 2015 European Social Policy Network (ESPN) thematic review (Frazer and Marlier, 2016)<sup>2</sup>.

Croatia is constitutionally defined as a welfare state (article 1), value of social justice is listed among the key values of constitutional order (article 3), and the state is to support the social well-being of its citizens (article 49), by providing the social and material conditions that promote the fulfilment of the right to life in dignity (article 63). While those principles are similar to the ones in the German constitution, the compliance of the social welfare regulatory framework or the adequacy of provisions has not been challenged or tested by the Constitutional court.

The Social Welfare Act states that assistance and support for basic life needs must be instrumental for improving quality of life and fostering independence of a beneficiary

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<sup>1</sup> In 2017, persons deemed fit to work accounted for 48%, children dependents for 28% and other inactive for 22% of all ZMN beneficiaries. This ratio is rather stable, with fit to work accounting for around 41-45% prior to 2013 SWA reform and 48-51% afterwards.

<sup>2</sup> Asylum seekers are not covered by the SWA, but receive a 100 HRK (EUR 13) monthly allowance as per the 2015 Act on International and Temporary Protection. Yet once an asylum request is accepted, they have the right to benefits as regulated by SWA for Croatian nationals, with additional provision of all residence expenditures for up to two years in case they do not have means of their own.

(article 3). The ZMN itself is defined in terse as the right to a sum of money adequate for fulfilment of basic life needs for individuals and households who do not have enough resources to satisfy these basic life needs on their own (article 26). However, the basic sum itself is determined by governmental administrative order (article 27), and stands at 800 HRK (107 EUR) since 2014.

The basic sum is weighted with respect to household composition, following simple rules set by law (single-person households: 100%, multi-person households: 60% per adult, single parents: 100%, and 40% per underage child. See Table 1). While revisions in late 2015 increased coefficients for single households incapable of working (115%), and children of single parents (55%), there is no evidence that the basic sum or the coefficients were determined on the basis of empirical analysis of the basic living needs or via any reference budgets<sup>3</sup>. There is no formal indexation mechanism with respect to inflation or wages, and the basic sum tends to remain fixed at the initially set level. As consumer price inflation was negative between 2014 to 2016, however, this has not yet led to diminishing purchasing power of the ZMN.

Table 1: Income eligibility for ZMN scheme in the context of poverty thresholds

	Eligibility threshold monthly income in HRK	As % of food budget, 2015*	As % of minimum wage, 2018**	As % of AROP threshold, 2017 (60% SILC median)	As % of SILC median household income, 2017
Single household, fit to work	800	63%	29%	34%	21%
Couple without children	960		35%	27%	16%
Couple with two children (one 14+)	1600	37%	58%	30%	18%
Single parent with a child under 14	1240		45%	41%	24%

\*no social or physical activities, \*\* one person working

Sources: Own calculations based on Social Welfare Act, EU-SILC (table ilc\_li01), 2018 Decree on Minimum Wage Level and 2015 Croatian Food Basket

As of 2018, the ZMN income eligibility threshold for a single household stands at only 29% of the minimum wage, and for a couple with two children at 58% of the single minimum wage (in 2014 respective values stood at 33% and 66%). The ZMN kicks in only when disposable income drops to 27-41% of the poverty threshold as estimated by SILC (2014: 32-48%). In other words, ZMN kicks in only when a household drops to 16-24% of the median household income, while 40% of this median is usually being considered as the extreme poverty line. In addition, the threshold for receiving ZMN is way lower than the healthy food budget estimate. Even without social or physical activities, a four-person household would need to have three times fewer resources than needed for a healthy diet in order to qualify for ZMN. This is consistent with Figure 1, and explains the primary mechanism of low MI coverage of the population at risk of poverty due to the eligibility threshold having been set at sub-extreme poverty income level.

<sup>3</sup> In the 2011-2013 period, the Social Welfare Act defined the minimal level of benefit for a single-person household at 22.5% of the SILC-derived AROP threshold, but this provision was removed later on. Another change in the 2014 setup was in the equivalence scale as to favour single-person and single-parent households to a greater extent, while providing less to families with two or more children (Šućur, 2018). While current coefficients for additional family members are more compressed than OECD equivalence scales used in SILC, both DE calculations and the 2015 EC Food basket estimate indicate almost linear increase in expenditure when housing costs are not considered.

As for means-testing, a household cannot qualify for the ZMN (and all other national and local transfers and services based upon it) if any household member has assets (housing, land, vehicles) that could be put to economic use, rented or sold without endangering their basic living needs. This prohibits ownership, borrowing or lease of a car (unless client is isolated from public transport). Such a setup can lead to distress of prospective beneficiaries if it is not possible to sell or utilise the asset for a fair price. As there is no elaboration of 'basic living needs', means testing can be challenging and to some extent arbitrary. Such asset limits are both stricter and less quantified than in case of presented German MI schemes and might be associated with lower take-up among those who qualify by disposable income criteria.

All the employment and retirement income, contributory benefits or asset-based household income is deducted from the ZMN. However, ZMN-related supplements, disability and child benefits, scholarship grants, ALMP-related income (including public works wages and traineeships), and one-off gifts for up to 5 000 HRK (670 EUR)<sup>4</sup> are not treated as income to be deducted from the ZMN. There is no partial disregard of earnings as in Germany nor substitute provision of in-work benefits, but long-term ZMN recipients are granted a three-month tapered withdrawal of benefits (more about activation in Matković, 2018).

### **3.2 Level and adequacy of benefits and their combinations**

Once a right to minimum income is asserted, it acts as a "passport to other benefits" (Stubbs and Zrinščak, 2015). In particular, just like in Germany, regional (counties) and local government (towns and municipalities) are responsible for providing housing support for the ZMN recipients. Counties earmark a part of income to provide funding for set amount of firewood per household. Towns and municipalities can provide up to 50% of the ZMN sum to cover housing expenditures, but there is no minimal level or budgetary transfers should municipality lack fiscal capacity, leading to uneven adequacy and coverage between the regions and municipalities.

The Constitution states that social welfare belongs among the responsibilities of regional and local government (art. 129a). However, most legally prescribed social services and transfers in Croatia are dispensed via the centrally administered Social Welfare Centres (SWC), not local government (see Table 2). Consequently, municipalities and towns often use their own income to provide own social services, quite often targeting ZMN recipients (Šućur et al, 2016), but are under no legal obligation to do so. Large and more developed local government units tend to provide more, thus exacerbating the local differences (Šućur et al., 2016, Stubbs, 2018). A project to establish ESSPROS-compliant reporting on the existing local government schemes was completed in September 2018, and legal obligations for data exchange and reporting are pending.

Table 2: Overview of other minimum income instruments

Government level	Benefit name	Annual limit	2017	
			Uptake (as % of ZMN beneficiaries)	Total annual expenditure (mil HRK) <sup>5</sup>
Central state (via Social Welfare Centres)	Guaranteed minimal benefit (ZMN)			558.7
	Discretionary one-off payments	Up to 4000/5600 HRK per year per household	1.7 times/year (avg sum 1003)	78.3
	Electrical energy supplement	Up to 2400 HRK per household	104%*	122.9

<sup>4</sup> This provision allows for local government to supplement ZMN in cash

<sup>5</sup> The total poverty-related expenditures on listed items are rather stable over the years, making up for 0.23-0.26 percent of national GDP.

Counties	Heating supplement (wood)	About 1000 HRK (3 m <sup>3</sup> of firewood)	89%	37.1
Towns and municipalities	Housing supplement (inc. utilities)	Arbitrary; up to 50% of household ZMN benefit <i>Effective: 15.8% (2017)</i>	82% (2016: 59%)	72.2
	Other local subsidies conditional on ZMN: public kitchens, food banks, school books and meals, in-cash supplements, public transportation...		Unknown, ongoing project	

\*out of eligible population: ZMN and personal disability benefit recipients (corrected for number of persons with disability in household receiving ZMN).

Sources: Own calculations based on Social Welfare Act; MDOMSP, 2017; State budget (electrical energy sup.).

There are two social assistance instruments provided by the Social Welfare Centres that are not explicitly limited to ZMN beneficiaries. First is the electrical energy supplement for households facing hardship (introduced late 2015). ZMN beneficiaries and recipients of personal disability supplements are entitled to this support. The second instrument are discretionary one-off payments disbursed by SWC for supplementary needs in extraordinary situations. The total sum disbursed via those instruments (about 200 million HRK) is double of county and local government housing-related supplements tied to ZMN (about 110 million HRK).

By resorting to such instruments, and being eligible to child benefit (299 HRK / 40 EUR monthly), most ZMN recipients manage to increase their income to a certain extent. Yet, in most cases they still fall short of (a single) minimum wage, the at risk of poverty and the extreme poverty threshold. However, total withdrawal of all benefits (apart from child benefits) with earned income makes for a high marginal effective tax rate, and thus taking up low-wage jobs rather unattractive, in particular for families with children<sup>6</sup> (See Table 3).

Table 3: Adequacy of total income from MI instruments with respect to poverty threshold, minimum wage and marginal effective tax rate.

	Income from ZMN (A)	Income if all MI schemes are used* - including child benefit (B)	(B) as % of AROP threshold (60% median income), 2017	(B) as % of minimum wage, 2018	Marginal effective tax rate for (B) if one member takes up a full-time minimum-wage job**
Single household, fit to work	800	1321	56%	48%	58.4%
Couple without children	960	1506	43%	57%	67.6%
Couple with two children (one 14+)	1600	2846	53%	114%	96.2%
Single parent with a child under 14	1240	2130	70%	88%	86.4%

\*Full use of heating supplement, average realised electrical energy supplement (177 HRK), housing resorting to one-off support for 1,7 times (1705 HRK), and local government housing support standing at 15.8% of ZMN. No other local ZMN-related benefits.

\*\* Includes pension contributions. Retention of some child benefits included.

<sup>6</sup> For part-time jobs that exceed ZMN eligibility threshold, taking up a job would lead to substantively lower income.

Sources: Own calculations based on Social Welfare Act, EU-SILC (table ilc\_li01), 2018 Decree on minimum wage level and Table 2 of this review.

Although not yet legally challenged, the long-standing shortcomings of Croatian minimum income support system, in particular with respect to its coverage and adequacy, are being noted in a series of annual Ombudsmen reports (Ured pučke pravobraniteljice, 2014-2017), expert reports by ESPN (Frazer and Marlier 2016), EMIN (2017), the Country Report and a Country Specific Recommendation in the 2018 European Semester process (European Commission 2018, 2018a) to improve the poverty reduction capacity of social benefits. Consequently, in the National Reform Programme 2018 (NRP, Vlada Republike Hrvatske 2018: p53/55), the government of Croatia has laid out a roadmap to improve the social benefit system via a new Social Welfare Act.

The reform is currently in the state of preliminary assessment, with dual goals of improving adequacy so that beneficiaries do not fall below the extreme poverty threshold (with children, older persons and persons with disability singled out in particular) and to increase coverage by making ZMN accessible to more people in financial distress. The tools being discussed are adjustment of benefits in line with minimum wage and the local development index, redefinition and scaling of household members and housing related supplements, and better targeting of one-off payments. The coordination and transparency are to be improved with the reform, in particular between local government and national programmes, while administrative burden is set to decrease, thus improving accessibility and take-up.

#### **4 Assessment of success factors and transferability**

Considerations on several dimensions laid out by the host county (Germany) might be relevant to the current attempts by the Croatian government to improve the legal framework and integrate governance of social benefits.

While the Constitutional Court is not likely to be involved in minimum income discussions in Croatia at this point, evidence-based efforts to define the reference budget and a set of standard needs seems critical in order to improve both their coverage and adequacy in an effective fashion. While the German model of a survey of income and expenditure is unlikely (but not impossible) as an evidence-base, the existing SILC and HBS data, coupled with a simulation model (such as EUROMOD), might provide valuable insights – and is already used within the country as a plausible poverty threshold criterion. However, contextualising basic needs in terms of reference needs, as done by the 2015 European Reference Budget Network, is still neglected as 'trade union baskets', instruments used in Croatia throughout 2000s, have petered out around 2010 to 2011 (Babić, 2017).

Utilising the individual-level microdata, comprising both national (already feasible) and local benefits (in development), would allow for calculation of uptake, targeting and effectiveness of each instrument at national and local level. Increasing the threshold would at the same time expand the coverage and increase the adequacy – yet both effects will lead to increasing expenditures from current (albeit low) levels. As the host paper demonstrates as well, increasing the adequacy might lead either to low incentives to work (high METR), or subsidizing low wage employment.

The application of formal procedures and rules regarding indexing of the minimum income schemes is important in order to ensure their adequacy. While minimum wage and local development indices are being considered in the Croatian NRP, the German experience of mostly adjusting for price trends (70%) and wage growths (30%) seems promising as well. However, there is little analysis in the host paper with respect to

developing a comprehensive system concerning housing and utility supplements that local governments provide.

The efforts towards developing the "basic pension" in Germany are congruent with efforts for development of such an instrument in Croatia, as in 2017 only about 9.6% of ZMN beneficiaries are above mandatory pensionable age, while poverty among older persons (in particular non-retirees) is above average and its reduction a goal of the NRP. Currently, a minimum pension provision applies only to retirees that have more than 15 years of contributions.

While the focus of reforms initiated by the NRP is directed towards the reduction of poverty among children, older persons, people with disabilities and in underdeveloped regions, the activation and labour market transitions of ZMN beneficiaries are of concern as well (for past developments see Matković, 2018). In this respect, however, Croatia and Germany share a challenge of better coordination with local employment services (e.g. via individual jobseeker plans) in order to improve uptake. In the Croatian case, incentives that might come from ALMP training allowances are not being treated as income for ZMN determination. Yet, in case of increasing adequacy of ZMN, considering allowances for gainful employment might ease transitions, as would the 'flattening' of child allowance.

## **5 Questions**

- Is there a role for the local and regional government level in providing the minimum income support apart from housing expenditures?
- Are there any coordination mechanisms with respect to assessment of housing needs, and how do local governments with less fiscal capacities cope with supporting housing needs of benefit recipients?

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## **7 Annexes**

### **Annex 1 Summary table**

The main points covered by the paper are summarised below.

#### **Situation in the peer country**

- Prolonged period of recession (2009-2014), coupled with low employment and high unemployment rate;
- Declining unemployment since 2014, growth of average and minimum wages since 2015;
- AROP rate stable at 19-21%, but declining severe material deprivation from 16% in 2012 to 10% in 2017;
- Low population coverage with minimum income schemes: 2.7% during peak crisis, 2.0% in 2017. In 2017 number of recipients equals only 10% of AROP population and 25% of population in risk of extreme poverty.

#### **Assessment of the policy measure**

- Constitutional commitment to supporting welfare, life in dignity and basic life needs of citizens: obligation shared by central and local government;
- Existence of a single comprehensive minimum income scheme ZMN, with strict means testing and very low-income eligibility threshold (16-24% of median household income);
- No elaboration of basic needs or evidence based-methodology for calculating ZMN or weighting for household composition. No indexation mechanism. Level of benefits is set up by administrative decrees;
- Very low adequacy of ZMN, even when including support from other instruments (43%-70% AROP in 2017);
- Uneven and uncoordinated delivery of minimum income support by local government with respect both to legally binding housing related support and to locally devised transfers and services (still being mapped).

#### **Assessment of success factors and transferability**

- Revision of minimum income support is pending with new Social Welfare Act – aiming at increasing adequacy and coverage;
- Importance of introduction of integrated evidence-based assessment of basic need levels, coefficients and indexation;
- A need for coordination, effective, transparent and non-overlapping mechanisms of support delivery at the local government level. Resources should be provided to less developed local government units;
- Introduction of basic pensions is being considered, reducing administrative burden and increasing coverage and take-up among the older persons;
- Introduction of electrical energy subsidy introduced in 2015 via a simple mechanism did considerably improve income adequacy for ZMN recipients.

## Questions

- Is there a role for the local and regional government in providing the minimum income support apart from housing expenditures?
- Are there any coordination mechanisms with respect to assessment of housing needs, and how do local governments with less fiscal capacities cope with supporting housing needs of benefit recipients?

## **Annex 2 Example of relevant practice**

Name of the practice:	Naknada za ugroženog kupca energenata (electrical energy supplement for households facing hardship)
Year of implementation:	2015
Coordinating authority:	Ministry of demography, family, social policy and youth
Objectives:	Reduce energy poverty
Main activities:	Monthly subsidy of up to 200HRK (27 EUR) per household for payment of electrical (or distributed heating) bills for recipients of minimum income (ZMN) and personal disability benefits, determined by Social Welfare Centre and disbursed via Financial Agency.
Results so far:	<p>The measure was quickly introduced with minimal additional administrative burden, and delivered to entire population of beneficiaries throughout the country, effectively increasing income adequacy and alleviating energy poverty to households in distress.</p> <p>In 2017 terms, this supplement increases adequacy of MI benefits for from 3.7% (couple with two children) up to 8.6% (single person households) against the SILC poverty threshold. In two years being in full effect, the annual expenditure of this stood at 122-126 million HRK (about 16 million EUR), and effectively increased transfers to ZMN and personal disability beneficiaries by 12.7%</p>

