

Government of the Republic of Croatia

**PRE-ACCESSION ECONOMIC PROGRAM (PEP)
2005-2007**

Zagreb, November 2004.

Table of Contents	Page
1. RECENT ECONOMIC DEVELOPMENT	- 2 -
2. MACROECONOMIC PROGRAM	- 10 -
2.1 Real Sector	- 10 -
2.2 Inflation	- 14 -
2.3 Monetary and Exchange Rate Policy	- 16 -
2.4 External Sector	- 17 -
3.1 Medium Term Fiscal Framework, 2005-2007	- 20 -
3.2 Public Debt Management	- 25 -
3.3 Deficit Financing	- 30 -
3.4 Fiscal Risks	- 31 -
4. STRUCTURAL REFORMS	- 34 -
4.1. Enterprise Sector	- 34 -
4.1.1. Privatization	- 34 -
4.1.2. Competition	- 38 -
4.1.3. Restructuring of the Real Economy (Public Utilities)	- 41 -
4.1.4. Business Environment Of SMEs	- 45 -
4.2 Financial Sector	- 48 -
4.2.1 Banking System	- 48 -
4.2.2 Capital Market	- 51 -
4.2.3 The Insurance Sector	- 53 -
4.2.4 Foreign Exchange System Regulation	- 54 -
4.2.5. Non-Banking Supervision	- 56 -
4.3 Labor Market	- 59 -
4.3.1 Employment	- 59 -
4.3.2 Safety At Work	- 61 -
4.3.3. Pension System Reform	- 62 -
4.3.4. Social Security System	- 66 -
4.4. Public Administration Reform	- 73 -
4.5 Agriculture Sector	- 78 -
4.6. Other Reforms	- 81 -
4.6.1 Health Care Reform	- 81 -
4.6.3 Regional Policy	- 88 -
4.6.4 Judicial Reform	- 91 -
4.6.5. Environmental Protection	- 95 -
4. 6. 6. Education And Science	- 103 -
4.6.7 Tourism	- 106 -
4.6.8. Public Procurements	- 108 -
4.6.9 Transport And Communications	- 110 -
4.6.10 Shipbuilding Sector	- 119 -
4.6.11 Investing in Croatia	- 120 -
5. POLICY MATRIX	- 122 -
6. STATISTICAL APPENDIX	
7. ADDENDUM 1: National Budget Revision	

1. RECENT ECONOMIC DEVELOPMENT

Economic Activity: According to the quarterly GDP estimate, the real growth rate of gross domestic product was 4.3% in 2003, lower than the 5.2% rate recorded in the previous year. An economic slowdown started in late 2002 and continued into 2003. Over the whole year, the growth was based on strong domestic demand, while net foreign demand negatively influenced GDP growth. In the second half of the year, final consumption went down, particularly personal consumption, which contributed to a slowdown in GDP growth.

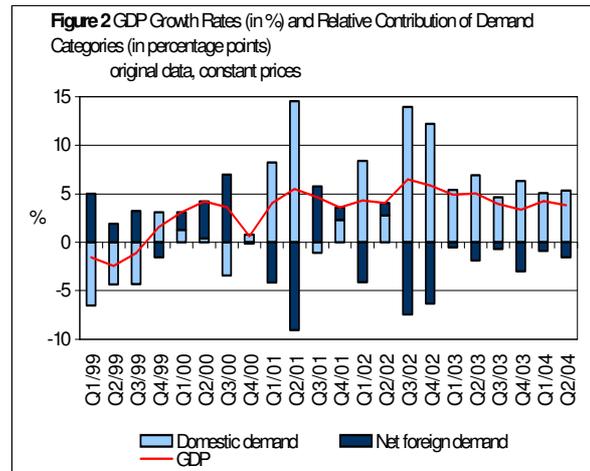
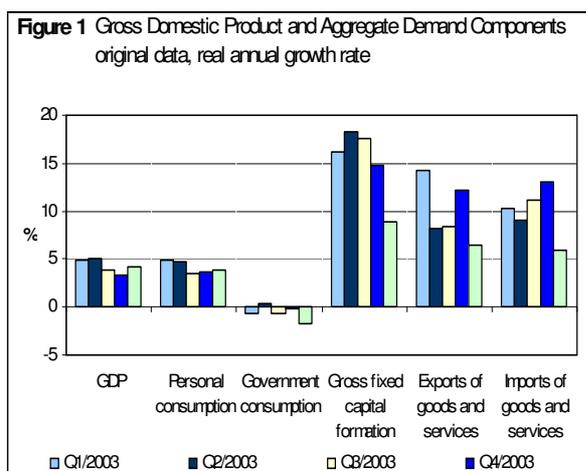
Table 1

MAIN MACROECONOMIC INDICATORS				
	2001	2002	2003	2004 _o
Real GDP growth (%)	4,4	5,2	4,3	3,9
Inflation, average	4,9	1,7	1,8	2,2
External Debt (in EUR, in % GDP)	57,0	61,5	74,6	80,7
Balance of Payments (in % GDP)	-3,7	-8,4	-7,3	-5,6
General Government Budget Deficit (in % GDI)	-6,7	-5,0	-6,3	-4,5
Exchange Rate (HRK/EUR), average	7,5	7,4	7,6	7,5
Unemployment rate, ILO (%)	15,9	14,4	14,7	14,9

Source: CNB and Ministry of Finance, o - estimate

The Croatian economy strengthened again in early 2004. According to the preliminary data of the Central Bureau of Statistics (CBS) for the first six months, real GDP went up 4.0% compared with the same period last year. At the beginning of 2004, the main sources of real GDP growth were again the exports of goods and services, gross capital formation (primarily on account of the volume and dynamics of gross fixed capital formation) and personal consumption.

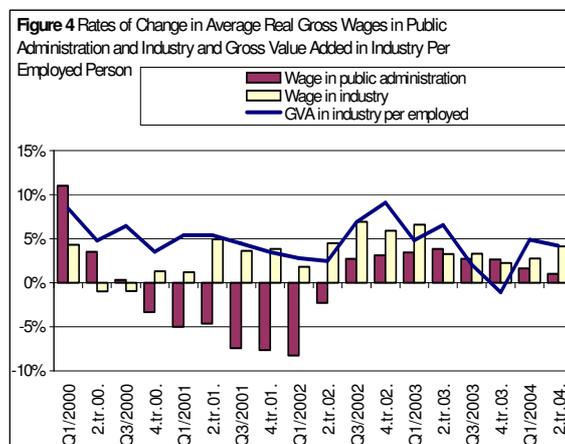
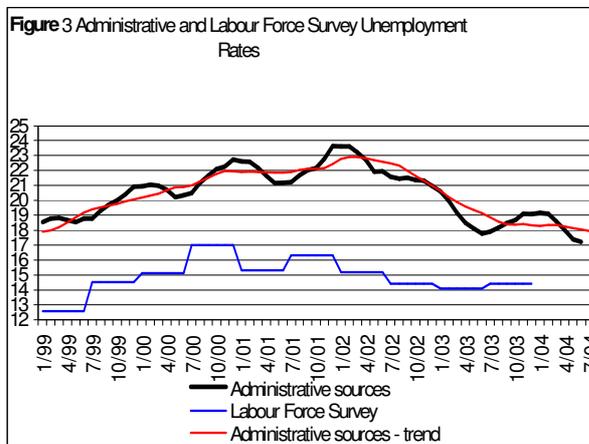
In the second half of the year, economic activity is expected to strengthen again. Such developments are indicated by a boost in industrial production and construction works, paralleled with the strengthening of services at the end of the second and the beginning of the third quarters.



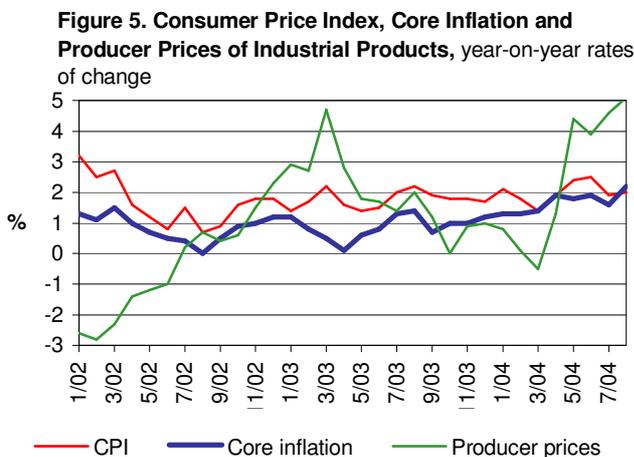
Labor Market: The upward trend in overall employment, which started in 2001, strengthened in 2003. During that period, total employment rose by an average of 2.6%. Irrespective of the seasonal fluctuations, registered unemployment trended strongly downwards, owing to

increased employment and changes in the registration procedure, which made the registration more difficult for non-active job seekers. During the first eight months of 2004, the downward trend in unemployment slowed and registered unemployment fluctuated around the rate of 18%. The Labor Force Survey unemployment rate, which is based on the ILO methodology and is internationally comparable, stood at around 14,7% in 2003, and in the first half of 2004, the unemployment rate fell to 13,8% the lowest in the last 5 years.

While the employment and unemployment dynamics in 2003 point to a continuing upturn in the labor market, real average wage stagnated in that year. The wage stagnation in public administration is particularly observed in low annual growth rates of average real gross wages, which dropped to 1.7% in the second half of 2003 as the base effects of the increase in average real wage from mid-2002 disappeared. The accelerated wage growth that started at the end of the first quarter 2004 continued into the second quarter. The average real gross wage paid grew at an annual rate of 4.8% in the second quarter, 1 percentage point faster than in the first quarter.



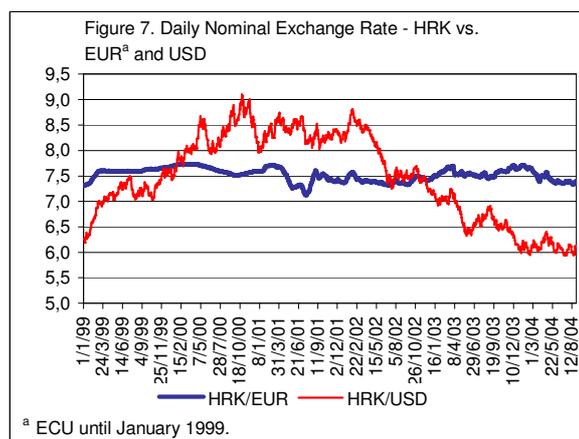
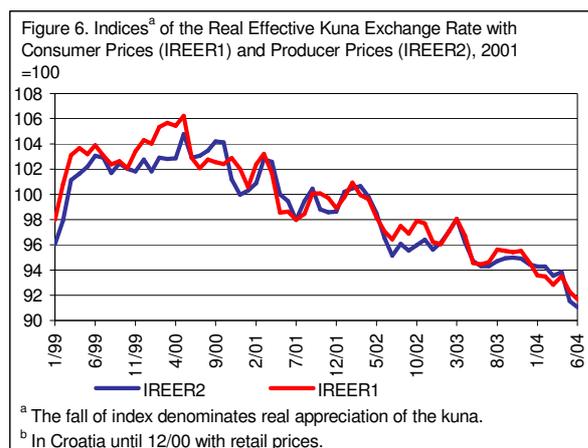
Prices: All basic price indicators for 2003 and the first eight months of 2004 point to a continuing high stability of prices in the Croatian economy. In 2003, the average year-on-year rate of change in consumer prices was 1.8% and in August 2004, according to the latest available data, the year-on-year rate of change in prices was 2.0%. The average annual core inflation rate was as low as 0.9% in 2003 but it rose to 2.2% in August 2004. Moreover, the average year-on-year rate of change in producer prices of industrial products was 1.9% in 2003 and 5.1% in August 2004.



Owing to a moderate wage growth, strong competition in domestic retail trade and sharper competition from imported goods as a result of a gradual foreign trade liberalization, the pressures on the growth of domestic retail prices remained under control. An additional price stability generator in 2003 was a mild growth of administered prices. Furthermore, a low inflation rate over 2003 was also attributable to a strong appreciation of the average daily exchange rate of the kuna against the US dollar totaling 14.8%,

which alleviated the effects of a marked growth in crude oil and other raw materials prices on the global market and contributed to a decrease in import prices of final products whose payment had been contracted in the US dollars. In addition to this, given the low and falling year-on-year rate of change in producer prices in the eurozone, which decreased from 1.6% in December 2002 to a low 1.0% in December 2003, the total imported pressures on the growth of domestic retail prices can be characterized as mild.

In 2004, some of these factors were not so favorable. A faster growth of wages was paralleled with a rise in certain administered prices, while imported inflationary pressures increased. Nevertheless, the average consumer price inflation rate should not exceed 2.2% in 2004, which indicates that inflationary pressures are still moderate.



Exchange Rate: In 2003 and in the first eight months of 2004, the kuna/euro exchange rate movements were stable with usual seasonal fluctuations.

The average daily kuna/euro exchange rate of 7.56 recorded in 2003 was 2.1% lower in nominal terms compared with the rate of 7.41 registered in the previous year. The daily exchange rate of the kuna vs. the euro fluctuated between a minimum of 7.44 and a maximum of 7.71, or within a relatively narrow band between 1.6% and 1.9% of the average daily exchange rate recorded in 2003. In the first eight months of 2004, the daily kuna exchange rate fluctuated between a minimum of HRK 7.34/EUR and a maximum of HRK 7.72/EUR.

Along with a mild depreciation of the kuna against the euro and a marked appreciation of the kuna against the US dollar, the index of the nominal effective kuna exchange rate in which the euro and the dollar account for the largest shares (66.0% and 31.0% respectively)¹ appreciated by a total of 2.7% in 2003 (December 2003 to December 2002). The index appreciated additionally by 2.3% in the first eight months of 2004. Due to a somewhat slower growth of domestic retail prices, and especially producer prices, compared with the prices abroad, the index of the real effective kuna exchange rate appreciated less than the nominal effective kuna exchange rate in 2003. Thus, the overall appreciation of the real effective kuna exchange rate, deflated by retail and producer prices, was 2.5% and 1.8% respectively. Over the first six months of 2004, the index of the real effective kuna exchange rate, deflated by retail and producer prices, appreciated by 2.9% and 3.4% respectively compared with the previous year.

¹ The remaining 3.0% in the basket of currencies are accounted for by the pound sterling, the Swiss franc and the Slovene tolar.

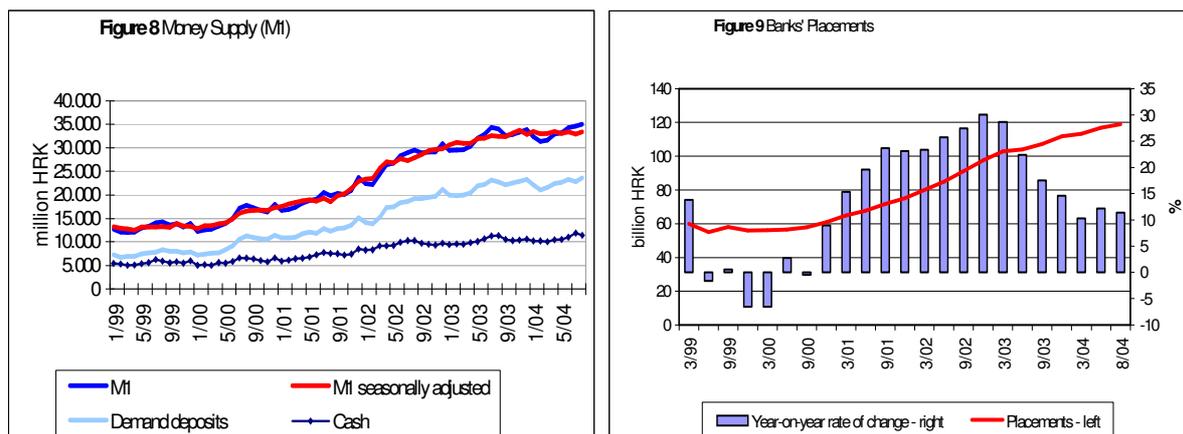
Monetary Policy: The growth of domestic demand in 2003 and 2004 did not affect the price movements, but it was reflected in the current account deficit, especially the goods account deficit, which remains high. In order to restrain the growth of placements, in January 2003, the central bank introduced administrative measures aimed at reducing the credit growth. As a result, the growth in bank placements to non-banking sector declined by one half in 2003 relative to the previous year and amounted to HRK 22.5bn or 14.6%. The developments in bank placements indicate that the CNB measures contributed to their slowdown compared with 2001 and 2002 when bank placements grew at considerably higher rates (25.5% and 30.0% respectively). It should be noted, however, that the increase in placements was still very large in 2003 and sufficient to finance the continuing strong economic growth. The total increase in financial assets made available to the economy was larger owing to the business sector's direct borrowing abroad and the fact that leasing activities remained strong in 2003. The growth of bank placements to non-banking sector stabilized in 2004, so its current annual rate stands at about 13%.

External debt of the overall economy grew strongly in 2003 and 2004, partly due to large fiscal deficits financed by government's borrowing abroad. Therefore, restraining the external debt growth, i.e. stabilizing the external debt-to-GDP ratio, fiscal consolidation of expenditures, and lowering the deficit became direct economic policy goals in 2004. Generally, monetary policy became more restrictive and in July 2004, marginal reserve requirement on banks' foreign borrowing was introduced.

Having grown steadily for three years, money supply (M1) declined sharply in 2003. The annual growth rate of M1 in that year was 9.8%; three times lower than in 2002, which is attributable to reduced credit activities of banks. A downward trend in the annual growth of money supply continued in 2004, so it declined from 7.2% in March to 4.4% and 2.9% in June and August 2004 respectively. The seasonal influences excluded, money supply remained stagnant over the last few months.

The 2003 developments in **total liquid assets (M4)** were marked by a strong growth in kuna non-monetary deposits (both savings and time deposits), which rose by 43.5%, much more than in 2002 (25.5%). In 2003, the total assets in kuna were 52,3 bill. HRK, (40,7% of total liquid assets), while foreign currency deposits were 76 bill. HRK (59,3% of total liquid assets). The growth of kuna deposits resulted from macroeconomic stability and increased confidence in the domestic currency, but also from banks' adjustment to the CNB measures, i.e. their efforts to reduce the share of foreign exchange liabilities in their balance sheets. At end-August 2004, kuna savings and time deposits stood at HRK 22.6bn, up 21.7% from the same month last year.

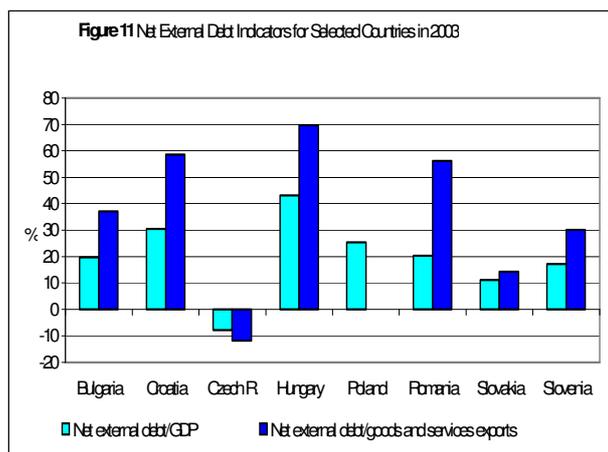
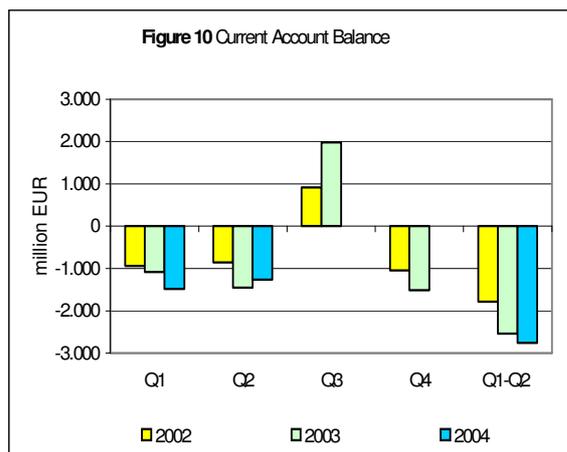
Foreign currency deposits rose again in 2003, following their stagnation in 2002. The 5.5% growth rate, although low, represents an absolute growth in foreign currency savings of HRK 4.0bn, which accounts for roughly 2/3 of the absolute increase in the kuna component of quasi money (kuna non-monetary deposits). In 2004, foreign currency deposits rose significantly during the summer months, following their only symbolical growth in the first half of the year. Thus, total foreign currency deposits increased by 3.1% in the first eight months compared with December 2003, while the year-on-year growth in August reached 6.2%. The effects of the exchange rate excluded, the growth was even sharper, 8.9% year-on-year in August.



International Transactions: The current account deficit for 2003 stood at EUR 1,769m or 7.2% of GDP. Such a high current account deficit mainly resulted from a negative balance in the goods account, although it should be noted that the Croatian goods exports performance was much better than in the previous year. The surplus of expenditures over revenues in the current account in 2003 was strongly influenced by the growth in net outflows recorded in the income account, which is almost entirely the consequence of increased expenditures on the reinvestment of earnings from equity investments. On the other hand, a strong positive contribution to the current account movements in 2003 was made by the services account, i.e. the annual growth in income from services rendered in tourism.

In the first half of 2004, the current account deficit totaled EUR 2,248m, down 0.9% from the first half of 2003. In this connection it should be noted that, by the end of the second quarter of 2004, some larger foreign-owned companies did not decide on their profit distribution, so the dividends, expected in the second quarter, would be paid out in the third quarter. Although a large surplus in the current account is common in the third quarter owing to the tourist season, it appears that the income from tourism will be the same in real terms in 2004 relative to the last year. However, exports of goods have grown faster than the imports. Looking at the whole picture, the current account deficit is not likely to decrease significantly in 2004.

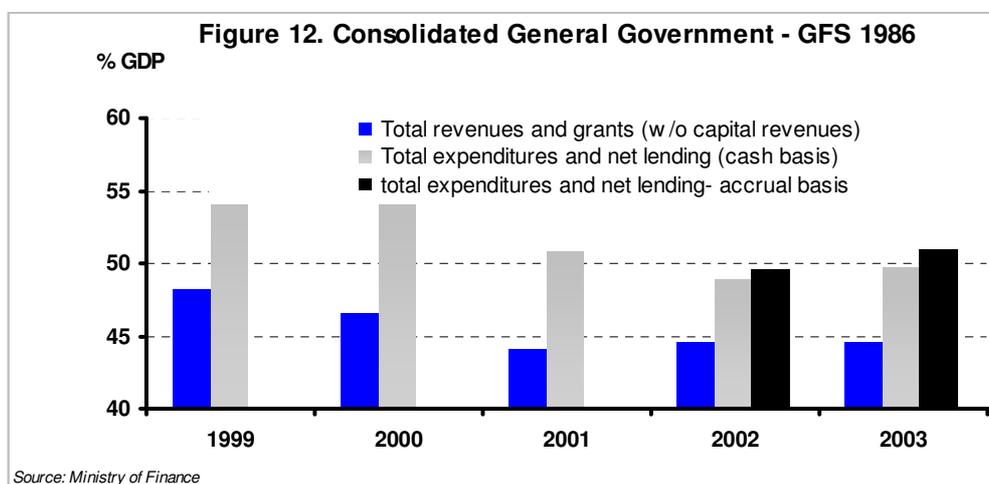
External debt continued to grow reaching a high EUR 18.8bn at end-2003, which is an annual increase of EUR 4bn or 27.3%. Unfavorable indicators of the Republic of Croatia's external debt balance (74.6% of GDP in 2003) indicate a faster growth of debt in 2003, while the high current account deficits in 2002 and 2003 additionally darken the economic picture of the country. Over the first two quarters, external debt continued to grow, so at end-July 2004, the share of total external debt in the assessed GDP climbed to 77.3% and was up 2.7 percentage points compared with end-2003. Despite the worsened total external imbalance, Croatia continued to record above-average international liquidity indicators. A further growth in the CNB's international reserves contributed to a continuation of favorable movements in the exchange market pressure index.



Fiscal development: The share of consolidated general government tax revenue of over 40% of GDP indicates that the government still plays a major role in the economy. Although there was a recorded fall of the share of tax revenue from 44,1% of GDP in 1999 to 40,2% of GDP in 2003, we can conclude that the tax burden is still higher than average for other transition economies in this region.

Taking into account that total consolidated general government expenditures, however, were again over 50% of GDP in 2003, it is clear that the lowering of the tax burden could not have happened without previous fiscal adjustment on the expenditure side.

The following graph shows revenue and expenditure of the consolidated general government as share of GDP) for the 1999-2003 period, shown according to GFS 1986 methodology.



After a fiscal deficit of 5% of GDP in 2002, in 2003 the Republic of Croatia signed a Stand-by Arrangement with the IMF, with the aim of further fiscal consolidation. The planned consolidated general government deficit for 2003 of 4.5% was not achieved. Although revenues were above planned, expansionary fiscal policy in 2003 created a significantly larger deficit. Actual budget expenditures were 98,1 billion HRK (or 50,8% of GDP). Using GFS 1986 methodology, the deficit was 12,3 billion HRK or 6,3 % of GDP.

Out of the total fiscal deficit, 2,4 billion HRK or 1,3% of GDP resulted from expenditures in 2003, which were not recorded on a cash basis for that year. Although they will be recorded

in 2004 as unpaid commitments made in the previous fiscal year, on an accrual basis they are part of the 2003 fiscal deficit (see Table 2).

Table 2: Consolidated general government deficit

<i>GFS 1986</i>	2002		2003	
	mil. HRK	% GDP	mil. HRK	% GDP
Consolidated general government deficit w/o capital revenues- cash basis	-7.873	-4,4	-9.759	-5,0
Total unpaid commitments	-1.096	-0,6	-2.439	-1,3
Consolidated general government deficit w/o capital revenues- modified accrual basis	-8.969	-5,0	-12.198	-6,3

From Table 2 it is clear that the planned fiscal deficit of 4,5 % of GDP for 2003 (as agreed upon in the Stand By Arrangement with the IMF) was not achieved, on a cash and/or accrual basis. The main causes of this larger deficit are the main components of budget expenditures.

In 200, the wage bill reached almost 11% of GDP, while subsidies and current transfers reached 20% of GDP. Furthermore, large capital transfers, which were intended for big infrastructure projects (building of roads and high ways), were one of the main features of budgetary consumption in the last few years. In 2003, the share of these transfers, as percent of GDP, was over 7 %. The level of the fiscal deficit generated by capital projects, which were a one-time investment, will thus also have a one-time effect on the overall deficit. Also, the share of expenditures for goods and services was over 9,3 %, although these expenditures were relatively smaller when compared to previous periods (in 2000 the share of expenditures for goods and services was 12,5 % of GDP). Finally, interest payments reached a high 2% of GDP, which is a direct result of accumulated government debt.

Therefore, we can conclude that in 2003 fiscal policy was undeniably expansionary, which resulted in a high fiscal deficit (increasing the need for further borrowing), and the share of government expenditures reached over 50%, which is unsustainable in the medium term.

After parliamentary elections at the end of 2003, however, the new Croatian government decidedly moved in the direction of the fiscal sector consolidation. In August 2004, a new Stand-by Arrangement was concluded which supports fiscal policy of consolidation that the Croatian government recommended for the next period. The planned general government deficit for 2004 of **4,5 % of GDP** aims for an ambitious fiscal adjustment of 1,8 % of GDP in a period of just one year. It is important to point out the important efforts invested in the aim of a more transparent system of public finance, made through a more efficient work of the Treasury and implementing of budgetary reporting in accordance with international standards. Beginning in 2004, the Ministry of Finance began using budgetary reporting according to GFS 2001 methodology created by the IMF. In order to remain consistent and for easier comparison with previous years, in this part we will look at the state of the government budget the first half of 2004 according to GFS 1986 methodology.

In the first half of 2004, total consolidated general government revenues were 42,3 billion HRK, which is 45,2 % of the planned amount for 2004. These revenues are as planned for the first half of the year, with the expectation that the second half of the year revenues will be even higher because of the successful tourist season. In addition, in the second half of the year the central government budget expects almost 2,5 billion HRK of revenues from dividends of

enterprises with government shares, which leads to the conclusion that revenues will be achieved according to the budget plan.

Total expenditures in the first six months of 2004 were 49,7 billion HRK, which is 48,3 % of the planned amount for 2004. In this period, the fiscal deficit was 7,4 billion HRK, which was largely generated by expenditures of extra budgetary funds (which include state agencies for road and highway building), and indicates a large share of expenditures targeted towards investments in road building. In the second half of 2004, however, extra budgetary funds are expected to have much smaller expenditures, which is in agreement with investment plans for 2004. With the expected larger budget revenues (as mentioned earlier), it can be expected that by the end of 2004, the targeted general government deficit of 9,25 billion HRK (4,5 % of GDP) will be achieved. Such a reduction in the budget deficit is in accordance with the commitments made by Croatia in the Stand-by Arrangement with the IMF, which supports the fiscal consolidation prepared for by the new Croatian period in its medium term framework.

2. MACROECONOMIC PROGRAM

2.1 Real Sector

Assumptions Underlying the Medium-Term Macroeconomic Projection

Individual parts of the medium-term macroeconomic projection have been prepared using different econometric and analytical techniques and they have been coordinated by applying the iterative method within the financial programming methodology. The projection is based on the assumed economic recovery in the EU, Croatia's most important foreign trade partner, as early as 2005, and a slight acceleration of GDP growth in that region toward the end of the projection horizon. Given the stated economic growth dynamics in the environment, we expect that the international trade in goods and services will continue to grow, although the increase in imports will be somewhat slower compared with the outturns for 2003 and estimates for 2004, largely due to the slowdown of fiscal expansion which had significant effects on growth of exports because of large investments.. This will result in a reduced foreign trade deficit and a slight decline in the current account deficit, which is expected to be almost fully covered by foreign direct investment. Thus, during the projection horizon, the contribution of foreign demand to domestic economic growth should remain neutral.

In accordance with the monetary and foreign exchange policy goals, we expect a stable nominal exchange rate of the kuna against the euro over the whole medium-term period. Given low rates of price growth in the environment, this will provide a basis for maintaining low inflation. However, somewhat higher inflation rates (approximately 2.5%) are expected in the following year, due to the liberalization of administered prices, whose effects will wear off toward the end of the projection horizon.

While the economic recovery in the environment should boost interest rate growth, due to the continuation of Croatia's accession to the EU and interest rate convergence, interest rates are expected to decline in Croatia during the projection horizon. This should encourage private investment and consumption.

Table 3

Macroeconomic Indicators for 2005-2007

	2002.	2003.	2004.p	2005.p	2006.p	2007.p
GDP real growth, %	5,2	4,3	3,9	4,4	4,5	4,6
Inflation average, %	1,7	1,8	2,2	2,5	2,3	2,2
Retail trade, %	5,5	5,8	4,6	7,9	6,5	4,0
Industrial production, %	5,5	4,2	3,8	4,1	3,7	4,0
Unemployment rate, ILO	14,4	14,7	14,9	14,2	13,3	12,1
Current Account, % GDP	-8,4	-7,2	-5,6	-5,1	-4,4	-3,8
Exchange Rate HRK/EUR, average	7,4	7,6	7,5	7,5	7,5	7,5
General government budget,% GDP	-5,0	-6,3	-4,5	-3,7	-3,2	-2,9
Public Debt, % GDP	50,4	51,6	52,8	52,3	51,0	51,0

Source: DZS, CNB, Ministry of Finance

Projections (p): Ministry of Finance

Fiscal policy concept for the period 2005 to 2007 envisages the end of fiscal consolidation with the goal of lowering the fiscal deficit to below 3 % of GDP. The growth in public sector expenditures on goods and services paralleled with stability in expenditures on wages should result in a moderate increase in government consumption. On the other hand, a decline in

public investment in infrastructure and its slight recovery toward the end of the period will slow down gross fixed capital formation. A decline in interest rates in Croatia should encourage private investment, which is expected to partially offset the slowdown in public investment.

The continuation of restrictive wage policy in the public sector will help maintain the growth of real wages below that of economic activity and further the employment recovery. Given such labor market dynamics and the growth in other types of household income (pension indexing), the average growth of personal consumption is expected to follow the growth of GDP.

The above mentioned assumptions for macroeconomic projection should, after a slight economic slowdown during 2004 due to a decline in government investment in infrastructure, provide for the continuation of the growth at approximately the same annual rate as in 2003, i.e. between 4% and 5%.

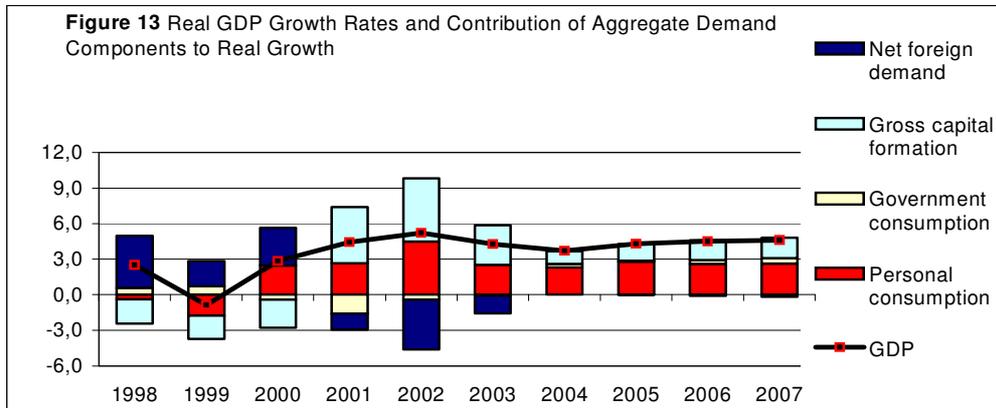
Aggregate Demand

According to the available monthly indicators of economic activity for the first eight months of the current year, balance of payments projection and the consolidated general government budget for 2004, we expect a mild slowdown in real GDP growth. Thus, GDP growth would be 0.4 percentage points slower in the current year compared with 2003 when it rose by 4.3%. The forecast growth of implicit GDP deflator is 2.2% in the current year, i.e. the projected nominal value of GDP for that year is HRK 204.8 billion.

We estimate that real GDP growth will accelerate again as early as in the following year, and this trend is expected to continue over the medium term. The forecast average rate of GDP growth in the period 2004-2007 is 4.3%. According to our projections, the growth rate of implicit GDP deflator will slightly exceed 2.6% in 2005, due to delayed effect of oil prices and import inflation but its growth is expected to slow down to 2.2% by 2007. Such dynamics of implicit GDP deflator should closely follow the developments in consumer prices and the deflator for personal consumption being the most significant component of aggregate demand.

A slower expected GDP growth in 2004 is mostly the result of slow down of economic growth in the second half of 2003, in addition to an increase in other domestic demand components. In the medium term, we expect that public investment will continue at the level from 2003. We assume that there will be no real changes in inventories at the annual level in the projection period, so the approximate level of total real gross capital formation will be established on the basis of gross fixed capital formation. Given an average annual growth of gross fixed capital formation of 5.4% in real terms, which is based on private investment growth, we expect that the average annual contribution of investment to real growth will be 1.5 percentage points in the period 2004-2007 (assuming that investment growth will accelerate towards the end of that period). Consequently, the projected growth of gross fixed capital formation by 2007 will constitute an important source of growth. With a real growth of personal consumption exceeding 4.0% by 2007, the average annual contribution of personal consumption to GDP growth will be 2.6 percentage points. Such personal consumption dynamics will result from a continuous income growth, favorable developments on the labor market (we expect a stable employment growth) and a rise in consumer optimism stimulated by heightened economic activity. Therefore, the main generators of economic growth in the

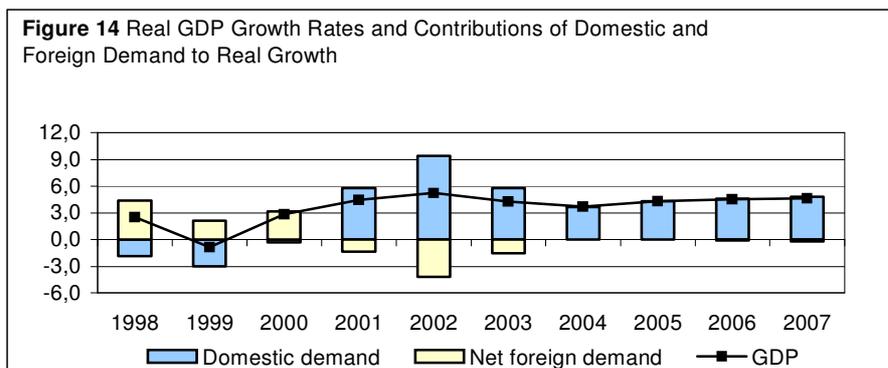
projection period will be, as in the previous years, strong personal consumption and investment activity.



Sources: CBS, CNB and MoF.

According to our forecast, in the above stated period, the growth of consumption and investment will be paralleled with a slight but positive contribution of government consumption to real growth. The projection of the consolidated general government budget assumes a 3.6% annual growth of government consumption in real terms, with expenditures on goods and services growing faster than expenditures on wages and salaries, and a slower annual growth of government consumption deflator, which will average 2.2% in the period 2004 to 2007 (much lower than in 2003 when the deflator growth was strongly influenced by increased severance payments in the public administration). Consequently, we expect a further decrease in the shares of government consumption and budget deficit in GDP. This will lessen the influence of government consumption on GDP growth in the projection period compared with other domestic demand components (the contribution of government consumption to real growth will not exceed 0.4 percentage points in the medium term).

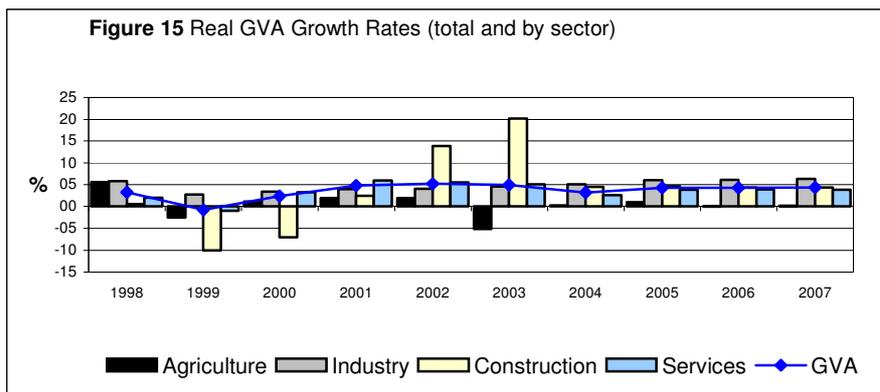
On the basis of these forecasts, we expect that the average contribution of domestic demand to GDP growth will be 4.4 percentage points in the 2004-2007 period. In the current year, we expect a neutral positive contribution of net foreign demand to real GDP growth, while in the medium term this contribution should be negative. Assuming low rates of export price growth, a continuous labor productivity improvement and strong foreign demand, goods and services exports are expected to grow at an average annual rate of 4.8% in real terms during the projection period. We also anticipate a somewhat slower increase in real goods and services imports paralleled with a slightly improved coverage of imports by exports and a reduced current account deficit.



Sources: CBS, CNB and MoF.

Gross Value Added

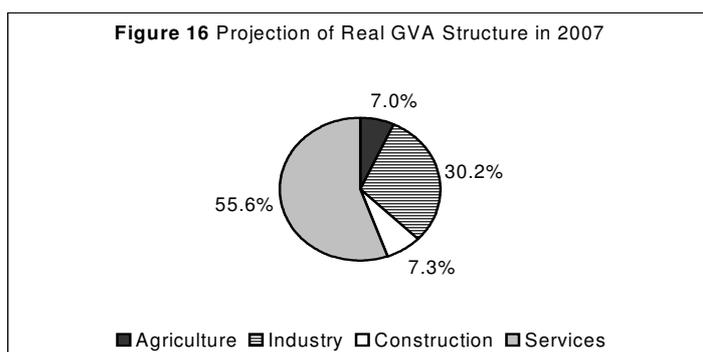
The medium-term projection of gross value added assumes that there is harmony between the GDP calculations made by the expenditure and production methods (i.e. there is no statistical discrepancy). This projection is also harmonized with the fiscal projection for the period 2004-2007, which assumes a somewhat faster growth of tax on products reduced by subsidies compared with GDP growth, which implies a somewhat slower growth of GVA. Consequently, we forecast stable nominal GVA growth of 6.3% on average over the medium term. Given the expected increase in GVA deflator ranging from 1.9% to 2.6%, the real annual growth rate of GVA would be 4.0% on average, 0.3 percentage points lower than the real GDP growth rate.



Sources: CBS, CNB and MoF.

In the projection period, we forecast positive effects of domestic and foreign demand on the real growth of gross value added in industry. As industrial products account for over nine-tenths of the total merchandise trade, the expected growth of goods exports, paralleled with a decline in foreign trade deficit, should encourage the growth of industrial activity. Owing to the expected increase in the real annual GVA in industry (excluding construction) of 5.9% on average by 2007, the importance of industry for the Croatian economy will slightly grow, and its average contribution to real GDP growth will be 1.4 percentage points. As before, the main source of GVA growth in industry will be manufacturing, in which food processing, metal manufacturing industry and chemical industry participate with the largest shares. This situation will remain unchanged in the medium term, but it will strongly depend on the trends in construction, which particularly relates to energy supply and manufacture of capital products.

In the current year, we expect a mild slowdown in GVA due to a decline in gross value added in construction and services sector. We predict stable share of the services sector in overall GDP in the period 2005 to 2007. Following a slowdown in GVA in the services sector during the current year, GVA is expected to grow at a somewhat higher average rate of 3.6%. Such developments will primarily be influenced by closely interrelated activities like trade, catering (hotels and restaurants) and transport, storage and communications. We expect that in the stated period, the services sector will make a strong annual contribution to GDP growth of 1.6 percentage points on average.



Sources: CBS and MoF.

Agriculture (which includes hunting, forestry and fishing) is expected to grow at positive rates, yet much slower than other economic activities. In the medium term, the share of agriculture in the GVA structure (at constant prices) is expected to approximate the share of construction (around 7.0%). In the current year, the slowdown in construction is expected to influence the growth of gross value added in that activity, which is the result of a decline in government capital investment projects within the road infrastructure development. According to our forecasts, real GVA in construction will grow continuously in the period from 2005 to 2007 at annual rates exceeding 4.0%. Consequently, construction is expected to make a constant contribution of 0.3 percentage points to the real GVA growth in that period.

2.2 Inflation

The average annual rate of inflation in Croatia in 2003, measured by changes in the CPI, was at a low 1.8%, which is an increase of only 0.1 percentage points compared with the average annual rate of inflation of 1.7% in 2002. Croatia thus managed again, for the tenth consecutive year, to achieve a noteworthy stability of its general level of prices, owing primarily to its policy of maintaining the stability of the nominal exchange rate of the kuna against the euro, the main anchor of domestic inflationary expectations contributing to price stability of imported inputs and final products from the countries in the eurozone, Croatia's major trading partners abroad.

There were also other factors that contributed to the country's low rate of inflation in 2002 and 2003. These included tariff reductions due to foreign trade liberalization and a significant appreciation of the kuna against the US dollar which helped lessen the impact of the increase in crude oil prices and other raw materials in the world markets and caused a drop in import prices of those final products whose payment had been agreed in US dollars. This, in addition to the low and falling annual rate of change of producer prices in the eurozone, caused low total imported price pressures on consumer prices in 2003. Also, the competitive strengthening of the domestic retail trade as a result of expansive policies of domestic chain stores and opening of a large number of big foreign-owned chain stores, coupled with increased competitiveness of imported goods caused by gradual foreign trade liberalization were all factors which, as in the previous several years, served to ease the pressures on consumer prices in Croatia. Another factor that contributed to price stability in the country in 2003 was only a mild increase in administered prices, attributable largely to a decline in the annual rate of change in the prices of refined petroleum products and electricity and partly to the 2003 election year effects and the postponement to 2004 of all demands for increases in individual administered prices. Developments in the annual rate of core inflation which never exceeded 1.3% in 2003 point to subdued pressures on the demand side of the Croatian market.

Stability of the domestic demand was largely due to moderate wage rise policy in the public and the business sectors.

With continued pursuit of a policy that focuses on maintaining a relative stability of the nominal exchange rate of the kuna against the euro, there was a mild acceleration in inflation as measured by the consumer price index in 2004, primarily as a result of shocks on the supply side (a rise in oil prices and prices of other raw materials on the world markets), rise in individual administered prices (such as gas, household water supply, road tolls, etc.) and higher excise duties imposed on tobacco and cars. In addition to its direct impacts, increase in the price of refined petroleum products also had an indirect impact on total consumer price index developments, as reflected in increased prices of transport services. The average annual rate of inflation in the first seven months of 2004 in Croatia, measured by developments in total consumer price index, compared with the same period last year, stood at 2.0%. The average annual rate of inflation, as measured by the consumer price index, is estimated to rise slightly in 2004 and reach 2.2%, a level that is still within a low inflation zone and that does not depart significantly from the rate of inflation in the eurozone.

The projected inflationary developments in 2005, 2006 and 2007 are based on several important assumptions. First, central to the projection is the authorities' commitment to maintaining the stability of the exchange rate of the kuna against the euro and the assumed average nominal exchange rate of the kuna against the euro in the relevant three year period of around HRK 7.52/EUR. Following marked appreciation of the average annual exchange rate of the kuna against the US dollar of 14.8% in 2003 and the expected appreciation of 8.5% in 2004, forecasts for 2005, in line with the projected movements of the US dollar against the euro in the world foreign exchange market, point to a mild appreciation of the average exchange rate of the kuna against the US dollar of 0.5% to be followed by a mild depreciation of the average annual exchange rate of the kuna against the US dollar of 1.2% and 1.8% in 2006 and 2007, respectively. These forecasts are based on the assumption that impacts of the appreciation of the exchange rate of the kuna against the US dollar on import prices of raw materials and final products will lessen. Following their rapid growth in 2004, prices of crude oil are expected to stabilize in 2005 (at a considerably high level of USD 35.9 per barrel of Brent crude) and then fall in the following two years. The assumption is that the oil price increase in 2004 will lead to a rise in the total level of consumer prices in Croatia in 2005, due to the postponed effects of the increase in the prices of individual goods and services whose production relies heavily on this raw material.

Second, the projection of price developments in Croatia between 2005 and 2007 was based on an assumed moderate wage increase policy in the public and the private sectors, in light of Government's commitment under the Stand-By Arrangement with the IMF not to augment the real wage bill in the country. Wage stability in the public sector is expected to have a stabilizing effect on demands for wage increases in the private sector. Another factor that could provide a stabilizing effect in this regard is the continuing high unemployment rate. General estimation is that, in the light of the given economic environment, oil price increase should cause no so called "second round" effects, which would lead to an increase in domestic inflation as a result of its incorporation into demands for adequate wage rises.

Under the above mentioned assumptions, the projected average annual rate of inflation of consumer prices in Croatia should reach 2.6% in 2005, an increase of 0.3 percentage points compared with the previous year. This is also due to carry-over effects from the previous year and the announced 10% increase in household electricity prices (electricity accounts for 4.1%

of the total index). A reversal in inflationary developments is expected to come in 2005 from slashed prices in mobile telephony following the entry into the domestic market of a third operator. The average annual rate of inflation in 2006 and 2007 is expected to fall to 2.3% and 2.2%, respectively. These rates of inflation are a little above those recorded before the oil shock in 2004, leaving room for any increases in individual administered prices required as a measure of adjustment before the country's EU accession.

2.3 Monetary and Exchange Rate Policy

Croatia's central bank, the Croatian National Bank (CNB) is responsible for formulating and implementing the monetary and foreign exchange policies in the country. The legal framework determining its competence in this area and its independence is provided in the Croatian National Bank Act. The primary objective of the CNB is to achieve and maintain price stability. Without prejudice to its primary objective, the CNB supports the economic policy of the Republic of Croatia.

The central bank pursues a so-called managed float policy. This involves central bank intervention in the foreign exchange market through its foreign exchange auctions and its purchases or sales of foreign currency from banks in an effort to alleviate excessive fluctuation of the exchange rate of the kuna against the euro. The central bank does not predetermine and pre-announce the upper and lower intervention points. However, the central bank intervenes to prevent larger exchange rate fluctuations. The exchange rate of the kuna against the German mark, or the euro later on, has ranged in the last ten years between a relatively narrow band of plus/minus 6%, compared with the average exchange rate during this period. There is a strong seasonal component to the exchange rate due to large foreign currency inflows from tourism during the summer.

In the implementation of monetary policy special emphasis is given to exchange rate stability due to the country's highly euroised financial system, continuing euro-indexation of individual prices and the effects of exchange rate developments on inflationary expectations. The reasons for such a situation stem from citizens' and business entities' experience with high inflation adjustment in the eighties and the early nineties of the past century.

The level of euroisation, which is high in comparison with other candidate countries and new EU members, makes the Croatian financial and economic system more vulnerable in terms of the fluctuation of the exchange rate of the kuna against the euro. Kuna deposits account for only 20% of total savings and time deposits, and household kuna deposits account for less than 10% of the total. To protect themselves from the exchange rate risk, banks as a rule grant either foreign currency loans or kuna loans with a currency clause, i.e. foreign currency-indexed loans. Kuna loans with no currency clause make up only about 1/4 of all bank loans (or only about 10% of household loans). Despite banks' efforts to protect themselves, currency risk is still indirectly present in the banking sector as it is contained in the credit risk, as loan beneficiaries are exposed to the exchange rate risk.

Further difficulty to monetary policy implementation is posed by large capital inflows (privatization, government foreign borrowing, and lately more intensive borrowing of banks and other financial institutions) which create appreciation pressures and stimulate domestic consumption, keeping the country's current account deficit at an undesired level. Capital inflow surge in the past several years can also be attributed to banking system restructuring and the entry of foreign banks. Foreign ownership of banks makes it easier for banks to

acquire cheaper foreign capital for investment in Croatia. This led to a big loan growth, particularly those to the household sector, in the past several years. Attempts to increase domestic interest rates fuel further capital inflows and appreciation pressures, thereby restricting Croatia's monetary policy. Foreign banks headquartered in the eurozone own over 85% of the Croatian banking system. This fact makes the Croatian monetary system indirectly even more connected to the EMU.

The selection and the use of instruments of monetary policy in Croatia are determined by the characteristics of the country's financial system. Foreign exchange interventions are the main instruments of monetary policy, with foreign currency purchases predominating. In pursuit of its monetary policy the central bank uses not only the exchange rate but also the level of banking system' excess reserves as an indirect indicator. To sterilize the kuna liquidity created through foreign exchange interventions, the central bank uses a high reserve requirements rate (19%) which is calculated against all sources of funding except capital and provisions. In its short-term liquidity management the CNB also uses other market instruments. Until last year the central bank operations involved transactions on the liabilities side such as those with CNB bills in kuna. Currently, the central bank is preparing to switch to operations on the assets side which would involve mainly repo transactions, which will aim to achieve compliance with similar ECB operations. An extremely high level of banks' assets immobilized in reserve requirements and the continued large capital inflows as the country undergoes the process of EU approximation, make the adjustment of Croatia's monetary policy instruments to those of the ECB more difficult, as there remains the need to sterilize surplus liquidity.

An important instrument for maintaining financial stability, given the high level of euroisation present in the banking system, is minimum foreign currency liquidity. Under this requirement, banks have to keep at least 35% of their total foreign currency liabilities in short term liquid assets.

The CNB does not plan any major changes in its exchange rate policy as the current exchange rate policy and its instruments have proven efficient in ensuring stability of the general level of prices, the central bank's main objective, for almost ten years. The current system is also compatible with the principles and the main elements of ERM II, as one of the steps towards EMU membership, so no major adjustments will be necessary to create the conditions for entry into the ERM II following the country's EU accession. Moreover, it is expected that the future introduction of the euro will counteract the high level of exchange rate risk present in the financial system due to high level euroisation. Such developments would contribute to arguments in favor of speedier EMU accession. Croatia's EMU accession strategy still needs to be prepared. This strategy will have to be comprehensive and necessarily incorporate the fulfillment of all the set criteria. In this respect, Croatia will be able to learn from EMU accession experiences of new EU member countries.

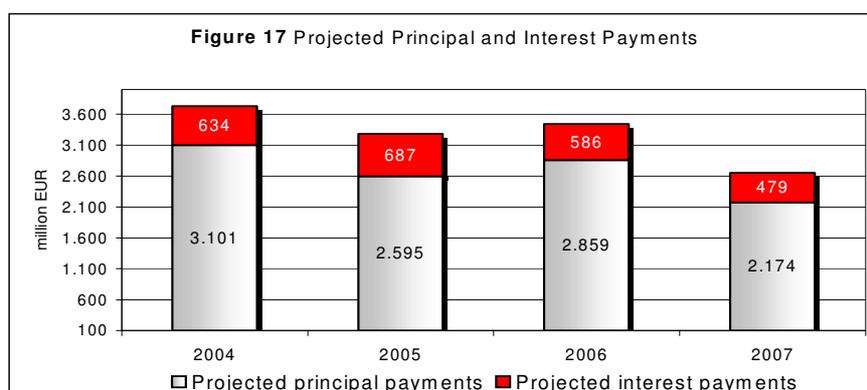
2.4 External Sector

Croatia's medium-term balance of payments projection indicates that the country's current account deficit, after its significant decrease from its level of 7,2% of GDP in 2003 to 5,6% in 2004, will continue falling gradually and reach a level of 3,8% projected for 2007. The narrowing of the deficit is expected to be brought about by budget deficit reduction, steady growth of Croatia's goods and services exports and also, in relative terms, a somewhat slower growth of goods imports compared with the trends that marked the years 2003 and 2004.

Further integration of the Croatian economy with EU economy, further restructuring of domestic companies and improved labor productivity, positive effects of the expected increase in foreign direct investment and the projected acceleration of economic activities in EU member countries are expected to speed up the dynamics of the Croatian goods exports between 2005 and 2007. Alternatively, wages growth and pension indexing, that are likely to exceed the growth rates of the general level of prices in Croatia, coupled with a significant difference in the price of banking products at home and in the EU, will continue to boost personal consumption and goods imports growth. However, it is believed that the consumption boom related to car purchases which had had a large effect on the annual growth rates of total goods imports in 2002 and 2003 reached its peak in the first half of 2004 and that car imports, now additionally burdened by recently imposed increased excise duties, should gradually ebb away. Our medium-term projection thus rests on the assumption that the country's wide foreign trade deficit, expressed as a percentage of GDP, will improve slightly over the next three years (from 27.4% in 2003 to 23.2% in 2007).

Despite instability and increased competition on the global tourism market, Croatia managed to record marked growth of physical and financial indicators of services in tourism in 2003. Given the country's image of a safe tourist destination of exceptional natural beauty which boasts the cleanest sea in the Mediterranean, expected improvement in the range of services provided to tourists and promotional activities, as well as improving traffic connections, the medium-term projection is also based on the assumption that Croatia can continue to count on good results from services in tourism and the assumed increase in income from air traffic services.

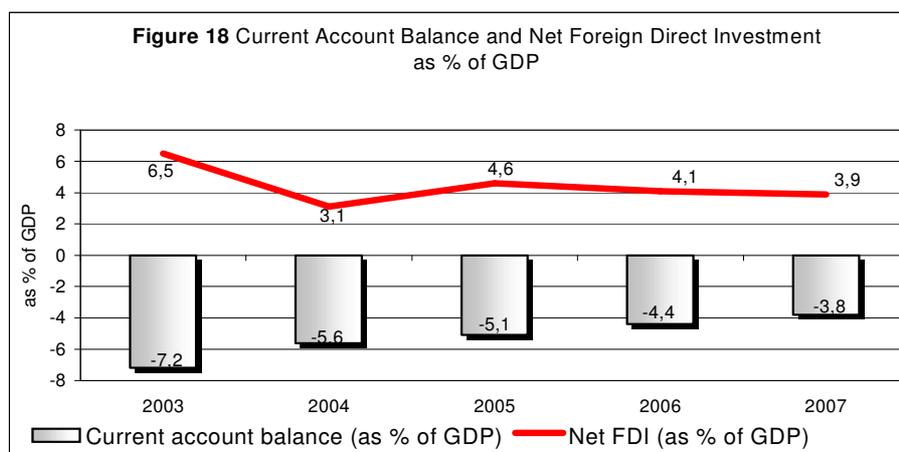
Expenditures on the income account have been projected in part on the basis of interest repayments data supplied by CNB foreign credit relations register unit (see Figure 17) and in part on the basis of projected values of dividends and retained earnings relating to foreign investors.² Regarding Croatia's total revenues from interest on all types of investment abroad, the CNB has a leading role, so the projection of the said revenues has been adjusted with projected developments and currency structure of the country's international reserves and developments in relevant interest rates abroad. Slight annual growth in net current transfers, including workers' remittances from abroad for the period 2005-2007 has been adjusted to match the expected GDP growth rates in EU countries and age structure of the target population.



Source: CNB.

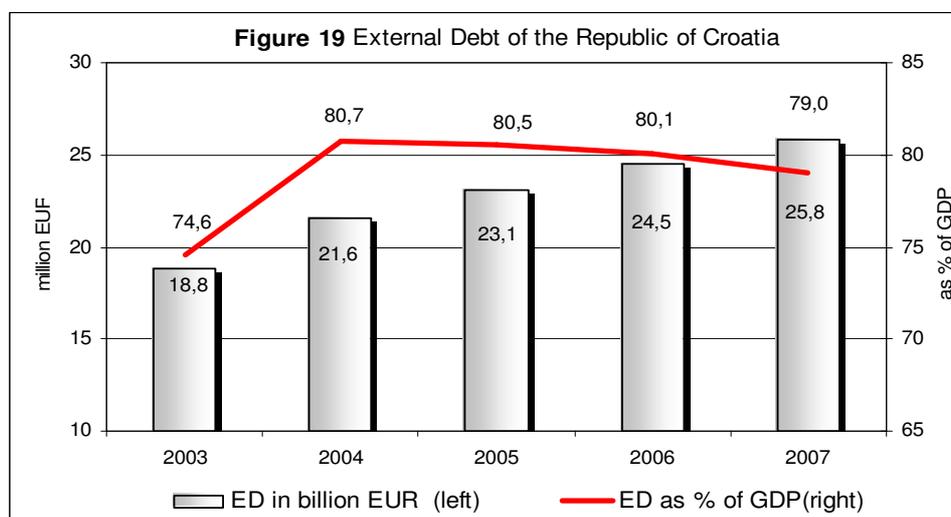
² It should be stressed that factor income account projection in 2004 does not include any dividend payments by Hrvatske telekomunikacije (HT) for the previous several years, where the estimated value of dividends attributable to the foreign owner of HT amounts to EUR 312m.

A decision of the European Commission to grant an official EU candidate status to the Republic of Croatia and to commence soon entry negotiations for full membership as well as the signing of a new Stand-By Arrangement with the International Monetary Fund have undoubtedly sent a positive signal to foreign investors that Croatia intends to continue with its reform efforts and its efforts towards legislative infrastructure adjustment. As a result, Croatia can expect bigger inflows from foreign direct investments in the future. Further privatization of the government portfolio, planned under Government's economic program, is expected to contribute further to increased income from foreign investment in shares and equity participation in Croatian companies. The external sector projection thus suggests that the current account deficit in 2005 and 2006 might be covered by approximately 90% of net inflows from foreign direct investment and the current account deficit in 2007 might be covered fully by net inflows from foreign direct investment (Figure 18).



Source: CNB.

Preliminary projections indicate that external debt will begin to stabilize after 2004 and that it will amount to about 79% of GDP by 2007 (see Figure 19). The projected movements in international reserves point to the continuation of the country's strong international liquidity, i.e. to the reserve cover ratio of imports of goods and services estimated at 5.5 months in a calendar year. The value of international reserves projected for end-2004 shows that they cover 196% of the value of the estimated due payments of principal and interest on the external debt of the Republic of Croatia in the current year.



Source: CNB.

3. PUBLIC FINANCE

3.1 Medium Term Fiscal Framework, 2005-2007

Goals and priorities of fiscal policy

In July 2004, the Croatian government adopted the Fiscal Policy Guidelines that define the main goals and priorities for the three-year fiscal period from 2005 to 2007. The main goals of this medium term strategy are stabilizing macroeconomic risks, which could arise because of the fast growth of external and public debt, and strengthening economic development by increasing macroeconomic stability through fiscal adjustment and a better investment climate.

Fiscal policy will be the main instrument for stabilizing the growth of the external and public debt that cannot surpass 60% of GDP, as prescribed by the Maastricht criteria. This goal is closely tied to the lowering of the general government deficit to less than 3% of GDP. It is clear that after a fiscal deficit of 6,3 % in 2003, a strong fiscal adjustment is necessary and was started this year with a targeted deficit of 4,5 % of GDP. Finally, the deficit is planned at a level below 3% for 2007.

It is also necessary to lower the fiscal burden so as to promote a higher level of competitiveness in the economy. The reduction of the fiscal burden has to begin with expenditure cuts. Therefore in the next few years, the government plans to reduce its share in GDP from the 2003 level of 53% to less than 50% in 2007.

The main macroeconomic assumptions in fiscal projections are continued economic growth and low inflation, as was previously mentioned in the macroeconomic projections.

Besides the already mentioned fiscal goals, it is important to also mention that in the next period the government plans to lower its intervention in the enterprise sector through creating and implementing budgetary ceilings and lowering of administrative obstacles to businesses by creating a fiscally sound public administration in accordance with EU standards. In addition, a public expenditure management system based on accountability, control and strategic planning (especially in the health sector and social expenditures) will result in improved fiscal and social sustainability. With that in mind, the medium term fiscal framework has the following priorities:

- ***Fiscal transparency*** - the first step towards rehabilitating public finances is for the Ministry of Finance to keep orderly records of all budgetary transactions and to publish them at regular intervals. Also, the started implementation of a budget reporting system in accordance with international standards (GFS 2001) needs to be further expanded to reporting in accordance with other standardized and internationally recognized methodologies (such as ESA95).
- ***Quality budget management*** – past experience has shown many deficiencies in the functioning of the Government Treasury system, brought into operation in 2000. The new Croatian government is determined to record all budget operations through the Government Treasury in the forthcoming period, in such a way that all extra budgetary funds and government agencies' operations are included into the consolidation.
- ***Reducing government interventions*** – the aim is to reduce government interventions in the enterprise sector by imposing and implementing strict budgetary constraints. The expected outcome is the reduction of subsidies to the enterprise sector from 3.4%

of GDP in 2004 to 2.2% of GDP in 2007 and to decrease arrears in the public enterprise sector (this does not include subsidies to the agriculture sector, which has special arrangements).

- **Creating a more efficient public administration** – fiscally acceptable and structured in compliance with the EU standards on aptitude/merit, competence and political impartiality.
- **Structural reforms of the public sector** – reduction of the size of the public sector, which will bring about a reduction in government spending, specifically the share of the wage bill, pensions and other social expenditures.
- **Improved reallocation of budget funds** – fiscal policy's objective in the forthcoming period is to increase funds available for the education and science sectors, while at the same time tightening social spending. In addition, expenditures for infrastructure projects are expected to remain the same as in 2003.
- **Privatization** – one of fiscal policy's key objectives in the forthcoming period is to restructure and privatize public enterprises that are still owned by the government. This will assure more competitive power and profit-oriented activity for companies in the market, attract new foreign investment and finally, promote faster development of the private sector and reduce the role of the government.
- **Taxation policy** – a comprehensive reform of the tax system is planned to revive production and assure a more equitable redistribution of income.
- **Fiscal decentralization** – to ensure an improved and more efficient functioning of local government and self-government units, the government plans to increase these units' discretionary powers to decide on the level of their taxes while simultaneously enhancing the transparency of local government budgets and determining responsibilities in budget execution. The government also plans to give more influence to cities with a population of more than 20.000, and to improve the coordination of counties.
- **Reconstruction** – finishing of the process of reconstruction of war damaged areas, and the rehabilitation of refugees, for which the fiscal cost is about 0,6 % of GDP.

A rational and restrictive fiscal policy, which implies a number of previously mentioned reforms of the social insurance system, a reform of the government administration and the educational system, the inclusion of certain costs related to the adjustment to European environment protection standards, the control of budget spending funds and tax collection, and an accelerated privatization of government holdings, is expected to reduce consolidated general government expenditures from an approximate 52.7% of GDP in 2003 to 49.7% of GDP in 2007. The tax burden on the economy, measured as the ratio of consolidated general government tax revenues to GDP, is anticipated to reduce by about 1.5% of GDP.

Such fiscal policy will enhance the stability of the domestic currency in the forthcoming three-year period, enable the release of private sector resources and their channeling into investment activities and new employment. By far the most important effect of such policy will be providing a sound base for the further alleviation of the tax burden in the period after 2007 and a strong support for economic growth. In the above manner, Croatia's fiscal policy would consolidate the budget towards the level prescribed by the Maastricht criterion by the end of 2006. The savings generated by restrictive measures would enable investments aimed at meeting European standards in the field of public services.

Central government budget for 2005-2007

The projection of central government budget for period 2005-2007 is based on expected macroeconomic assumptions (as explained earlier). In the forthcoming three-year period, **total revenues** (using GFS 2001 methodology) are projected to be around 39,5 % of GDP.

Tax revenues make up over 60% of total revenues and they are expected to be around 24% of GDP in the 2005-2007. In the structure of tax revenues, indirect taxes make up the largest share, of which value-added tax is planned at around 15% of GDP in 2005, and will grow to 15,3% of GDP in 2007. The annual growth of VAT is projected using the growth rate of nominal GDP, taking into account also its elasticity as related to GDP.

Total revenues from excise taxes for the projected period are expected to amount to 4,4 % of GDP. Their annual growth is based on expected economic growth and positive expectations in the tourism sector, which seasonally creates a larger consumption of goods on which excise taxes are paid.

As for direct taxes, income tax is planned on a annual level of 1,5% of GDP, based on projected annual growth of gross wages and salaries of 5% and growth in employment levels of 1,8% annually until 2007. This projection assumes that there will not be any new tax deductions. At the same time, profit tax is projected on an annual level of 1,6% of GDP. Based on the growth projections of industrial production, construction, retail trade turnover, tourist nights and banks' activities in the 2005 – 2007 period, a further growth in profit tax revenue is estimated (10% at the annual level).

Revenues from contributions for social security, which make up 37% of total revenues, are projected to amount to 14,5% of GDP in 2005, and 14,6% in 2006 and 2007. Contributions for the 2005 – 2007 period are projected in view of the employment and gross wage growth.

Other revenues of the central government budget have a smaller fiscal importance, and their projections are given in an aggregated form in the Statistical Appendix. As a side note total revenues from customs tax are projected in such a way that their share in GDP in the given period is gradually falling, from 0,7% of GDP in 2005 to 0,5% of GDP in 2006 and 2007. Their share in total revenues is also projected to become less important, which is based on the continuation of liberalization of trade relations between Croatia and other countries. Due to EU accession, this trend is expected to continue and further projections assume a 10% reduction in customs taxes for years following 2007.

Projections of **total expenditure** for all government units have been recalculated so as to achieve the deficit according to GFS 1986 methodology, and for ease of comparison to historical data. Therefore, total central budget expenditures are projected at 41,4% GDP in 2005 and will fall to 41,0% GDP in 2007, which reflects a relatively large fiscal adjustment of 1,4 % when compared to 2004 (see Table 4).

The largest share of central budget expenditures is made up by social security spending. The government plans to lower corporate subsidies. The growth of current spending which is not tied to the process of European Union accession is expected to slow down. It is important to point out that in the forecast period, a large share of spending will be attributed to interest payments, of about 2,0% of GDP in 2006 and 2007.

Planned lower spending on behalf of the government is planned to reduce the share of government in GDP, leading to a reduction in the fiscal deficit and reaching the criteria from the Maastricht agreement.

The central budget deficit is planned at 2,0% of GDP in 2005, 1,7% of GDP in 2006 and 1,5% GDP in 2007. Table 4 shows the tendency of lowering of the central government budget deficit already in 2004, compared to its level in 2003 when it was 3,6% of GDP. The reduction in the central government deficit is based on the general fiscal strategy that aims to lower general government deficit to fewer than 3% of GDP by 2007.

Extra budgetary funds budget 2005-2007

Extra-budgetary funds include social insurance funds (Croatian Bureau for Pension Insurance, Croatian Bureau for Health Insurance, and Croatian Bureau for Employment) and the public company Croatian Waters. From January 1 2003, extra-budgetary funds also include four more agencies (Croatian Motorways, Croatian Roads, State Agency for Deposit Insurance and Bank Rehabilitation, and the Croatian Privatization Fund). From January 1, 2004, it also includes the Fund for Protection of the Environment and Energy Efficiency.

Total revenues of extra budgetary funds are planned at 3,5% of GDP in 2005 with a tendency of falling to 3,1% of GDP in 2007 (see Table 4). The largest share of revenues comes from government agencies, especially agencies for highways and roads, which collect revenues from excises on gas and gas derivatives.

Total expenditures are planned at 4,8% of GDP in 2005 and will fall to 4,2% of GDP in 2007.

Based on mentioned forecasts, the **deficit of extra-budgetary funds** is projected to fall from 1,7% of GDP in 2004. to 1,1% GDP in 2005 and 2006. Compared to 2003, this represents a fiscal adjustment of 1,4 % of GDP.

Local Units Budget for 2005-2007

Total budget revenues of local units are planned at 4,2% of GDP for 2005-2007. Over 60% of total revenues for 2005-2007 come from income and profit taxes, which were already discussed in the central budget revenues section.

Total budget expenditures of local units show a large fiscal adjustment, and are projected at 4,7% of GDP in 2005 falling to 4,5% of GDP in 2007. This reflects more restrictive government spending that is necessary on all levels of fiscal administration.

The planned reduction in the local government **deficit** is from 0,5% of GDP in 2004 to 0,3% of GDP in 2007. Therefore, this deficit also reflects the fiscal adjustment seen in all levels of government.

Consolidated general government budget for 2005-2007

Total consolidated general government revenues for the next three years show a relative reduction as a share of GDP, from 47,6% in 2004 to 46,8% in 2007, despite the average annual growth rate of 6,2% from 2005 to 2007. The consolidated general government budget in

the forecast period assumes a strong fiscal adjustment, which would stabilize macroeconomic risks, and satisfy the criteria related to the fiscal deficit, and the level of public and external debt. It is evident that reducing the fiscal burden has to be preceded by restrictions of behalf of government expenditures, so as to ensure a stronger business cycle resulting in the growth of total competitiveness of the domestic economy.

Therefore, total expenditures in 2005-2007 should be looked at in the context of fiscal consolidation when compared to 2003, when expenditures were 52,7% of GDP. In the next three years, with the reduction in the public sector, expenditures are projected to fall to 49,7% of GDP. This assumes a gradual and decisive fiscal adjustment for each year leading to 2007, and also requires rational management of the budget on all levels of fiscal administration (central government, extra-budgetary funds, and local governments).

Table 4: Consolidated General Government

(millions HRK)	2003	2004	2005	2006	2007
Cons. Gen. Gov. Total Revenues	89.500	97.556	103.227	109.530	116.949
% GDP	46,4	47,6	47,1	46,8	46,8
Cons. Gen. Gov. Total Expenditures	101.698	106.806	111.399	117.003	124.194
% GDP	52,7	52,1	50,8	50,0	49,7
Cons. Gen. Gov. Budget Deficit	-12.198	-9.250	-8.172	-7.473	-7.245
% GDP	-6,3	-4,5	-3,7	-3,2	-2,9
Gross Domestic Product	193.067	204.817	219.098	233.886	249.694
Central Government Revenues	74.662	82.279	86.357	92.345	98.643
% GDP	38,7	40,2	39,4	39,5	39,5
Central Government Expenditures	81.647	86.913	90.695	96.392	102.320
% GDP	42,3	42,4	41,4	41,2	41,0
Central Government Budget Deficit	-6.985	-4.634	-4.338	-4.047	-3.677
% GDP	-3,6%	-2,3%	-2,0%	-1,7%	-1,5%
Extra-Budgetary Funds Revenues	6.309	6.565	7.562	7.248	7.698
% GDP	3,3	3,2	3,5	3,1	3,1
Extra-Budgetary Funds Expenditures	11.136	10.146	10.476	9.862	10.557
% GDP	5,8	5,0	4,8	4,2	4,2
Extra-Budgetary Funds Deficit	-4.827	-3.581	-2.914	-2.614	-2.859
% GDP	-2,5%	-1,7%	-1,3%	-1,1%	-1,1%
Local Government Revenues	8.528	8.712	9.308	9.936	10.608
% GDP	4,4	4,3	4,2	4,2	4,2
Local Government Expenditures	8.914	9.747	10.228	10.748	11.317
% GDP	4,6	4,8	4,7	4,6	4,5
Local Government Deficit	-386	-1.035	-920	-812	-709
% GDP	-0,2%	-0,5%	-0,4%	-0,3%	-0,3%

Total expenditures of consolidated general government in the forthcoming three-year period (2005 -2007) will be determined by the new expenditure categories:

- Completion of the reconstruction process of residential facilities and directing outlays at providing incentives for regional development.
- The construction intensity in the following four years (2005 - 2008) will be defined by the new mid-term construction plan.
- Reduction in the health care sector structural deficit by applying a number of measures for rational operation and control of expenses.
- Public administration reform and reduction of non-civil service employment.
- Government Treasury functioning – As a result of the previous practice of non-payment and non-compliance with the funds allocated by the budget, settlement of government

liabilities within the legally prescribed time limits must be a priority of the public finance management.

In 2003, **consolidated general government deficit** stood at 6.3% of GDP. Already in 2004, the government has decided to reduce it to 4.5% of GDP, as agreed upon in the new Stand-by Arrangement with the IMF.

In the 2005 – 2007 period, fiscal consolidation will be gradual in a way that in 2005 consolidated general government deficit will be reduced by 0.8 percentage points of GDP (from 4.5% to 3.7% of GDP), in 2006 by 0.5 percentage points of GDP (from 3.7% to 3.2% of GDP), so that by 2007, the criterion in the Maastricht agreement with the deficit projected at a level of 2,9% of GDP. In the case of significant changes in the macroeconomic assumptions described earlier, appropriate corrections in the level of the deficit can also be anticipated.

Also the slowing down of the growth of public debt is a direct consequence of the planned lowering of the budget deficit, so that in the period from 2005 to 2007, the Maastricht criterion related to the level of public borrowing, which states that the public debt needs to stabilize at a level below 60% of GDP, would also be satisfied. It is important to note that the mentioned fiscal reforms which the government is planning to undertake in the forthcoming three-year period, will have strong support from international financial and development institutions, namely the International Monetary Fund (through the Stand-by Arrangement) and the World Bank (through various support programs).

3.2 Public Debt Management

Institutional Arrangement of Debt Management

Legal structure. The legal structure of borrowing and debt management is set forth by the Budget Act of 2003 which clearly defines the authority to borrow and to issue new debt, invest, and undertake transactions on government's behalf. The Act states that the main goal of debt management is insure that the financial needs of the government and to repay government debt with the lowest costs in the medium- or long-term.

The government can borrow in order to finance the budget deficit, investment projects, and special programs (approved by the Parliament), refinance public debt, settle of payments due associated with government guarantees, and to support the balance of payments. Refinancing can only be used to lower the existing costs of public debt repayment, to extend the average period of maturity of the public debt, and to achieve a balanced schedule of public debt repayment. The Act also establishes a debt ceiling of no more than 60 percent of GDP.

The Parliament (Sabor), at the proposal of the government, decides the level of public debt and government guarantees, while the government decides the debt management strategy, and the sort of loans and instruments used (advised by the Ministry of Finance). The government also decides on the issuing of state guarantees, except when the guarantees are under the jurisdiction of the Parliament.

The Ministry of Finance is responsible for public debt management. According to the Budget Act, the Ministry of Finance is supposed to recommend to the government the best borrowing

methods (the type of loans and instruments for repayment of loans), to keep a record of current debt, issued guarantees and loans, while the Minister of Finance can issue state securities and other forms of borrowing, sign agreements on state budget borrowing and issuing of guarantees, and prepare an annual and semi-annual report on the state of the public debt.

Organization. In the Ministry of Finance, the *Public Debt and Cash Management Department* is responsible for managing and keeping track of public debt, which includes arranging new loans and transaction of securities on the domestic and foreign markets.

Other units within the Ministry of Finance that are included in the activities of managing debt and financial markets are:

- *Department for International Financial Institutions and European Integration*, whose main task is to foster relationships between the Republic of Croatia and leading international financial institutions (World Bank, EBRD, European Investment Bank, IMF, etc.) and banks. They prepare negotiations and lead activities related to use and repayment of loans.
- The *Sector for Budget Execution* is responsible for short term borrowing on domestic markets. They also follow local units and regional self governments which cannot incur long-term loans without the advice of the Minister of Finance and in accordance with the government.

Reorganization of the *Public Debt and Cash Management Department*, according to results and recommendations set forth by the joint World Bank/IMF project, includes splitting the duties of the Department between a "front office", "middle office", and "back office", so as to ensure a transparent distribution of work and responsibility, and improve the processes of debt record-keeping, reporting, and managing of public debt.

A quality institutional system for record-keeping and managing of public debt is a basic assumption for development and good functioning of a public debt market. It is important to clearly define the goals of government borrowing, to have access to comprehensive data on public borrowing and develop cooperation with other bodies in charge of public debt management, investors and the Central Bank.

The above mentioned assumptions have only partly been met. In an effort to meet them fully, the Ministry of Finance will take on the following activities in 2005:

- Purchase of a new system for debt management, which will be financed by the EU through CARDS programs;
- Professionally educate staff in record-keeping and debt management and risks (CARDS program includes a component of technical support which will in addition to other activity also include capacity building).
- Improve risk management.

Development of public debt market and instruments. The Croatian financial system is dominated by banks, while the capital market is in development (see section 4.2 *Financial sector*). A developed domestic capital market ensures an additional financing possibility for the state and the economy, thus lowering the risk associated with relying on foreign financing sources. There is a great need for further development of domestic capital markets in which the Ministry of Finance, through quality management of public debt, can ensure additional

possibilities for financing of the government and the economy, and contribute to the lowering of risks associated with dependency on foreign sources of financing.

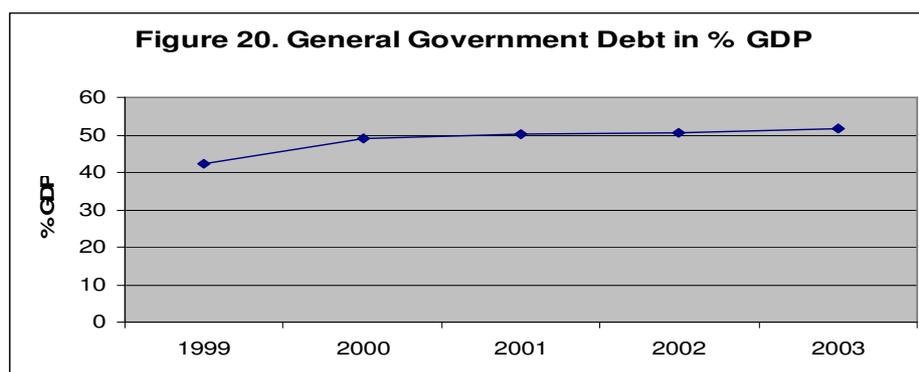
A strong public debt market is a pre-requirement for the development of domestic capital markets. The successful pension reform which began in 2002, introduced mandatory pension funds as a category of significant institutional investments which were not present until then in the development of the domestic capital markets. We estimate that with time, this category of investments will become a dominant factor in the development of domestic financial markets, as it has already, in the past two years, with its investment potential, ensured that a significant amount of budget based financing actualize itself by borrowing on domestic markets. In this way, it has lowered the dependency on foreign financing sources.

The choice of instruments for financing of the public debt of the Republic of Croatia was in past periods dependent on macroeconomic indicators, the types of investors and their preferences, and the monetary policy in place. To cover short-term government debt, the state issued treasury bills, while the medium- and long-term needs for financing were met through euro and samurai securities, placed on foreign markets, and in domestic markets securities were denominated in euros

Overview and Projections of General Government Debt

Consolidated general government public debt is composed of central government debt (about 70%), extra-budgetary fund debt, local government debt, government guarantees, and Croatian Bank for Reconstruction and Development (HBOR) debt. The Maastricht criteria, especially the requirement that public debt cannot surpass 60% of GDP, play an important role in debt management.

The level of debt compared to other transition economies, the average of the European Union, and the Maastricht criteria is not alarming. In 2002 public debt was 90.330 million HRK, that is 50,4% of GDP. In 2003, it grew to 99.592 million HRK, which is 51,6 % of GDP.



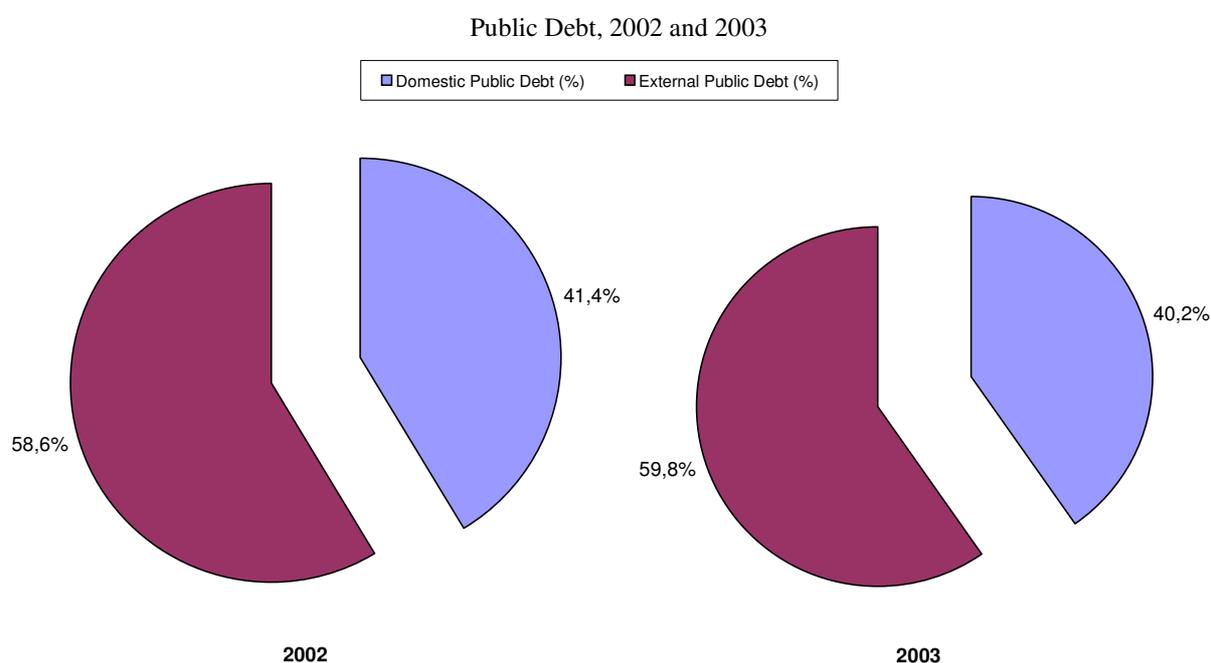
Although the share of public debt in GDP of 51,6% in 2003 is under the given criteria, the movements of public debt over the last 4 years indicate a growth trend.

As can be seen from Table 5, in the given period general government debt grew by about 40 billion HRK, or 9,3 % of GDP (from 42,3 to 51,6%). In local government, additional legal bindings established at the end of the 1990s, as a solution to the sudden growth of debt from 1997 to 1999, resulted in the stabilization of loans in the period from 2001 to 2003.

Table 5. General government debt, in millions of HRK

GENERAL GOVERNMENT DEBT End period, in mill. HRK	1999	2000	2001	2002	2003
1. General government domestic debt	17.634,00	22.461,80	26.128,30	29.891,80	33.060,60
2. General government external debt	29.147,10	37.402,10	40.220,90	41.563,70	46.618,30
3. TOTAL (1+2)	46.781,10	59.863,90	66.349,2	71.464,6	79.678,90
Commitments of the Republic of Croatia					
1. Domestic	3.300,00	3.377,00	5.957,80	7.423,80	6.796,50
2. Foreign	8.568,00	9.330,30	8.259,40	7.681,60	8.217,00
3. Total debt of HBOR-a	1.280,70	2.012,30	2.725,90	3.769,10	4.899,70
Total commitments of the Republic of Croatia (1+2+3)	13.148,70	14.719,60	16.943,10	18.874,50	19.913,20
TOTAL:	59.929,80	74.583,60	83.292,40	90.330,00	99.592,10
GDP	141.579,10	152.518,80	165.639,50	179.390,10	193.066,80
TOTAL GEN. GOV DEBT IN % GDP	42,3	48,9	50,3	50,4	51,6

The share of external debt still presents a much larger share of total debt. In 2002, it was 52,9 million HRK (58,6% of total public debt), and in 2003, it was 59,6 million HRK (59,7 % of total public debt).



Source: Ministry of Finance

In the medium term framework, the Ministry of Finance will implement fiscal policy whose main goal will be to lower the pressure of the government sector on the growth of total external debt.

Table 6. External government debt, in millions HRK unless indicated otherwise

	1999.	2000.	2001.	2002.	2003.	2004.*
Total External Debt	76.307,4	90.155,7	94.562,0	110.230,2	144.170,4	161.240,0
Of which, government**	38.964,8	48.696,0	51.140,2	52.924,6	58.514,6	66.000,0
Of which, other sectors	37.342,6	41.459,7	43.421,8	57.305,6	85.655,8	95.240,0
GDP	141.579,1	152.518,8	165.639,5	179.390,1	193.066,8	204.743,0
External Debt in % GDP	53,90%	59,11%	57,09%	61,45%	74,67%	78,75%
Share of Government						
External Debt in Total, in %	51,06%	54,01%	54,08%	48,01%	40,59%	40,93%
Share of Other Sector						
External Debt in Total, in %	48,94%	45,99%	45,92%	51,99%	59,41%	59,07%

* projection

**includes external debt of Croatia and all other sectors for which the government guarantees

Although the share of external public debt in total external debt fell from 45,4 % in 2001 to 35,3 percent in 2004, foreign debt from other sectors has shown a growth trend (in 2004 debt of other sectors made up 64,69% of external debt).

Measures of the three-year strategy of debt management to be implemented by the Ministry of Finance in the coming period are focused on lowering public external debt in an effort to lower total public debt, and are the following:

1. Lowering of the general government deficit;
2. Continuation of privatization;
3. Slowdown of borrowing by HBOR;
4. limiting further issuing of government guarantees;
5. focusing on domestic financial markets.

As can be seen from Table 7, the ratio of domestic to external public debt of the general government in 2004 was 40:60. In 2005, we expect an increase in the share of domestic debt in total public debt (42:58), and additionally the shares of domestic and external debt in total public debt will be almost equal by 2007 (48:52). The strategy of public debt management envisions that the share of general government public debt will be lowered from 32,2% of GDP in 2004 to 27,3% of GDP in 2007. The Ministry of Finance plans to finance new debt in the medium term on domestic markets.

Table 7

	2004		2005		2006		2007	
	mill. HRK	% BDP						
General Government	110.151,0	53,8	114.946,0	52,5	122.811,0	52,5	129.948,0	52,0
Domestic Debt	44.151,0	21,6	48.296,0	22,0	55.446,0	23,7	61.796,0	24,7
External Debt	66.000,0	32,2	66.650,0	30,4	67.365,0	28,8	68.152,0	27,3

Source: Ministry of Finance

The lowering of the fiscal deficit to 2,9% of BDP is planned for 2007, which will satisfy the Maastricht criteria which requires that the deficit be below 3% of GDP. Interest payments are expected to rise in the medium term from 2,2% to 2,6%, while privatization receipts are expected to be at around 2% of GDP in 2005. With the expected growth rate of GDP, it is also expected that the growth of public debt will slow down, as is shown in Table 7.

The structure of external public debt (on December 31, 2003) shows that it is denominated in 9 currencies, out of which the most important ones are the Euro (56%), USD (29%), JPY

(13,6%), while the CHF, DKK GBP, NOK, SEK, ad KWD make up only 1,4% of the external debt of the state. In the period from 2005 to 2007, the share of JPY will be significantly lower (due to coming repayment of Samurai bonds) and also the share of USD will be lower due to the increase of the share of Euro in the currency structure of debt.

With the goal of stabilizing the costs of repaying the public debt, the debt management strategy for 2005-2007 establishes that at least 70% of borrowing is done with a fixed interest rate. The intention is that the established level of debt with a fixed interest rate will eliminate the risk due to interest rate change and lower the risk of increase in the costs of repayment of interest above the planned amount. This cautious strategy of borrowing with fixed interest rate will be implemented as a measure of support to the main goals of fiscal policy which aims to achieve fiscal discipline and lower the deficit of the general government.

On December 31, 2003. the share of debt with a fixed interest rate made up 68% of the total public debt. In the forthcoming three-year period the share of fixed interest debt is planned to be between 70 and 75%.

Bonds make up half of the debt portfolio of the general government debt. Domestic bonds are included in the first quotation of the Zagreb and Varaždin stock exchange. Commitments on the basis of issued domestic bonds December 31, 2003, were 1.477.771.793 EUR, and on December 31, 2004. bonds amounted to 2.305.771.793 EUR. The Ministry of Finance manages the portfolio of issued bonds on domestic markets by extending maturities of the issues and gradual lowering of the interest rates.

The weighted average interest rate for domestic bonds in 2003 was 7,23 %, and in 2004 it was 5,474%. The Ministry of Finance has the right to extend maturity of issued bonds. So the structure of maturities in 2004 was extended for 308,26 days when compared to 2003, that is in 2003 the weighted maturity was 4,38 years, and in 2004 it was 5,23 years. The same trend is expected to continue in the medium term as well.

Commitments on issued euro bonds on December 31, 2003 were 2.703.387.564 EUR, and on December 31, 2004 they were 3.050.000.000 EUR. The weighted average interest rate was lowered from 6,37% in 2003 to 6,16% in 2004, while the weighted maturity increased from 4,59 years in 2003 to 4,73 years in 2004. The main goal in the managing of the euro bond portfolio is ensuring regular repayments in the long term and lowering of costs. The above mentioned goals will be affected by the improvement in credit rating of instruments which will be accomplished with Croatia's accession to the European Union.

3.3 Deficit Financing

In the medium-term (2005-2007), the Ministry of Finance will focus its attention on financing the deficit through domestic sources. The shift to domestic financing will reduce exposure to exchange rate risk, foster domestic capital markets development, and help absorb liquidity in the private sector.

In 2005, the repayments of loans and bonds for the central government budget were 12 billion kuna. For repayments of extra budgetary funds, it is necessary to include 370 million kuna, which makes the total repayment amount 12,37 billion kuna in 2005.

From 2005, with the planned completion of privatization, the majority of deficit financing will move to domestic markets.

The financing need also includes the amount of the deficit, which give us the following figures for 2005. For the central government budget the financing need is 16,6 billion kuna, of which the largest part, 8,8 billion kuna, is from issuing of securities. After that 4,4 billion come from capital revenues (privatization) and 3,4 billion from loans of international financial institutions and development banks. Foreign financing will be used exclusively for needs of foreign repayments, thus the issuing of Eurobonds will be used for repayments coming to term in the first quarter. It is also planned that foreign commitments will be lower by 705 million kuna. For extra budgetary funds, the financing need of 3,2 billion kuna, of which the largest part falls on HAC and HC. They will borrow from international financial institutions and domestic markets.

Table 7a. Deficit Financing Projection

million HRK	2005	2006	2007
Deficit without capital revenue	4.508.879	4.186.393	3.470.510
Financing	4.508.879	4.186.393	3.470.510
Foreign	-705.187	-615.179	-200.988
Lending	5.712.259	5.833.229	4.832.954
Repayments	6.417.446	6.448.408	5.033.942
Domestic	970.066	3.581.572	2.451.498
Lending	6.602.631	5.101.885	6.980.776
Repayments	5.632.565	1.520.313	4.529.278
Capital revenue	4.244.000	1.220.000	1.220.000

3.4 Fiscal Risks

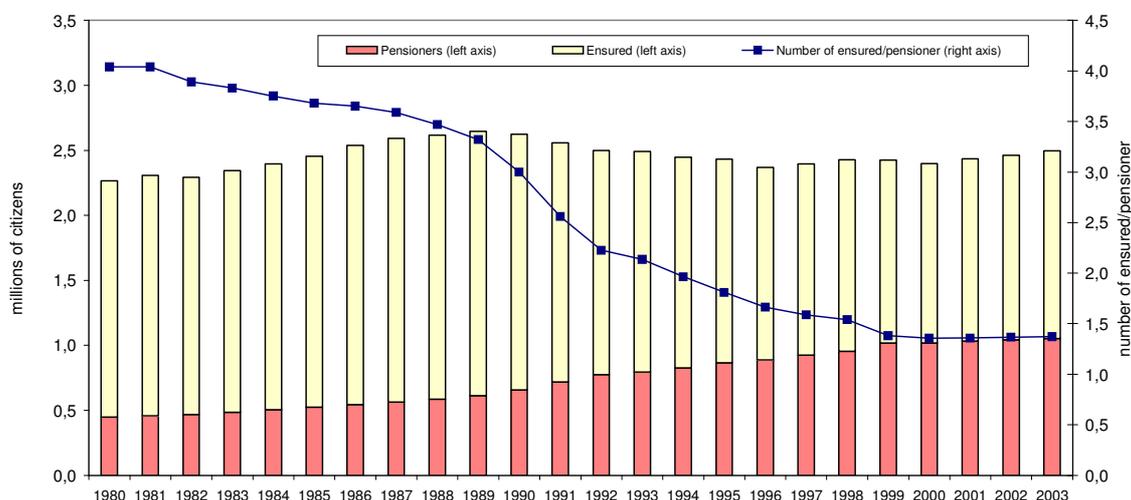
Macroeconomic and socio-political developments, within the country and in neighboring regions, determine potential fiscal risks. The most important of these for the medium term are the following:

1. **Social expenditures** – unfavorable movements in the demographic structure of Croatia's population, where there is a noticeable trend of aging of the population in the last six decades, create a potential danger that in the medium term there will be greater pressure exerted on the social insurance system.

The following graph clearly shows that during the last few years the relative number of insured persons compared to retired persons is getting smaller, and in 2003 it was 1.4 insured persons/retired person. If the reduction in social benefit expenditures through a reduction in total number of social benefits (while at the same time reallocating social spending), due to social pressure on government policy of fiscal tendencies, in this case the strategy of public expenditure sustainability would be at risk. Special attention should focus on the question of adjusting pensions in the medium and long term, and the legal commitment made by the government to pensioners. The potential danger could result from a change in the formula of adjusting pensions that doesn't strictly tie together fiscal possibilities and the level of economic growth.

Also in 2003, expenditures for health services were over 6% of GDP, while expenditures for other social security and insurance schemes were around 18% of GDP. The share of social spending in GDP of over 20% is absolutely unsustainable and the danger of further expansion in social expenditure can be a direct threat in the coming period.

Figure 22. Relation between number of insured person and number of pensioners



Source: Croatian Bureau for Pension Insurance

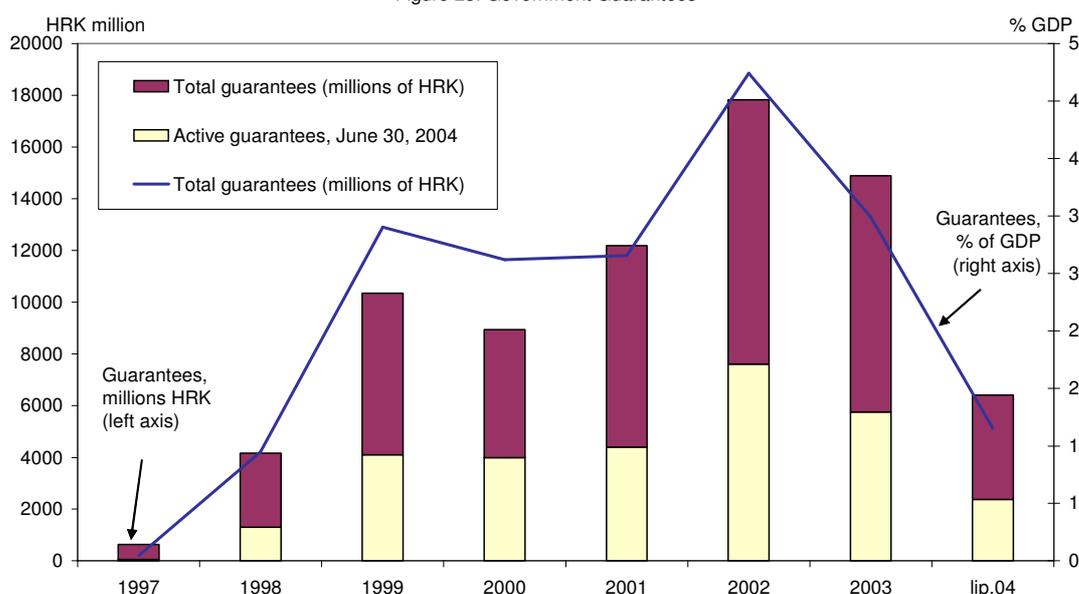
2. **Deviation from macroeconomic projections** – primarily the risk of lower economic growth, followed by interest rate risk, and oscillations in the exchange rate, especially in relation to currency tied to Croatian exports.

Lower than expected GDP growth is considered a fiscal risk because it would lead to lower budget revenues, a result of weakening economic activity. In other words, lower GDP growth reflects a weaker business environment, which wouldn't achieve its expected profit, leading to a smaller taxable base and small budget tax revenue. If in this case the government doesn't automatically react with a fiscal adjustment that reduces budget expenditures, it could lead to failure to achieve the main fiscal goal of lowering the fiscal deficit to below 3% of GDP by 2007. .

3. **Public debt and government guarantees**– until the end of 2003, the dynamics of public debt growth (including issued government guarantees) indicates an unsustainable borrowing tendency in the medium term. The potential risk in terms of public debt in Croatia can be looked at several aspects. In the structure of public debt with guarantees, the external public debt is much larger (with a share of 60% in total debt), while the domestic borrowing market is still undeveloped. Therefore, if the conditions of borrowing on financial markets change, for example from higher interest rates, it will be necessary to devote greater attention to servicing the debt repayments due, which presents potentially higher budget spending.

Special attention should be paid to fiscal risk associated with government guarantees. The next graph shows the movements of issued and active government guarantees at the end of July 2004.

Figure 23. Government Guarantees



Source: Ministry of Finance

Potential fiscal risks of issued government guarantees comes from the danger that in the medium term the issuing of guarantees isn't reduced enough, and that those already issued come to term, which presents an increase in government expenditures. The plan for restructuring and privatization of public enterprises is related to this problem, if a thoughtful selection in issuing government guarantees does not include only those enterprises, which satisfy acceptable business criteria.

The intention of fiscal policy in the 2005-2007 period is to slow the growth of public debt, primarily through fiscal adjustment, that is through lowering of the fiscal budget. If current trends (high budget deficit and fast growth of debt) continue, however, public debt (including guarantees) could grow to over 62% of GDP in 2007, which would break the Maastricht ceiling limit. This effect is made even stronger if privatization receipts aren't as expected, and with which the government deficit could be financed.

4. **Changes in the external environment** – Due to its economic activity (on the trade and financial markets) Croatia is mostly tied to European countries, and thus any radical changes from current expectations in the euro-zone region could have a fiscal risk impact. Slowing down of economic growth in the EU could negatively affect its absorption of Croatian exports. The level of GDP would automatically reflect this, and would result in lower budget revenues and possibly a larger than planned fiscal deficit.

On the other hand, upward movements in the interest rates on foreign financial markets could increase foreign public debt payments (if there is a variable interest rate). The growth of interest payments directly increases government budget expenditures and jeopardizes the planned level of the budget deficit.

Finally, all possible political instability in Southeast Europe is considered a fiscal risk. Such a development of events negatively stimulates FDI in the entire region. This would again lead to a lower than envisaged GDP and a potential increase in the fiscal deficit.

4. STRUCTURAL REFORMS

4.1. Enterprise Sector

4.1.1. Privatization

Croatia was the first among the successor states of the former Yugoslavia to start privatizing, as early as April 1991 when the Law on Transformation of Socially Owned Enterprises (hereinafter: The Law on Transformation) was enacted, which has since when been amended a few times. The aim of the Law on Transformation is to determine the owner of the socially owned enterprise, abolish social ownership and transform it into the legally transparent forms of ownership which normally exist in functioning market economies.

Privatization has been done though a combination of different methods. The first model was of preferential share sale to the workers, the 'insiders', whereas the unsold shares were transferred to the state funds (privatization and pension fund). These funds would privatize the shares, in case of minority share-packages, at the stock exchange, while for the majority share package a public tender would be organized.

To accelerate the privatization process, the "mini voucher privatization"³ of Czech type was successfully implemented, which enabled the selected categories of population most hurt by the war to become share holders at no charge.

To summarize the results of the privatization process from 1991 to 2003, out of 3000 enterprises that entered into the process of ownership restructuring, up until now 2000 companies have been privatized. That number does not include companies of 'special public interest' (post and telecommunication, oil industry, Croatian railways, electricity, radio and television) because the Privatization law has envisaged that public sector companies, while being of a strategic importance to the Croatian economy, will be privatized on the basis of a special law which will be enacted for each company in question.

Table 8. Companies privatized by public tender

	Number of Companies	Nominal value	Achieved Price
		Kn	kn
1992 - 1999.	470	3.485.059.049,00	3.074.541.579,00
2000.	9	178.333.050,00	53.447.796,00
2001.	17	779.875.120,00	442.002.809,40
2002.	5	139.237.100,00	10.721.736,00
2003.	5	282.147.600,00	208.474.475,00
Total	506	4.864.651.919,00	3.789.188.395,40

Besides selling of majority share stakes though a public tender, minority shares are privatized at two local stock-exchange houses: Zagreb and Varaždin stock exchange. At the Zagreb stock exchange the shares are sold for cash, while at Varaždin stock exchange the share sale is done by compensation; so called 'trade of rights'. Namely, the Ministry of Reconstruction has issued these 'rights' during reconstruction of the war devastated areas as a payment method to the companies engaged in the reconstruction. Also the Ministry of Finance issued 'the rights'

³ This means that technically the voucher privatization was done through the bidding process of exchanging voucher points for the shares of the companies assigned to participate in the voucher privatization. The prices of the shares were formed based on the demand for certain shares. Also the Privatization Investment Funds were mediating the process between the voucher holders and firms.

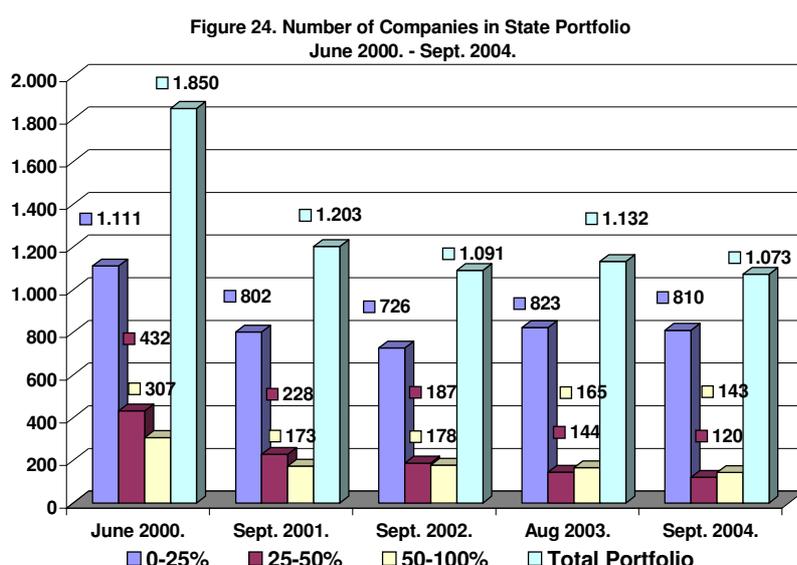
for the purpose of building infrastructure objects. In that way minority shares have been privatized in approximately 700 companies.

Table 9. Realization of sale at Zagreb stock exchange

	Number of companies	Nominal value		Achieved Price	
		EUR	kn	EUR	kn
1992.	4	1.539.157,80		1.539.157,80	
1993.	25	6.475.794,93		9.665.231,64	
1994.	183	205.399.466,21		208.911.554,1	
1995.	61	29.946.293,39		31.433.293,79	
1996.	54	13.057.378,20		11.871.796,63	
1997.	20	7.276.057,74		7.276.630,38	
1998.	47	464.142,59		474.092,33	
1999.	20		1.566.062,27		1.630.163,44
2000.	33		1.762.052,00		1.782.583,00
2001.	347		689.155.476,59		36.661.843,45
2002.	71		166.940.266,00		11.306.492,00.
2003.	10		5.648.922,00		1.829.595,00
Total	875	264.158.29086	865.072.778,86	271.171.756,7	53.210.676,89

The privatization process is now in its final stage. The strategic privatization goal is to complete the privatization of the remaining companies left in the Fund portfolio by the end of 2005, as well as to continue with the privatization of the public sector. Major stakes (51% of the total share capital) of the Croatian Telecom were sold to Deutsche Telekom. In Croatian oil company (INA) 25% plus one share were sold to the Hungarian oil company MOL.

As of September 2004, the state portfolio numbered 1.073 companies, with the nominal share capital of 20.620.626.400,00 HRK. Because of obligations towards so called 'ex-owners' (whose property was nationalized by the ex-communist government) and because of numerous legal suits, a part of the state portfolio is under reservation (approximately 5 billion HRK).



Currently CPF is the owner of minority stakes in approximately 930 companies (out of which the number of CPF's share in the registered nominal capital is less than 25% in 810 companies). CPF is still majority share-holder in 143 companies whose gross nominal value amounts of 14 billion HRK. These companies are mostly in tourist and agriculture sector as well as in the ship-building industry.

Privatization of minority share packages is expected to continue with share selling at the stock exchange, The public tender model is still used for privatization of majority share stakes,

together with a new model according to which all important economic and social tender parameters should be defined in advance and should be accepted by the potential strategic investors. The most appropriate bid will be selected through the highest price reached at the auction process. The new model of privatization in a form of public-private partnership is to be created and shall be used for the first time in the privatization of the famous hotel company Sunčani Hvar.

CPF's obligation towards Privatization Investment Funds (PIF), founded during the 'voucher privatization' process, should speed up privatization. This obligation derives from the fact that certain companies whose shares were sold in the 'voucher' privatization went into bankruptcy, though the law requires that only the liquid shares could be offered at the voucher auction. Therefore CPF and PIF have entered into an agreement on share exchange whereby non-liquid shares shall be exchanged for the shares of better quality. CPF has not fulfilled its contractual obligation yet, therefore PIF have a claim against CPF in amount of 850 million HRK.

Regardless of activities that are accelerating the privatization process, numerous hindering factors are delaying planned privatization time schedule. These factors are affecting the value of the Fund's portfolio. The main reason is the status of the property that was not (during the transformation process in the beginning of '90's as mention above) evaluated earlier (capitalized) and included in the company's asset. According the law, new shares should be issued in the appropriate value in the name of the CPF for the non evaluated property.

In addition, another hindering factor in delayed privatization is cancellation of the share sale agreements because of non-payment, since these were concluded on an installment basis. As a result, CPF is receiving numerous unpaid shares back.

Privatization problems of the agriculture sector

A prompt ending of privatization will depend on successful privatization of the agriculture sector and companies associated to it.

The Republic of Croatia currently has a minor stake (less than 25% of the company's total registered share capital) in 39 agriculture companies, whereas it has a stake of 25% to 50% in the total register share capital within 6 companies. There are 12 agriculture companies wherein the Republic of Croatia has majority ownership (more than 51% of the company's registered share capital).

Privatization of the biggest agriculture companies is an extremely complex issue because of inefficient organization structure, high number of employees, high level of indebtedness and high losses. Although the political consensus is to sell the agriculture companies directly to the strategic partners, there is pressure exerted by unions and local political lobby groups to sell companies to the employees by ESOP privatization model and to keep the present number of employees.

It is necessary to increase the efficiency of the agriculture sector in the pre-accession period. Therefore, the faster privatization of agriculture companies (included in PAL program of the World Bank as a main goal) requires its organizational restructuring, as well as financial consolidation through which the level of indebtedness will be reduced, and smaller and self-existing producing entities shall be founded).

Privatization strategy for the remaining tourist portfolio

The Republic of Croatia currently holds a minority share (less than 25% in total share capital) in 90 hotel companies whereas available ownership portion above 25% of company's total capital holds in 29 hotel companies (for some of them public tender is just recently announced). Problems inherited as a consequence of war and post-war operations and refugee issues are a big burden on the hotel business performance and may delay its privatization.

Another issue is the unresolved problem of the "tourist real estate/land" that does not have an estimated value in the registered capital of the socially owned companies in the transformation phase of privatization.

In order improve privatization of this sector, we plan:

- a competent preparation for privatization
- faster selling of minority stakes by public tender at stock exchange
- approving and executing an operative privatization scheme for remaining portfolio with defined time schedule and privatization models for each particular company.

The goal of the planned privatization can be accomplished by intensifying communication with potential investors, through reorganization of CPF, and by using already recognized privatization models (public auction at stock exchange and public tender) as well as new models (public-private partnership, stock-exchange auction with public tender models). In addition, the planned privatization goals may be achieved through Government measures of financial consolidation and restructuring of hotel companies. The purpose of these measures is to reduce the level of indebtedness and to create economically plausible investment conditions.

The Government of the Republic of Croatia has enacted a special law ensuring appropriate conditions and measures for regulating protected sea-coast areas for the purpose of its preservation and sustainable economic development. The government of the Republic of Croatia is currently drafting a law that would regulate the issue of 'tourist real estate' that has not been estimated (capitalized) in the nominal share capital during the transformation of hotel companies.

Shipbuilding

CPF has the minority share (less than 25%) in 2 shipbuilding companies and it has a majority share (more than 51% of the total share capital) in 5 companies.

Regarding those shipbuilding companies with majority government ownership whose financial consolidation has partly been implemented (Law on financial recovery of certain companies – Official Gazette 56/95), their privatization requires significant preparation and a master plan defining specific subjects to be privatized.

Therefore, all shipbuilding companies are required, in preparing for future privatization, to sort out their activities according to the model of privatization prescribed by the CPF, and complete the process of restructuring of basic activities which includes rationalization of business activities, technological upgrading, and cooperation with development of industry to the level that it can successfully participate under given market conditions. This process could

be finished by 2006, which would allow the shipbuilding industry to fully complete its privatization.

4.1.2. Competition

Competition policy (the anti-trust sector, excluding the field of state aid) in the territory of the Republic of Croatia has been actively implemented since 1997 by the Croatian Competition Agency (hereinafter: the CCA). In 2003 the new Competition Act was adopted and completely harmonized with the provisions of the relevant EU law. At the same time, in 2003, the State Aid Act was adopted, expanding the powers of the CCA concerning the anti-trust sector to authorization, monitoring the implementation and recovery of general and individual state aid.

Anti-trust sector

The objective of competition law and policy is to prevent and deter any market behavior which may place particular undertakings at a competitive disadvantage and thereby challenge free competition in the market. In the market where the undertakings practice their business activities in compliance with competition rules, the result is strengthening of their business activities, efficiency and competitiveness both in the national and international markets.

Thus, the harmonization of the national legislation in this field with the relevant EU acquis in the accession process of the Republic of Croatia to the EU is of paramount importance, in the first place regarding the timely adjustment of the Croatian undertakings to the market conditions applicable in the EU Common market.

In 2003 and 2004 Croatia adopted the majority of regulations which brought the national legislative framework into compliance with the EU acquis. The new Competition Act entered into force in July 2003, and it was followed by a number of bylaws which are necessary for its implementation (concerning the notification and assessment of concentrations, the definition of relevant market, the block exemption granted to certain categories of agreements, the agreements of minor importance etc.) By the end of 2004 and in the first quarter of 2005 other necessary regulations, concerning the block exemption granted to transfer of technology agreements, licensing agreements and know-how, and to agreements in insurance sector respectively, are to be adopted by the Government.

In addition, it is to be pointed out that since secondary EU legislation is subject to frequent changes and modifications, it is also to be expected that the corresponding Croatian bylaws are going to be subsequently amended.

Whereas the priorities in the later period have been set as to harmonize the legislation and to build the institutional framework of the implementing authority, the CCA, the future activities are to be focused on the effective implementation of the adopted regulations, which are essential in the development of competition policy in Croatia, and which is to be carried out by the CCA.

In order to achieve efficiencies in the implementation of competition law it is also necessary to raise competition awareness, in other words, actively engage in competition advocacy by making the knowledge and information in this field accessible to undertakings, consumers, government bodies and other public authorities, judicial bodies and the general public, especially in the form of seminars, conferences and publishing activities such as subject

related brochures etc. Therefore, the importance of competition law and policy in further development of market economy and strengthening of the competitiveness of Croatian undertakings deserve special attention.

The above mentioned duties fall within the competence of the CCA, being a *sui generis* authority in the implementation of the Competition Act. However, it is within the general competence of the Competition Agency to deal with all competition issues, unless they fall under the competence of some other authority. For instance, in the banking sector, energy sector, telecommunications or postal sector competition is regulated by separate pieces of legislation. Nevertheless, the provisions of given legislation do not entirely regulate competition in these sectors but, separately or additionally, merely cover particular competition issues. This is the reason why the Competition Act is at the same time the primary source of competition law for the given sectors covered by the relevant legislation. This makes the co-operation between the CCA and the regulators in particular sectors indispensable for the protection of competition therein. In that sense, in 2003 the CCA signed the Agreement on Co-operation with the Croatian National Bank, being a separate regulator in the banking sector, and in 2004 the Agreement on Co-operation with the Council for Energy Regulation, a separate regulator in the energy sector.

In 2005 and 2006 similar agreements on co-operation with other regulatory bodies, such as telecommunications, electronic media and postal sector are to be concluded as a necessary pre-condition for establishing the efficient competition system in Croatia. Special attention will be given to co-operation with consumer protection authorities.

Additionally, in the forthcoming period it is necessary to review and eventually carry out significant modifications of the legislation with the view to efficient application of competition regulations relating to imposing fines for infringements and their effectiveness, enhancing the efficiency of judicial review etc.

Croatia has already established productive international co-operation with several competition authorities abroad and will pursue in its development. Here is particularly meant the participation of Croatia in the SEECAN Project, which has been recently set up on the basis of the mutual initiative on the part of the OECD, European Commission and Stability pact and their support with the view to promoting regional co-operation between the competition authorities in the South East Europe, i.e. involving Croatia, Bulgaria, Rumania, Bosnia and Herzegovina, Serbia and Monte Negro, Albania and Macedonia.

Furthermore, it is also of uttermost importance to strengthen the administrative capacity of the CCA as well as to provide for capacity building and training of the staff. The objective of the CCA is to increase the current number of employees from 34 to 64 by the end of 2007.

The CCA is financed from the state budget. Since 2003 it has also been receiving support from the CARDS Program, as a beneficiary country in the Stabilization and Association Process, within the implementation of the Stabilization and Association Agreement (SAA). The financial resources from the CARDS Project have been directed to particularly established areas and the resources have been allocated for the purchase of professional literature, IT equipment and training activities for the staff of the CCA.

State aid policy

Croatia created a legal framework in the field of authorizing, granting, monitoring the implementation and recovery of state aid by adopting the State Aid Act in April 2003, which was followed by the Regulation on State Aid in July 2003. The given legislative framework established the state aid system in Croatia which is compatible with the obligations undertaken by the Republic of Croatia within the SAA.

In April 2004 the State Aid Act was amended, nevertheless, merely with the objective to regulate the powers of the CCA, the authority competent for the implementation of the state aid system in Croatia, more precisely.

Pursuant to the obligations deriving from the National Program of the Republic of Croatia for Association to the European Union, in 2004 two programs on state aid were adopted: the Adjustment Program of the Croatian State Aid System to the EU State Aid System, and the Alignment Program of the Existing State Aid Schemes to the Criteria Stipulated in Article 70 paragraph (2) of the SAA.

Pursuant to the latter (Alignment Program), the CCA already started with the assessment and authorization of the existing aid schemes and other legal acts pursuant to which general state aid had been authorized or granted, whereas the final alignment of the aid schemes concerned with the legislation in this field is due by the end of 2005. With the view to establishing a state aid inventory that would comprise all existing schemes and other legal acts pursuant to which general state aid had been authorized or granted, in the beginning of 2004 the CCA requested all specified providers of state aid, concerning aid falling within their competence, to provide a list of state aid granted, its legal grounds, purpose, amount and instruments for the period of the last three years and submit it to the CCA. On the basis of the received data the CCA has established a temporary list of providers of general state aid, whereas the compilation of the final inventory concerning existing aid schemes by providers is in the pipeline. The complete inventory is due 2005.

In 2004 the CCA for the first time submitted its Report on state aid to the Croatian Parliament, which had been compiled according to the EU methods and consisted of the data on state aid for the years 2002 and 2003. According to the Report, the structure and amount of state aid reflect the significant changes that Croatia has undergone in the past ten years, particularly relating to post-war reconstruction, investments into agriculture and tourism, restructuring of some parts of the economy and building of new motorways. The given state aid amounts in 2002 and 2003 directly correspond to the fiscal capacity framework. Moreover, the Report data prove that the major part of aid has been allocated to sectoral aid, whereas a small amount has been assigned as to aid relating to horizontal objectives. This proportion must be changed in future, whereas the ratio of state aid in the GDP is to be reduced.

In 2005 the amendments to the State Aid Act and to the Regulation on state aid are to be proposed, in that way completely harmonizing the legislative area in question with the EU *acquis* in force. For 2005 and 2006 it is also planned to adopt separate bylaws regulating notification, authorization, monitoring and register of state aid, guidelines on horizontal aid and certain sectoral aid, as well as establishing the procedure for filing complaints by the interested parties.

With the view to realization of the planned objectives and implementation of the measures concerned, it is necessary to strengthen the administrative capacity of the CCA by employing legal experts and economists and pursue with the training of the staff, as well as the education of the beneficiaries (public administration authorities and local and regional self-government units), which is to contribute to efficient implementation of the state aid system in practice. At the same time the purchase of IT equipment and setting up of an electronic data base on state aid will be of primary importance. The necessary support in this area is ensured from the resources within the CARDS Program which is expected to be carried out during 2005.

4.1.3. Restructuring of the Real Economy (Public Utilities)

Public Utilities

The utilities sector in the Republic of Croatia is regulated primarily by the Act on the Utilities Sector (Official Gazette No. 26/03 - consolidated text 82/04 and 110/04) and by other subordinate legislation.

The Act mentions 11 activities, specifically:

1. Supply with drinking water
2. Drainage and purification of the effluent
3. Public transport of passengers
4. Sanitation
5. Disposal of municipal waste
6. Maintenance of public areas
7. Maintenance of unclassified roads
8. Retail markets
9. Maintenance of cemeteries, crematories and transport of deceased persons
10. Chimney-sweeping
11. Street lighting

It is the units of local self-government (municipalities and towns) who are primarily in charge of ensuring that the activities are performed: a)in a continuous and quality manner, b)in a way to make utility structures and devices functional, c)according to the principles of sustainable development, and d)transparently.

If a unit of local self-government does not ensure continuous and quality performance of one or more public utilities, the counties on whose territory the relevant unit of local self-government is located organize the performance of the activity in question at the cost of such unit of local self-government (subsidiary responsibility).

The Act also regulates that a unit of local self-government may decide in a decision which activities of local significance (apart from those enumerated in the Act) are to be regarded as public utilities under the conditions laid down in the Act.

In addition, the Act regulates that public utilities may be performed by:

1. a company established by the unit of local self-government,
2. a public institution established by the unit of local self-government,
3. a plant established by the unit of local self-government,
4. a legal or natural person on the basis of a concession agreement,
5. a legal or natural person on the basis of a public utility agreement.

Local self-government units hold a majority package of shares or business shares (50% + 1 share) in the company they founded for the performance of public utilities, and the plant itself does not have legal capacity.

A Working Group, which is to be responsible for the making of a proposal of the new Act on the Utilities Sector, which could be passed in 2005, is presently in the process of formation.

Table 10. Prices of certain public utilities (in HRK)

	Drinking water	Drainage	Gas	Energy	Sanitation	Passenger Transport
MINIMUM	3.06	0.35	1.64	2.47	0.18	143.00
MAXIMUM	14.47	5.17	2.97	10.80	1.00	263.00
AVERAGE	6.02	2.07	1.98	5.72	0.39	191.83

* prices set by the Unit of Local Self-government

Energy Sector

The principal objectives of the energy policy of the Republic of Croatia are stated in the *Energy Sector Development Strategy*, which was adopted by the Croatian Parliament in March 2002 for a period of 10 years: improvement of energy efficiency from the production, transformation, transmission and transport to distribution and consumption of energy, which includes encouraging the process of gas pipeline installation and possibilities of gas usage, and generation of energy outside public networks, safe energy provision and supply, inclusion in the international energy market, ensuring several lines of connection to international networks and provision of energy from several directions for all energy network systems, development of transmission and transport networks, development of distribution networks, observation of safety limitations and state interests, diversification of energy-generating products and sources, including the selection and provision of energy-generated products which will ensure safe supply to the consumers, and spatial arrangement of sources which will ensure the safety of supply of each area, utilization of renewable sources of energy which will be in accordance with sources, technological development and economic policy as a whole, realistic and market-related prices of energy and development of energy market and entrepreneurship, and privatization processes in accordance with the interests of the Croatian state, which should encourage energy efficiency and good energy management and enable inclusion of the Republic of Croatia into the European energy market, environmental protection, which in the energy sector implies the primary action in connection with energy efficiency, renewable sources, choice of energy-generating products and application of state-of-the-art protection technologies, quality legislation and supervision, the public opinion and education and promotion of best practices.

In accordance with the energy legislation, on 1 July 2002 Hrvatska elektroprivreda d.d., transformed into a system of affiliated companies performing core electric activities and auxiliary activities, became responsible for the electric and energy system. HEP Group is a holding consisting of the parent company HEP d.d. and its subsidiary companies over which HEP d.d. exercises prevailing control: HEP Proizvodnja d.o.o., HEP-Prijenos d.o.o., HEP-Distribucija d.o.o., HEP-Opkrba d.o.o., HEP-Plin d.o.o., HEP-Toplinarstvo d.o.o. and Toplinarstvo Sisak d.o.o.

Oil and gas industries are mostly within the competence of INA-Industrija nafte d.d., a vertical integrated company. In 1993, INA became a joint-stock company INA Industrija nafte d.d., fully owned by the Republic of Croatia. In the context of consolidation of oil industry in the world and liberalization of energy market in the European Union, the Croatian

Government decided to privatize INA. In March 2002, a special Act on Privatization of INA entered into force, according to which 25% plus 1 share are to be sold to a strategic partner. The Act on Privatization of INA also plans a further sale of 15% of the total number of shares of INA by public offering at the Croatian stock exchanges.

An important factor in the energy sector of the Republic of Croatia is also PLINACRO d.o.o., fully owned by the Republic of Croatia. Its primary activity is the transport of natural gas within the territory of the Republic of Croatia. The transport is carried out using 1 741 km of main and regional gas transmission lines, 139 measuring-reduction stations and 221 measuring lines. The price of transport is determined by the Tariff System, and its application is supervised by the Croatian Energy Regulatory Council.

Jadranski naftovod d.d. (JANAF d.d.) operates the oil pipeline system, designed and constructed in the period from 1974 to 1979 as a modern, functional and cost-efficient system of oil transport intended for local and foreign customers in Eastern and Central Europe. The designed capacity of JANAF's pipeline is 34 million tons, and the installed capacity is 20 million tons per year.

At its session held in July 2001, the Croatian Parliament adopted a package of five energy acts (Official Gazette 68/01). The acts, which reform the energy sector in line with the legislation of the European Union, are the already mentioned Energy Act, Electricity Market Act, Gas Market Act, Act on the Petroleum and Petroleum Products Market, and the Act on Regulating Energy-Related Activities. The said acts introduce market relations and enable gradual liberalization of the energy market. They also define a transparent relationship between the providers of energy and buyers. The new legislation, supplemented with subordinate legislation essential for the implementation of reform acts, creates a legislative framework for restructuring Croatia's energy sector: Hrvatska elektroprivreda (HEP) and Industrija nafte (INA).

Further Sector Development

In line with the development of the energy market in the EU and the adoption of several new directives relating to the energy sector, and in accordance with the recommendations of the EU about the situation in the energy sector in the Republic of Croatia, and the signed International Memoranda on Understanding: the Memorandum of Understanding on the Regional Energy Market in South East Europe and its Integration into the European Community Internal Energy Market - "The Athens Memorandum 2003", and the Memorandum of Understanding on the Regional Electricity Market in South Eastern Europe and its Integration into the European Community Internal Electricity Market - "The Athens Memorandum 2002", further adjustments are required to the existing legislative framework in the Republic of Croatia.

With respect to the legal-institutional reform of the energy sector, which includes the area of renewable energy sources and energy efficiency through changes, it will be made possible through amendments to the energy legislation. That represents the achievement of the goal to produce 900 GWh of electrical energy out of renewable energy sources in the Republic of Croatia in 2010, not counting the energy generated in large hydro-electric power plants. It is expected that the production of 900 GWh in 2010 will be at least 4.5% in the structure of overall consumption of electrical energy. All consumers of electricity will be encouraged to use renewable energy sources, depending on the amount of their overall consumption, and the

projected increase of the electricity bill as a specific addition is estimated to be from 0.0041 HRK/kWh (2005) to 0.02 HRK/kWh (2010).

Priorities in the field of energy efficiency are adjustments to the energy legislation and the related implementing regulations in line with the EU *acquis communautaire*, that is, the directives regulating the area. Technical regulations are being developed in parallel with the regulations, and the relevant EN standards are also being adopted. The said activities will be prepared through a proposal of amendments to the legislative framework within the package of energy acts. Amendments to the Energy Act will propose the defining of gas storing and obligations towards the buyers of energy entities, and they will intensify penal provisions. The new Electricity Market Act will propose changes to enable the functioning of the electricity/energy market in line with the EU directives and enable organizational changes required to perform organizational changes to the electricity/energy sector in the best possible manner. The new Gas Market Act will propose a more thorough definition of the activity of natural gas distribution in order to enable a true opening of the market in the area of natural gas. The new Act on the Petroleum and Petroleum Products Market wishes to incorporate the existing regulation on reserves in the Act, so that there would also be penal provisions in case of non-compliance, that is, to improve the mechanism of their application. The new Act on Regulating Energy-Related Activities will mark the beginning of changes required in accordance with the legal practice of the EU and the remarks mentioned in the analysis of the situation made by the EU. Next several years will also bear witness to the strengthening of all institutions important for the energy sector.

Nuclear Safety

The area of nuclear safety relates to the securing of preconditions for safe use of nuclear technology in times of peace, and primarily to the control of nuclear material and special equipment with the aim of preventing the spread of nuclear weapons, and the monitoring of the situation relating to the safety of nuclear plants in the environment of the Republic of Croatia and the state of alert in case of nuclear accidents. The area is regulated by the Act on Nuclear Safety (Official Gazette No. 173/03) and the Act on Responsibility for Nuclear Damage (Official Gazette No. 143/98), and a number of international treaties.

The Republic of Croatia does not have nuclear plants in its territory or plans for their construction, but Hrvatska elektroprivreda is the co-owner of the Krško Nuclear Power Plant in Slovenia. The Ministry of the Economy, Labor and Entrepreneurship plays the regulatory role.

The Act on Nuclear Safety states that at the latest by 1 January 2005 the State Institute for Nuclear Safety as an independent body of state administration competent for nuclear safety activities - an independent regulatory body, should become operative. The same Act obligates the Ministry of the Economy, Labor and Entrepreneurship to make preparations for the commencement of operation of the State Institute.

The subordinate legislation anticipated by the Act on Nuclear Safety should be passed by the head of the State Institute within 12 months from the commencement of operation, therefore in the course of 2005.

In the area of nuclear material control, it is necessary to make improvements in the process of discovering impermissible trade with nuclear material and special equipment.

With respect to the monitoring of the situation relating to the safety of nuclear plants within the environment of the Republic of Croatia, it is necessary to intensively train experts and develop direct co-operation on the basis of the Convention on Nuclear Safety.

Regarding the state of alert in case of nuclear accidents, it is necessary to ensure technical equipment according to the criteria of the EU EURDEP/ECURIE /RODOS system and to train all relevant persons at the national level.

4.1.4. Business Environment of SMEs

The 2004-2008 Program of Incentives to Small and Medium Size Enterprises, adopted at the session of the Government of the Republic of Croatia in May 2004, names small and medium size enterprises as the moving force of Croatia's economy and it is the framework for the realization of entrepreneurial initiatives forming the basis of economy. The incentives were created in line with the basic goal of the economic policy - the creation of a competitive economic system able to exist in global market competition and the achievement of maximum feasible and stable growth of the living standards of all citizens.

Small entrepreneurship in the Republic of Croatia is defined by the relevant laws, and is performed by:

a) small and medium size companies, b) cooperative business ventures, c) crafts, and d) the self-employed.

The 2004-2008 Program of Incentives to Small and Medium Size Enterprises covers several forms of incentives (co-financing, grants, donations, assistance, awards, aid, state guarantees) implemented in projects involving small and medium size enterprises. The Act on Incentives to Small-size Enterprise Sector accepts the definition of small entrepreneurship from the recommendations and the definition of the European Union.

Table 11. Number of commercial entities in small and medium size enterprise sector

BUSINESS ENTITIES	2002	2003	Index	Share 2003
Crafts	97 832	101 848	104.10	60.59
Cooperative business ventures	801	917	114.48	0.50
Small and medium size enterprises	62 841	67 295	107.09	38.92
TOTAL	161.474	170.060	105.32	100

Source: Croatian Bureau of Statistics, Financial Agency and Croatian Crafts Register

Table 12. Number of employees in small and medium size enterprise sector

BUSINESS ENTITIES	2002	2003	Index	Share 2003
Crafts	135 000	138 582	102.65	24.52
Cooperative business ventures	4 058	4 750	117.05	0.84
Small and medium size enterprises	403 569	421 815	104.52	74.64
TOTAL	542 627	565 147	104.15	100

Source: Croatian Bureau of Statistics, Croatian Pension Insurance Fund and Financial Agency

Based on the evaluation of the existing situation, the Program names preconditions for the development of the small and medium size enterprise sector, specifically:

- Tax reform with the aim of facilitating the situation in the economy and increasing competitiveness
- Changes in law with the aim of achieving legal security
- Access to more favorable sources of financing
- Expansion of entrepreneurial infrastructure with the aim of creating preconditions for a faster development of small size enterprise sector and a more even development of Croatia
- Measures and activities at the level of regional and local self-government with the aim of activating local sources of financing for the building of entrepreneurial infrastructure
- Decentralization of state administration
- Faster processing of transfers of ownership and servitude, as well as structures owned by the state with the aim of making them active in the enterprise sector
- Introduction of the institute "temporary license" with the aim of simplifying and accelerating the initiation of production (up to 6 months) until final consents are obtained
- Adjustment of the system of public procurement in small size enterprise sector with the aim of equal access to tender procedure
- Creation of a stimulating environment with the aim of making entrepreneurship a way of life and the starting point and moving force of positive activities in all segments of society
- Education of public administration to increase the level of training and responsibility - professionalism

The Republic of Croatia accepted the document "EU Charter for Small Enterprises" whose ten principles have to be incorporated by the Governments of the European Union Member States, candidate countries and countries who signed the Stabilization and Association Agreement in their economic policies with the aim of developing the area of small size enterprise sector. The basic principles of the Charter are: Education and training for entrepreneurship; Cheaper and faster start-up; Better legislation and regulation; Availability of skills; Improving online access; Getting more out of the Single Market; Taxation and financial matters; Strengthening the technological capacity of small enterprises; Making use of successful e-business models and developing top-class small business support; Developing stronger, more effective representation of small enterprises' interests at Union and national level. The Ministry of the Economy, Labor and Entrepreneurship as the competent authority is obligated to complete the Questionnaire showing progress according to the specific principles of the Charter.

For the next 12 months, we plan:

1st principle - Education and training for entrepreneurship

- 20 new consultants for entrepreneurship certified by the end of 2004, and in 2005 thirty more
- crafts - improve the existing educational programs in secondary schools with 57 crafts, finally define the educational program for master's examination, adjust educational programs by the implementation of a dual concept (integration of practice and learning)
- 3 920 new entrepreneurs-beginners educated to start a business in the "Program for Beginners"; 4000 attendants of various seminars in the "Program for Growth" for the existing entrepreneurs
- 2 new information centers of the Croatian Bank for Reconstruction and Development

2nd principle - **Cheaper and faster start-up**

- improve the conditions for crafts registration, so that the procedure would be even more simplified and accelerated

5th principle - **Improving online access**

- develop an inter-operative framework for public administration by adopting regulations that will enable data exchange between state administrative bodies

7th principle - **Taxation and financial matters**

- increase the number of issued guarantees to small and medium size enterprises to 1 500 and increase the total amount of guarantees to EUR 106 000

9th principle - **Making use of successful e-business models and developing top-class small business support**

- create a favorable environment for the formation of new enterprises and opening of new work posts by incentives to private-public partnerships, presentation of the best world practice and accelerated use of new technologies in Government institutions

4.2 Financial Sector

The Croatian financial system is bank-centric. Banks play the most important role in the provision of funds for the economy and the capital market is relatively underdeveloped. At the end of 2003, market capitalization of shares and bonds in the Croatian market accounted for 31% and 7% of GDP, in contrast with banking system assets that accounted for 106% of GDP. Despite their high growth rates in the past several years, total assets of non-banking financial institutions at the end of 2003 made up only 13% of the value of GDP.

4.2.1 Banking System

Banks are the most important segment of the Croatian financial system. Their total assets account for over 80% of total financial system assets. There were 40 banks operating in Croatia at end-June 2004 with HRK 212,100m, or 110% of GDP in 2003, in total assets.

Other banking institutions at end-June 2004 comprised four building societies, accounting for about 1.4% of total financial system assets. The legal framework for the establishment of building societies in Croatia has been provided by the Building Societies and Relevant State Incentives Act, which came into effect at the beginning of 1998. The four building societies operating in the Croatian financial market today are owned by major banks. In terms of accumulated savings, these institutions are gaining in importance. Total consolidated assets of these building societies on a gross basis stood at HRK 3.5bn at end-2003 (1.9% of GDP), almost a 50% increase compared with end-2002.

Table 13. Assets of Financial Institutions and Shares in Total Assets at end-December 2003

	Number	Million Kn	%
Banks , consolidated assets on a gross basis	40	195,278	83,3
Insurance companies	25	12,689	5,4
Leasing companies*	35	12,606	5,4
Mandatory pension funds , net assets	4	4,677	2,0
Building societies , cons. assets on a gross basis	4	3,469	1,5
Open-end investment funds , net assets	32	3,259	1,4
Credit unions	109	1,387	0,6
Closed-end investment funds , net assets	4	1,027	0,4
Voluntary pension funds , net assets	4	30	0,0
Total		234,420	100,0

*Out of approximately 60 active leasing companies, data are collected from the most significant 35 companies, which constitute 90% of the leasing market.

Sources: CNB, MoF, CROSEC, DINADOS and HAGENA.

Of the total of 40 banks, 18 are in majority foreign ownership and their share in total banking system assets as at 30 June 2004 stood at 91%. Foreign banks accounted for a relatively small share of total banking system assets until end-1999, when it increased sharply, following the privatization of major Croatian banks. The privatization of the Croatian banking system was largely completed by end-2000 with only one more bank being privatized in 2002. The share of the remaining two state banks in total banking system assets at the end of June 2004 was 3.4%.

Simultaneously with privatization, the banking sector underwent restructuring and consolidation. Through bank mergers and bankruptcy or liquidation proceedings, the number of banks fell from 53 at the end of 1999 to 40 banks at the end of June 2004. Six banking groups in majority foreign ownership which now dominate the market account for over 80%

of total banking system assets. The creation of banking groups and consolidation of medium-size banks led to improved competition and efficacy of banks as well as to interest rates fall and rapid growth of placements. After domestic sources of funds became insufficient, the banks turned to foreign sources. Increased foreign borrowing of banks has thus contributed to rising external debt while increased bank placements stimulated imports and led to a deterioration in the balance of payments current account. In an attempt to counteract such developments, the Croatian National Bank tightened its monetary policy in early 2003 by introducing penalty measures for excessive loan growth and foreign borrowing of banks. Such monetary policy tightening led to a slowdown in bank placements' growth in 2003 and the first half of 2004.

Banks in Croatia are liquid and well capitalized. Their capital adequacy, commonly above the legally prescribed minimum of 10%, stood at 14.9% at the end of the first six months of 2004. Banks in Croatia have been highly profitable in the past several years. Their return on average equity in 2003 was 14.5% and in the first six months of 2004 it was 17.9%. Despite rapid bank growth, the quality of their portfolio does not show signs of deterioration. The share of bad placements and contingent liabilities of banks at the end of June 2004 accounted for 5.1% of total placements.

The responsibility for banking system supervision lies with the Croatian National Bank and is regulated by the Banking Act that came into effect in July 2002. In all its essential elements this Act is in line with relevant EU legislation. A number of subordinate decisions,⁴ regulating specific aspects of bank operations were issued in 2003. Key changes introduced by this Act and its subordinate decisions include market risk coverage in capital adequacy calculations, inclusion of options in the calculation of banks' foreign exchange positions, legal immunity of supervisory staff, consolidated supervision of banks, and co-operation with supervisory institutions abroad. In addition, following the reorganization of CNB's banking supervision area, on-site inspection now focuses in particular on risk exposure and currency exposure of banks' debtors.

The Croatian National Bank regularly monitors developments and trends important for the stability of the domestic financial system. This task was institutionalized in early 2004 when the CNB decided to set up a Financial Stability Department as a separate organizational unit within the central bank. The responsibility of this unit, among other things, includes analysis of early warning indicators, pointing to difficulties in operations of individual banks, analysis of the vulnerability of the banking system as a whole to macroeconomic disturbances, and macroprudential analysis which aims to assess the stability of the entire domestic financial system. Analyses made so far seem to indicate that the Croatian banking system is relatively well-capitalized, highly liquid and resistant to moderate macroeconomic shocks. Banks are almost fully immune to direct currency risk which is commonly present in all highly dolarized economies such as the Croatian as the CNB has limited bank exposure to direct currency risk to twenty percent of banks' regulatory capital. Indirect currency risk (risk from the kuna depreciating), arising from the fact that the income of the majority of debtors is in domestic currency exclusively, cannot be estimated with precision at the moment. Credit risk has also

⁴ Decision on the Capital Adequacy of Banks, Decision on the Limitation of Banks' Exposure to Foreign Exchange Risk, Decision on the Classification of Placements and Contingent Liabilities of Banks, Decision on Consolidated Financial Reports of a Banking Group, Decision on the Audit of Financial Reports and Business Functions of Banks, Decision Regulating Market Competition within the Banking Sector and Decision on the Application of the Provisions of Law and Other Regulations within the Sphere of Competence of the Croatian National Bank on Banks under Liquidation.

lessened considerably in the past several years due to banking system consolidation. Stable macroeconomic conditions and moderate level of indebtedness of all institutional sectors in line with EU standards, should ensure continuation of such positive developments.

In 2004, a new interest act was adopted that is harmonized with European Council Directive No 93/13/EC and a CNB Decision was issued regulating the application of the provisions of the Banking Act on foreign bank branches. Plans for further adjustment of the Croatian legislation with the regulations of the European Union in the area of banking for 2004 include the adoption of a new act governing a deposit-guarantee scheme, in line with Directive No 94/19/EC of the European Parliament and of the Council.

The Croatian Reconstruction Bank, a specialized state bank for development established in Croatia in 1992 on the basis of Croatian Reconstruction Bank Act, was renamed in 1995 into Croatian Bank for Reconstruction and Development (HBOR). The bank's founder and its 100% owner is the Republic of Croatia and the bank is classified in monetary statistics as a central government fund. HBOR performs its credit activity on the basis of specific loan programs, both through banks and direct lending. The lending provided by this bank is commonly long-term.

The Croatian payment system reform, whose primary objective was to transfer payment system transactions and transaction accounts of business entities from the Institute for Payment Transactions to banks, was completed in 2002. The first basic step in payment system reform was the establishment of the Croatian Large Value Payment System, an up-to-date system for inter-bank payments in real time and on a gross basis, owned by the CNB. The necessary infrastructure for the new payment system was completed with the establishment of the National Clearing System for small value payments and the establishment of a Unified Register of Business Entities' Accounts with the Croatian National Bank. The National Payment System Act which provided the framework for the transfer of payment system transactions to banks was adopted in 2001 and came into effect in April 2002. The Financial Agency Act, adopted in early 2002, prescribes that this state-owned institution should take over the rights, obligations and the assets of the former Institute for Payment Transactions and should continue to pursue its business policy under market conditions. The responsibilities of the Financial Agency now included keeping the Unified Register of Business Entities' Accounts, providing IT support, collecting and processing data on business entities and financial flows as well as providing services to banks on a market basis. The regulation and oversight in the area of payment system is provided by the Croatian National Bank.

The Committee on Payment and Settlement System of IMF's Financial Sector Assessment Program rated high the Croatian Large Value Payment System and the country's National Clearing System in terms of their efficiency and modern technology which are in line with the best international practices. The Committee pointed to several deficiencies in this area, primarily those related to the lack of real time delivery versus payment (DvP) for government and central bank securities trading. The authorities plan to rectify this deficiency soon.

With the aim of further promoting the country's domestic payment system and establishing inter-institutional co-operation in this area, the Croatian National Bank established a National Payment System Committee in 2003. The Members of the Committee include the representatives of the Croatian National Bank, the Ministry of Finance, the Croatian Banking Association and the Croatian Chamber of the Economy.

4.2.2 Capital Market

The Croatian money and capital markets are relatively underdeveloped. The Croatian money market operates on two levels, as an institutional market and an informal direct inter-bank market. The Zagreb Money and Short-term Securities Market (the Zagreb Money Market - ZMM), established in 1990 as a regulated place for public trading of participants in line with the Money and Capital Markets Act, operates today as an independent joint stock company owned by 24 shareholders (22 banks and 2 insurance companies). The basic activity of the ZMM is organized trading in money market instruments: money (kuna and foreign currency), short-term securities, long-term securities in their last year before maturity and other money market instruments. ZMM participants include banks and other financial institutions (insurance companies, investment fund management companies, brokerage houses trading in short-term securities and others). There are over 150 active participants registered with the ZMM.

Total ZMM turnover in 2003 was HRK 28bn, and total turnover on direct inter-bank market in the same year was HRK 77bn.

The legal framework for the operation of the ZMM is provided by the Money and Capital Markets Act and Trading Regulations, while the supervision over the operations of the ZMM and informal inter-bank market is the responsibility of the Croatian National Bank.

There are two stock exchanges in Croatia, the Zagreb Stock Exchange and the Varaždin Stock Exchange. The country's central stock exchange, the Zagreb Stock Exchange, was established in 1991 while the Varaždin Stock Exchange was established in 1993 as an OTC market first (the Varaždin Securities Market), subsequently changing into a stock exchange in 2002. The institution responsible for the oversight of securities' issuing and trading is the Croatian Securities Commission, established in 1996 for the purpose of regulating, supervising and developing the Croatian capital market. The Croatian Securities Commission reports to the Croatian Parliament. It is responsible for the preparation of draft legislation in the area of the capital market, decisions and granting of licenses to brokerage houses and other authorized agents in securities trading, the supervision of the stock exchanges, market participants and the Central Depository Agency. The new 2002 Securities Market Act and the Corporate Takeover Procedures Act enhanced the supervisory and implementing powers of the Croatian Securities Commission. Other changes introduced by these two new Acts included the obligation for public joint stock companies with over 100 shareholders and equity capital of over HRK 30m (EUR 4m) to obtain a stock exchange listing for all their shares, to use banks for the execution of their securities transactions, explicit notification requirement, requirement for takeover bid announcement approval by the Croatian Securities Commission, greater supervisory powers of the Commission in respect of all participants in a takeover and the obligation to ensure for the Commission a full insight into all relevant takeover data and documentation.

Another institution important for capital market functioning is the Central Depository Agency (SDA), a central securities depository in the Republic of Croatia in charge of securities clearing and settlement. The SDA was set up in 1997 as a joint stock company on the basis of legislative framework provided by the Securities Issue and Trading Act (replaced in 2002 by the Securities Market Act) and by the Companies' Act. SDA's majority shareholder is the Republic of Croatia (62.2%), the remaining shareholders being different capital market participants. For the purpose of further improving the services in the capital market, the

authorities' plans for 2004 involve work on the harmonization of the country's legal system with that of the EU. In the context of the SDA, this harmonization will in particular relate to the shortening of the settlement period from T+4 to T+3.

The total number of shares listed on the Zagreb and Varaždin Stock Exchanges at the end of June 2004 was 568 shares whose market capitalization was HRK 61.3bn, or 31% of the country's GDP. The number of shares listed rose significantly during 2003 following the entry into force of a 2002 Securities Market Act which prescribed obligatory listing on the stock exchange for all public joint stock companies with a certain amount of capital and a certain number of employees. However, only about 200 of those shares are actively traded. Share trading in the last two years has gone up slightly, and the total turnover in shares trading on the both exchanges in the first half of 2004 amounted to HRK 1.5bn. Fifteen bonds were quoted on the Zagreb Stock Exchange at the end of June, with market capitalization of HRK 17.8bn (8.7% of GDP). The largest share of the market capitalization went to eight government bonds (HRK 13bn). The market in corporate bonds is very shallow but it rose significantly towards the end of 2003 and in early 2004 owing to new issues of several corporate bonds of major Croatian companies. One of the obstacles to corporate bond market development until recently was the fact that there was no long-term kuna yield curve, i.e. no reference long-term interest rate. Until 2003 all bond issues on the domestic market were denominated in euro. In mid-2003, Croatia issued its first, five-year, kuna bond. Shortly afterwards there was an issue of corporate kuna bonds. The emergence of large institutional investors, pension and investment funds, provided a boost to the development of the bond market (especially the market in government bonds, which under law have to make up a minimum of 50% of pension funds' total investments). Bond trading has thus been increasing steadily since 2002 and it now outstrips shares trading several times over. In the first six months of this year, bond trading amounted to HRK 7.5bn, mainly attributable to government bond trading.

The Croatian pension system reform was completed at the beginning of 2002 following the introduction of the second and the third pension pillars, i.e. mandatory and voluntary pension insurance systems based on individual capitalized savings, in addition to the existing pay-as-you-go system. The legal framework for the Croatian pension insurance is provided by the Pension Insurance Act, Mandatory and Voluntary Pension Funds Act, Pension Insurance Companies and Pension Payments on the Basis of Individual Capitalized Savings Act and regulations and decisions based on these acts.

Pension funds in Croatia have to observe the principles of the security of investment, investment diversity and appropriate liquidity management. Investment restrictions are detailed in the Mandatory and Voluntary Pension Funds Act and Pension Funds Additional Investment Criteria and Investment Restrictions Regulation.

The emergence of pension funds as big institutional investors had a positive impact on the development of the Croatian capital market. At the end of June 2004, there were four mandatory pension funds and four open-end voluntary pension funds in the country. Mandatory pension funds net assets stood at HRK 5,916,7m, accounting for 3.1% of the country's GDP in 2003. Around 60% of mandatory pension funds assets are invested in government bonds. Net assets of open-end voluntary pension funds at end-June 2004 were HRK 46.9m, or 0.02% of the country's GDP in 2003. Interest for this type of savings is yet expected to increase. The first closed-end voluntary pension fund started operating in the first

half of 2004. It is expected that the share of this type of pension funds, which can be set up by companies, unions and professional associations, in total household savings will rise.

The institution responsible for the supervision of pension funds management companies, pension funds, pension insurance companies and the Central Registry of Insured Persons (Regos) is Hagea, the Agency for the Supervision of Pension Funds and Insurance which reports to the Government of the Republic of Croatia and the Croatian Parliament.

The development of the Croatian fund industry started in 1997 with the establishment of seven privatization investment funds set up to handle the coupon privatization project. Instead of money, privatization investment funds publicly collected from investors' privatization coupons of participants in the coupon privatization and exchanged them at Croatian Privatization Fund's auctions for privatization shares. The objective of privatization funds was to adjust their assets structure with the provisions of the Investment Funds Act within maximum five years from the date of their establishment and continue operating as closed-end investment funds. Even before the expiry of the legally prescribed deadline, all fund management companies applied for authorizations to continue operating as closed-end investment funds, pursuant to the Investment Funds Act, with several of them merging into holdings.

The legal framework for the fund industry is provided by the 1995 Investment Funds Act and decisions based on this Act. The Croatian Securities Commission, in co-operation with the Ministry of Finance, also plans to propose the draft investment funds legislation by end-2005 and to propose amendments to the existing laws in its field of competence in line with amendments to EU directives by 2007 (this in particular refers to the Securities Market Act provisions on prospectuses and Corporate Takeover Procedures Act) and thus contribute to legislative EU adjustment initiative.

At the end of 2003 there were 15 investment funds management companies in Croatia, managing 37 open-end and 4 closed-end investment funds. With regard to the type of open-end funds investments, the majority of the funds were mixed assets and money market funds (eleven each), nine of them were bonds funds and six were shares funds. Total assets of all open-end investment funds at the end of 2003 stood at HRK 2,950.8m. Compared with end-2002, open-end investment funds' assets rose by 27%. Total assets managed by the four closed-end investment funds at the end of 2003 were HRK 977.2m. Net assets of all investment funds at the end of 2003 stood at HRK 3,955.7m, or 2.1% of the country's GDP in 2003.

4.2.3 The Insurance Sector

At the end of 2003 there were 24 insurance companies and 1 reinsurance company operating in Croatia with HRK 12,790m in total assets. The majority of these insurance companies (13) dealt in life and non-life insurance business, 7 dealt in exclusively non-life and 4 in exclusively life insurance. Of the total of 25 insurance and reinsurance companies in the country, 13 were in the majority domestic and 12 in the majority foreign ownership. If viewed from the perspective of realized life and non-life insurance premiums, companies with domestic capital accounted for 74% of total premiums (83% of total non-life and 43% of total life insurance premiums).

Croatia osiguranje, the largest insurance company in the majority state ownership, alone covers 40% of gross premiums realized in 2003 (51% of all non-life and 15% of all life

insurance premiums). Total gross premiums charged in 2003 amounted to HRK 6,067m (3.2% of GDP) of which HRK 1,350m went to life insurance premiums. Compared with 2002, gross premiums charged rose by 8.8%, life insurance premiums rose by 17.1% and non-life insurance by 6.6%.

The responsibility for the supervision of the insurance market in Croatia rests with the Directorate for the Supervision of Insurance Companies which reports to the Government of the Republic of Croatia. The legal framework for the operation of insurance companies is provided by the 1994 Insurance Act and a line of its subsequent amendments as well as subordinate legislation adopted by the Government of the Republic of Croatia, the Ministry of Finance and the Directorate for the Supervision of Insurance Companies. There are plans for the adoption of a new Insurance Act in 2005 (the second quarter) that would be harmonized with the Directives of the European Parliament and the European Council.

4.2.4 Foreign Exchange System Regulation

The Republic of Croatia signed on 29 May 1995 Article VIII, sections 2, 3 and 4 of the Articles of Agreement of the International Monetary Fund, introducing current account convertibility of the domestic currency. The exchange rate of the kuna against other currencies is determined on the domestic foreign exchange market. There is no taxation or any system of subsidy for foreign currency purchases and sales. Settlement between residents and non-residents may be executed in foreign and in domestic currency alike.

Foreign exchange transactions are regulated by the Foreign Exchange Act that came into effect on 18 June 2003. The Ministry of Finance of the Republic of Croatia and the Croatian National Bank are the bodies responsible for issuing subordinate legislation on the basis of this Act. Foreign exchange transactions are executed through authorized banks only.

Resident and Non-resident Accounts

Although as a rule residents may open accounts in domestic banks only, the Croatian National Bank may authorize the opening and keeping of accounts abroad in cases specified in subordinate legislation regulating the opening of foreign accounts abroad.

Legal persons headquartered abroad, natural, self-employed persons performing an economic activity abroad, other foreign organizations and branches of resident companies doing business abroad may pay into their foreign currency account not more than EUR 25,000 a month, and may withdraw not more than EUR 5,000 in foreign cash from their account. As regards their kuna deposits, they are allowed to withdraw or deposit up to HRK 30,000 in kuna cash per month. Any deposits or withdrawals in excess of these limits are subject to CNB approval.

Non-resident natural persons and representative offices of foreign legal persons may deposit into their accounts or withdraw from their accounts domestic and foreign cash without any restrictions.

Taking Cash In and Out of the Country

When traveling in and out of the country, residents and non-residents have to report to the authorized customs officer any transfer of checks or cash in foreign currency and in kuna in excess of the limits specified by an anti-money laundering act (currently HRK 40,000).

In international passenger traffic, natural persons (residents and non-residents) may take out of or in the Republic of Croatia maximum HRK 15,000 in kuna cash. Amounts in excess of the prescribed limit are subject to CNB approval.

In international passenger traffic, domestic natural persons may take out of the country maximum EUR 3,000 in foreign cash or checks. Amounts in excess of the prescribed limit are subject to CNB approval. There are no restrictions to taking foreign cash into the country by either residents or non-residents.

Real Estate

Pursuant to the Foreign Exchange Act, residents are allowed to remit fund abroad for real estate acquisitions, provided they have fulfilled their legally prescribed obligations in the Republic of Croatia.

Subject to approval of the Foreign Affairs Minister and previous opinion obtained from the Justice Minister, foreign natural persons may, unless otherwise provided by law, and under the condition of reciprocity, acquire real estate in the Republic of Croatia.

Credit Transactions

Residents may borrow abroad without restrictions. Resident legal persons may grant short-term financial loans only to those non-resident legal persons in which they have invested directly. Resident natural persons are free to grant long-term financial loans to non-residents and short-term financial loans only to their family members abroad.

For statistical purposes, financial loans and long-term commercial loans have to be reported to the Croatian National Bank.

**Table 14. Foreign direct investment flows in Croatia,
in million USD**

1993	120,3
1994	117,0
1995	114,2
1996	510,8
1997	532,9
1998	932,4
1999	1.467,2
2000	1.088,7
2001	1.561,3
2002	1.124,0
2003	1.713,0

Source: Croatian National Bank

Direct Investment

There are no restrictions to direct investments of non-residents in the Republic of Croatia. There are also no restrictions to residents' direct investments abroad.

Each direct investment has to be reported to the Croatian National Bank for the purpose of balance of payments statistics.

Investments in Securities

Investments of residents in securities in the capital and money markets abroad have been partly liberalized for natural and legal persons. Residents are allowed to buy securities abroad issued by OECD member countries, international financial institutions and issuers meeting the conditions prescribed by subordinate legislation.

Under the new Foreign Exchange Act, investments of non-residents in securities in the Republic of Croatia are not forbidden, but are subject to certain restrictions. For instance, non-residents may not buy CNB bills and T-bills and may only buy or sell other short-term securities subject to subordinate legislation issued by the CNB.

When issuing, listing or selling foreign securities in the Republic of Croatia, non-residents are required to meet the minimum conditions as prescribed by the Ministry of Finance.

The Republic of Croatia is signatory to bilateral investment promotion and protection treaties with 53 countries. Forty two of these treaties have been published in the official gazette *Narodne novine*. Residents of the treaties currently in force, which is the majority of them, are not subject to restrictions imposed by the Foreign Exchange Act and the relevant subordinate legislation concerning investments in securities in the Republic of Croatia. This implies that, in effect, non-residents investments in domestic securities have been full liberalized. Ratification of the remaining treaties is underway. Of EU Member Countries, Croatia has not signed this type of treaty only with five countries (Ireland, Luxemburg, Cyprus, Estonia and Latvia).

Further capital account liberalization is being considered, although a specific plan that would address this issue has not been adopted.

4.2.5. Non-Banking Supervision

Supervision of the non-banking financial sector in the Republic of Croatia, in accordance with specific laws regulating the area, is within the competence of the Securities Commission of the Republic of Croatia (hereinafter the "Commission"), the Agency for the Supervision of Pension Funds and Pension Insurance (hereinafter the "HAGENA"), and the Directorate for the Supervision of Insurance Companies (hereinafter the "Directorate").

The Commission was formed pursuant to the Act on the Issuance and Sale of Securities (Official Gazette Nos. 107/95, 142/98 and 87/00). In the performance of its public powers in accordance with the provisions of the Securities Market Act now in force it supervises business operations of the following entities:

- exchanges (Zagrebačka burza d.d. and Varaždinska burza d.d.),
- regulated public markets (following the transformation of the Varaždin securities market into Varaždinska burza d.d , at present there are no regulated public markets in the Republic of Croatia),
- authorized companies (or brokers and banks who have the permit of the Commission to trade with securities),
- issuers of securities,
- investment and privatization investment funds,
- companies for managing investment and privatization investment funds,
- brokers,
- investment advisors,
- institutional investors (means domestic or foreign investment funds, pension funds, banks, insurance companies and legal entities whose status as an institutional investor

- under the provision of Article 102, paragraph 3 of the Securities Market Act is approved by the Commission),
- Central Depository Agency.

HAGENA is an independent agency established in 2001 for the purpose of implementation of the pension reform in the Republic of Croatia, when it also became operational. As part of its duties, it supervises business operations of the following entities:

- companies for the management of the mandatory pension fund and mandatory pension funds,
- companies for the management of voluntary pension funds and voluntary pension funds,
- banks guardians of pension funds (in the performance of guardian activities for pension funds),
- pension insurance companies.

The Directorate was established pursuant to the Insurance Act (Official Gazette No. 46/97, consolidated text Nos. 116/99 and 11/02). As part of its duties, it supervises business operations of the following entities:

- insurance companies,
- insurance mediators,
- insurance agents - the agents are generally supervised by the insurance company, but also by the Directorate when deemed necessary.

In view of the development of financial conglomerates, it is clearly necessary that supervisory institutions should mutually exchange information, as provided for in the present institutional legislative framework. Article 57, paragraph 6 of the Banking Act (Official Gazette No. 84/02) states that institutions in charge of supervision of financial institutions have to cooperate together. Article 57, paragraph 1 of the Banking Act states in particular that supervisory institutions have to forward any requested information to each other. Paragraph 2 states that supervisory institutions have to inform each other about any irregularities, while paragraph 3 states that the consent and form of mutual cooperation of supervisory institutions are within the competence of the finance minister and the governor of the Croatian National Bank on the basis of previously obtained opinions by all supervisory institutions.

Mutual cooperation of supervisory institutions is regulated in Article 13 of the Securities Market Act (Official Gazette No. 84/02), which states in paragraph 1 that the Securities Commission of the Republic of Croatia and bodies responsible for the supervision of other financial institutions have to, at the request of an individual supervisory body, deliver to that body all the data and information on the entity being supervised that are necessary when carrying out supervision and in the procedure relating to the entity being supervised. Paragraph 2 states that supervisory bodies referred to in paragraph 1 have to notify one another about any irregularities found during supervision if these findings are essential for the work of another supervisory body.

In 2003 the Croatian Parliament consequently accepted the Program of Supervision over Financial Institutions and Financial Market on Consolidated Basis. In accordance with the said Program, the Government of the Republic of Croatia founded the Committee for Coordination of Supervision of Financial Institutions and Financial Market (hereinafter the "Committee") comprised of the representatives of supervisory institutions - the Croatian National Bank, Securities Commission of the Republic of Croatia, Directorate for the

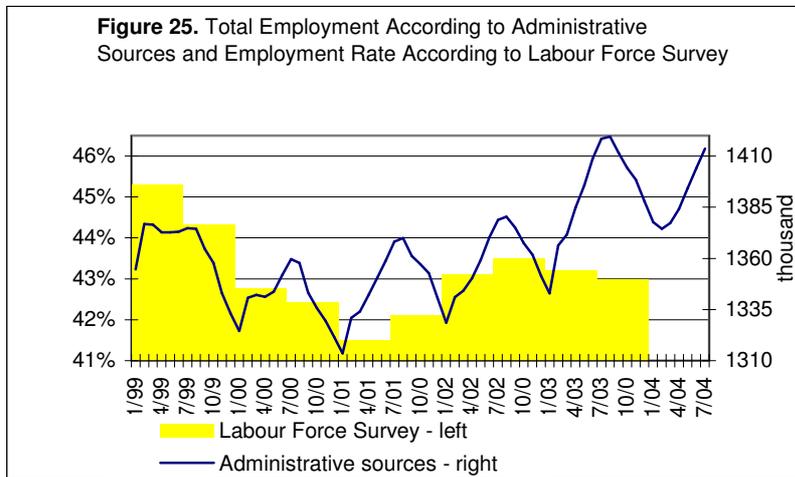
Supervision of Insurance Companies, State Agency for Savings Deposit Insurance and Bank Rehabilitation, Agency for the Supervision of Pension Funds and the Ministry of Finance.

In the forthcoming period, that is, in 2005 it is planned to prepare legislation as the basis for the procedure of unification of supervisory institutions in the non-banking financial sector. A project titled "More Efficient Supervision of the Financial Sector" was proposed as part of the PHARE program for 2005-2007. The project anticipates technical assistance in the preparation of the basis for the establishment of a single supervisory body in the non-banking financial sector, but also financial assistance in the investment part of the project. The planned value of the project is EUR 2,000,000, where the Republic of Croatia would participate up to 25% of the amount of the investment part of the project.

4.3 Labor Market

4.3.1 Employment

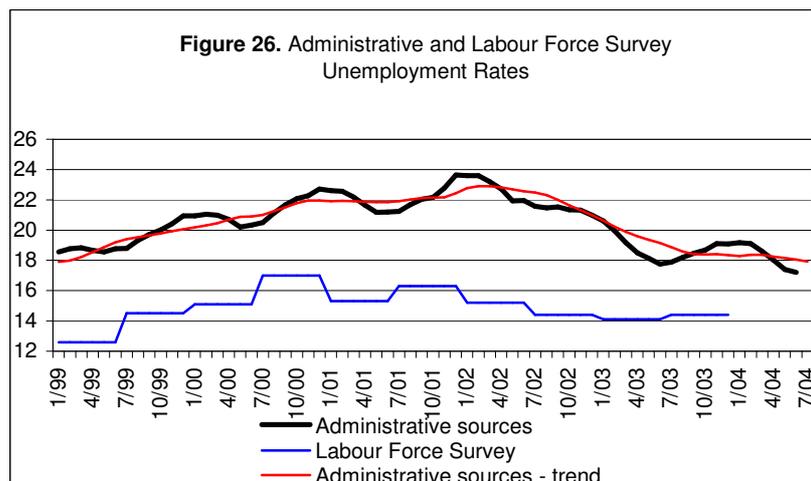
A downward trend in employment that lasted more than a decade in Croatia was reversed in 2001, when employment started to grow owing to a heightened economic activity and a restrictive public sector wage policy. According to the administrative sources, the number of the employed continued to increase till 2004, while Labor Force Survey points to its stagnation in 2003 following a strong growth in the previous year. The Labor Force Survey unemployment rate started to fall parallel with the beginning of employment growth, while seasonally adjusted registered unemployment continued to move upwards for one more year after the rise in employment had been recorded. However, during 2002, registered unemployment grew at a slower pace and has even trended downwards since March 2003. This fall, which gradually became sharper, was primarily caused by reduced inflows into the register of the Croatian Employment Service (CES).



In addition to the employment recovery recorded in Croatia over the last few years, the structure of employment is also encouraging. Owing to the restructuring process, the structure of employment, in which services had the dominant position even before the transition, became even more similar to that in developed countries. Thus, according to the

Labor Force Survey, industry participated with 21% and agriculture with a little less than 17% in total employment. The share of the employed in construction was about 8%, while services accounted for the remaining share in employment. A drawback of the restructuring process was that the adjustment mainly consisted in reducing employment, while the growth of employment in certain activities was restricted until recently.

Despite the above-mentioned improvements in the labor market, there are still serious problems in its functioning. Firstly, young people are still faced with great difficulties in accessing the labor market, which is reflected in low labor force participation and high youth unemployment rates. In addition, long-term unemployment still accounts for more than one half of the total unemployment, which may hamper the future growth of employment and reduce chances of employment for such persons, who are faced with a negative perception from their potential employers and obsolescence of their professional skills. Owing to the privatization progress achieved over the last few



years and an increased number of newly created jobs in small private enterprises, the share of public sector employment in overall employment decreased from over 40% in 2001 to below 35% in 2003. However, the number of newly created jobs is still insufficient, especially in small and medium-sized enterprises, which employ fewer workers than the comparable enterprises in EU Member States and other transition countries. This aggravates the problems of low employment and high unemployment. Moreover, untypical employment forms, like part-time or temporary employment, are insufficiently developed, which reduces the labor market flexibility. And finally, both employers and employees invest insufficiently in knowledge and skills improvement in order to adjust the labor supply with the labor market needs.

In early 2002, a labor market legislation reform was launched with the purpose of affecting the labor market recovery, reducing the remaining weaknesses, increasing its flexibility and stimulating the restructuring of enterprises, domestic and foreign investments and job creation. The reform also provided a basis for the harmonization of the labor legislation with EU directives. The first step towards the reform was the adoption of amendments to the Law on Employment Intermediation and Rights During Unemployment (official gazette *Narodne novine*, No. 32/2002), aimed at separating social rights from the rights arising from the unemployment status, as well as activating unemployed persons. In September 2002, the Croatian Employment Service introduced new business procedures based on the amendments to the Law. They involve stricter registration criteria with the CES including the obligation to accept the offered jobs, willingness to work and active job seeking. The reform also provides for the establishment of private temporary employment agencies.

The reform of employment intermediation was paralleled with a broad discussion about the Labor Law reform, which was ended after two-year negotiations by adopting the amendments to the Law (official gazette *Narodne novine*, No. 114/2003) in July 2003. The new provisions concerning shorter periods of notice and lower severance pays apply as of January 2004. During the discussion, legal protection of employment has been assessed as one of the most stringent in Europe, which is mainly attributable to a complex dismissal system and restrictions on temporary employment as well as the definition of collective dismissal. In keeping with the main goals of the amendments to the Law, restrictions on dismissal have been relaxed for individual and collective dismissals as well as for the termination of temporary work contracts. The amendments to the Law also imposed some new requirements on employers. Thus, according to the amendments, employees participate in supervisory boards of all enterprises with over 200 employees (earlier, this only applied to enterprises in which the state held significant stakes), the so-called solidarity contribution is also payable by employees who are not trade union members, if the majority of workers in an enterprise decides so, and the beneficial position of small employers concerning the dismissal of employees has been restricted (although the definition of a small employer has been broadened to include enterprises with a maximum of 20 employees instead of the former maximum of 10 employees).

In view of the significantly relaxed restrictions imposed on employers by the new Law, the majority of changes consist in reducing the level of employment protection, which indicates that the new Law is harmonized with the European standards.⁴

⁴ Following the amendments to the Labour Law, the value of the EPL (Employment Protection Legislation) index developed by OECD, which is calculated as a weighted average of 22 indicators quantifying various procedures, costs and restrictions in the case of employee dismissal, has been reduced in Croatia from 3.6 to 2.8

The process of amending and harmonizing the regulations was paralleled with the introduction of a new set of pro-active policy measures in the labor market in 2002. The cost of these measures in Croatia roughly approximates the comparable costs in other advanced transition countries. However, the measures implemented in Croatia are rather specific. Firstly, they mainly relate to employment subsidies, which, together with employment intermediation, account for the largest share in public funds earmarked for that purpose, while the expenditures on other pro-active policy measures are negligible. Secondly, the measures are not intended for any specific group of unemployed persons, but can be considered as general, as approximately 95% of all registered unemployed persons are potential participants in some of the schemes. It is still impossible to assess the effects of these measures and in future, it is necessary to make the assessment and examination of such effects on a regular basis in order to reallocate or increase the available funds as necessary.

During 2003 and 2004, a National Action Plan for Employment was prepared and harmonized with ten revised guidelines for the European Employment Strategy. The National Action Plan for Employment, which establishes the situation on the labor market, analyses previous labor market policies and presents a number of measures for their improvement, is based on wide consultations with the representatives of government bodies and various non-government organizations, as well as the representatives of the Croatian Employers' Association, Croatian Chamber of the Economy, Croatian Chamber of Crafts and Trades and trade union federations. As the adoption of the Plan was still pending at the time of drawing up the Program, it is not possible to explain in greater detail the measures envisaged under the Plan.

4.3.2 Safety At Work

The area of safety at work has been neglected in the past, although there are a large number of regulations on the issue. The main piece of legislation is definitely the Act on Safety at Work, which is fully in line with the provisions of the EU Directive 89/391/EEC. An analysis of compliance of the Croatian legislation with the provisions of EU Directives has been prepared, as well as an analysis of the effects of the Directives whose implementation will require large investments (machines, protection screens, asbestos). In most companies where there is danger to life and health, hazard evaluations have been made. A significant number of regulations are to a large extent in line with the provisions of individual Directives, but there is still much work on the harmonization of Croatian legislation with EU Directives. The Ministry of the Economy, Labor and Entrepreneurship has a special department working on that process.

However, the situation regarding safety at work is unsatisfactory, primarily because of old equipment and lack of work and technological discipline, the most frequent causes of work-related injuries. Employers are not interested in improving safety at work, but the same is to a large extent true of trade unions, whose work until now has mostly revolved around salaries.

In the existing health and pension insurance systems, prevention in the area of safety at work is completely neglected. Although the Health Insurance Act does offer stimulation to employers who decide to improve safety at work, there is no such option in the pension insurance system. In the existing insurance system, the employer suffers costs, because he is insured only to a small extent against risks relating to injuries and professional diseases, and

(the higher the index value the stricter the employment protection regulations), which broadly corresponds with the EU15 average of 2.6.

at the same time it has no impact on the improvement of working conditions and it does not ensure to employees adequate compensation in case of a work-related injury and professional disease.

In the area of safety at work, it is necessary to continue working on further harmonization of the legislation with EU Directives, and to ensure their implementation in practice. Such process will require substantial material investments, so it will be performed gradually. A better situation in the area of safety at work cannot be expected without the establishment of a special system of insurance against work-related injuries and professional diseases.

Considering that the continuation of work on the harmonization of our legislation in the area of safety at work with the provisions of EU Directives will require substantial material funds, which our economy is presently lacking, the entire procedure of harmonization will have to be more long-term and it will have to follow the overall rejuvenation of the economy. As there are no preventive measures aimed at reducing the number of injuries and professional diseases within the existing health and pension insurance systems, in the short run it is necessary to strengthen the infrastructure within the ministry that will be able to provide expert assistance to social partners in the area of safety at work. A long-term goal is definitely the establishment of a special system of insurance against work-related injuries and professional diseases in which, depending on hazards in specific activities, various degrees of contributions will be envisaged.

Decrease of the contribution rate will also materially motivate those employers who decide to invest in the improvement of safety at work.

4.3.3. Pension System Reform

The system of pension insurance in the Republic of Croatia functions as a combined pension system, with the following elements:

- the first pillar, mandatory public pension insurance generational solidarity (PAYGO),
- the second pillar, mandatory private pension insurance based on capitalization,
- the third pillar, voluntary private pension insurance based on capitalization.

Pension insurance covers the actively working population and their family members, on the basis of insurance and contributions that are paid by the employees, self-employed and other groups encompassed by mandatory insurance. Mandatory pension insurance for the time being provides insurance against the risk of old age, disability and death, while for the time voluntary pension insurance is limited to insurance against the risk of old age and death.

Reform. The pension system reform began in 1999, when the public mandatory pension system (PAYGO) inherited from the former state was changed. Conditions for old age and early old age pension were made stricter, pension in case of early retirement was substantially reduced (3.6% per year), disability contributions (a new definition of disability and contributions in case of partial disability, and bonus for aid and care only in the social welfare system) and a new formula for calculating pension were introduced (on the basis of points and the average salary from all working years of the insured person).

The process of raising retirement age will be completed by 2008. From then onwards, retirement age will be 65 years of age for men and 60 for women, and the age for early retirement will be 60 for men and 55 for women. In the meantime, the process of decreasing

pension in case of early retirement was increased to 4.08% per year (total up to 20.4%), and as of 2010 the calculation of pension will be based on the salary of the insured person throughout his working career (in 2004, the calculation is based on 25 annual salaries).

In the pension reform, private mandatory and voluntary pension insurance based on individual capitalized savings began in 2002. Mandatory capitalized insurance covers insured persons who on the date of commencement of application of the insurance had more than 40 years of age, that is, insured persons between 40 and 50 years of age had the freedom to choose, and benefit from the insurance (old age retirement and early old age retirement) can be realized on fulfillment of the conditions for pension in the PAYGO pension insurance. As far as pensions out of mandatory capitalized pension insurance are concerned, it is expected that the payment of such pensions will begin in 2012.

Voluntary pension insurance is open to all inhabitants of Croatia who are free to independently contract conditions for the realization of the rights out of such insurance. In this form of pension insurance it is possible to insure individuals if they so choose and decide, and to conclude collective insurance for specific groups (employees of a single employer or group of employers, self-employed, etc.).

Legislative framework. Mandatory public pension insurance (PAYGO) in Croatia is regulated in the Pension Insurance Act (Official Gazette Nos. 102/98, 127/00, 59/01, 109/01, 147/02, 117/03 and 30/04), and capitalized pension insurance is regulated in the Act on Mandatory and Voluntary Pension Funds (Official Gazette Nos. 49/99, 63/00 and 103/03) and the Act on Pension Insurance Companies and Payment of Pensions based on Individual Capitalized Savings (Official Gazette Nos. 106/99 and 63/00). Apart from the said laws, legislation on pension insurance consists of a number of laws regulating rights out of pension insurance for specific categories of insured persons (veterans of the War for Independence, soldiers, police officers, public servants, members of parliament, former political prisoners), and a certain number of laws regulates specific rights (list of physical disabilities, professional diseases). The Act on Compulsory Insurance Contributions (Official Gazette Nos. 147/02 and 175/03), which regulates the system of contributions for all insurances, is also important for the pension system.

Institutional frameworks. Mandatory public pension insurance (PAYGO) is within the competence of the Croatian Pension Insurance Fund, which registers insured persons, decides on the rights of individual beneficiaries and pays funds out of the insurance (pensions). The Ministry of the Economy, Labor and Entrepreneurship supervises the implementation of mandatory public pension insurance (PAYGO). Mandatory and voluntary capitalized pension insurance is within the competence of mandatory and voluntary pension funds, which are administered by companies founded especially for that purpose. Payment of pensions out of this segment of the pension system will be performed by pension insurance companies. At present, Croatia has 4 mandatory pension funds, 4 voluntary pension funds and one pension insurance company.

All contributions for mandatory pension insurance are collected by the Tax Directorate of the Ministry of Finance, which also collects contributions for health insurance and rights in case of unemployment. In voluntary pension insurance, beneficiaries pay contributions directly to their pension funds. Two new institutions were founded - the Central Register of Insured Persons (REGOS), performing expert-technical activities related to the keeping of records required for an efficient functioning of the system of mandatory capitalized savings, and the

Agency for the Supervision of Pension Funds and Pension Insurance (HAGENA), supervising the implementation of capitalized pension insurance.

Macroeconomic and financial aspects of pension insurance. Financial stability of the pension system is a precondition for its ability to ensure social security and protection against the risk of old age, disability and death. Economic movements and employment have most impact on movements in the pension system in the mid-term, and in the long-run unfavorable demographic movements, that is, aging of the population, will have most impact. Every tier/pillar of the pension system has its advantages and disadvantages. For the purpose of dispersing and reducing overall risks and enabling long-term higher and safer pensions, development of the capital market, encouraging savings and economic growth, Croatia introduced a mixed system in which pensions are financed in two ways - on current basis and out of capitalized pension savings.

After the ratio of the number of insured persons and retired persons grew continuously worse, especially during the past decade, at the beginning of this decade the ratio has stabilized and begun to slowly improve. In June 2004 there were 1.057.05 million retired persons and 1.477.476 million insured persons (ratio of dependency 1 : 1.4). The share of an average pension in an average salary is about 42%.

The share of pension expenditure in GDP was the highest in 2001, when it was 14.1%. In 2003, the expenditure of PAYGO pension insurance was HRK 24,7 billion, and its share in GDP decreased to 13.04%. About 56% of revenues are contributions, which amount to 20% of the salary/basis for payment of contributions, that is, for insured persons in the 2nd tier 15% for the 1st pillar and 5% for the 2nd pillar. About 44% of pension expenditure is financed from the state budget - for pensions realized under more favorable conditions, coverage of the lacking contributions in the 1st pillar caused by the introduction of the 2nd pillar (transitional costs) and for other legally prescribed expenditures.

The transitional costs in 2003 amounted to HRK 2,5 billion, that is, about 1.3% of GDP. In view of the increased number of insured persons in the 2nd pillar and increase of the average salary in the Republic of Croatia, it is estimated that the transitional costs would increase at an annual rate of about 6%. In 2004, it would be about 1.35% of GDP, in 2005 about 1.4%, and in 2006 about 1.45% of GDP.

Capitalized pension savings in the 2nd pillar amount to about HRK 7.5 billion. In the ensuing fifteen years, the number of insured persons in the 2nd pillar will increase (when almost all insured persons will be insured in both pillars), and the first pensions out of that insurance will be payable only in several years' time, so the property of mandatory pension funds will therefore gradually increase.

Implementation of the Decision of the Constitutional Court ("return of debt to retired people"). Several laws were passed with the aim of implementation of the Decision of the Constitutional Court of 12 May 1998 relating to the period 1993-1998 when pensions partially followed the growth of salaries. The addition of HRK 100 and 6% paid to beneficiaries next to their pensions as of October 1998 was included in the amount of pension by the Act on Amendments to the Pension Insurance Act (Official Gazette No. 30/04) of April 2004 and will be adjusted regularly. In addition, as of 1 January 2001, according to the Act on the Increase of Pensions to Eliminate Differences in Pensions Realized in Different Periods (Official Gazette No. 127/00), pensions realized until 1998, depending on the year when the

right to pension was realized, were increased from 0.5% to 20%. The annual cost of application of the laws is about HRK 3.6 billion. In July 2004, the Act on Implementation of the Decision of the Constitutional Court of 12 May 1998 was passed, whose purpose is to indemnify retired people. Indemnification would be carried out by establishment of a special investment fund. This issue will be regulated in a special law and implemented in accordance with the economic ability of the state.

Harmonization with the legislation of the European Union. With respect to the pension reform, the legislation about mandatory public pension insurance has been adjusted to the related legislation about such insurance in Europe (Germany, Austria), and the performed amendments harmonized the legislation with the Directive 79/7/EEC dated 19 December 1978, relating to the implementation of the principle of equal treatment of men and women in social security schemes.

Considering that the European Commission and the World Bank evaluated that the pension reform was satisfactory and successful, one of the goals will definitely be to proceed with the reform and to improve fiscal and social feasibility of the pension system.

Continuation of the reform will include specific measures in the system of generational solidarity, such as the strengthening of social security for those employees who have non-conventional jobs by encouraging their inclusion in the system and the continuation of the efforts to simplify the system of application for pension insurance in order to encompass the largest possible number of workers. Furthermore, re-evaluation of the application of the institute of years of service for insurance with prolonged duration and finding a solution to achieve the same objective - protection of insured persons who are exposed to increased levels of risk to their health and working capacity on their jobs, without transferring the burden of such protection to all insured persons in the system of generational solidarity. Continuation of the reform will in the long run include raising of the retirement age limit and possibly equaling the age limit for women and men, in view of the longer life span.

As far as the latest amendments to the Pension Insurance Act are concerned, which anticipate the inclusion of the addition of HRK 100 and 6% in the pension, and indexing of pensions according to the growth of salaries, which would partially undermine the sustainability of the system, it is necessary to urgently change the way of adjusting pensions by returning to the old "Swiss formula" or by finding a new formula that would enable the re-establishment of the fiscal sustainability of the system.

Regarding the capitalized savings system, the priority will be the strengthening of voluntary pension savings and all forms of individual insurance, meaning continuous efforts on making voluntary pension funds more popular amongst the public and improving the until now weak interest in such form of insurance. With the amendments to the legislation aimed at simplifying access to voluntary insurance the system should be made more interesting to a larger number of insured persons, and at finding a way of encouraging employers to establish closed pension funds and enabling the funds to invest abroad a larger portion of the funds than permitted now or increase the offer of security instruments in Croatia. Development of the capital market and strengthening of the capacity of agencies administering the system are an essential precondition for the establishment of sustainable mechanisms for voluntary pension insurance.

In the three years ahead, it will be necessary to harmonize the legislation about pension insurance with the Directive 86/378/EEC of 24 July 1986 (as amended) on the implementation of the principle of equal treatment for men and women in occupational social security schemes, Directive 98/49/EC of 29 June 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community and the Directive 2003/41/EC of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision.

Child Allowance (Family Allowance)

In the Croatian social security system, child allowance means allowance granted for upbringing and raising children and is regulated in the Child Allowance Act (Official Gazette No. 94/01) and other implementing legislation. The legislation states that the entire population may receive child allowance, but the granting of the right itself depends on family income. In June 2004, there were 241,961 beneficiaries, receiving child allowance for 461,351 children. Expenditure on child allowance in 2003 was HRK 1,600,449,779. As opposed to pension insurance, child allowance is financed exclusively out of the state budget. The National Program for the Integration of the Republic of Croatia into the European Union plans harmonization of the Child Allowance Act with the Directive 1408/71/EEC of 14 June 1971 on the implementation of the social security system of employed, self-employed persons and their family members moving within the Community. The said Program plans amendments to the Child Allowance Act in 2004, presently being prepared in the Ministry of the Family, Veterans' Affairs and Intergenerational Solidarity

4.3.4. Social Security System

In the social security system in Croatia, comprised of the pension and health system, social protection of the unemployed and the family policy, social welfare represents the last social-protective measure whose aim is the care and social inclusion of socially most deprived citizens, that is, socially vulnerable groups of citizens.

In the social welfare system the poor, but also other socially vulnerable groups receive various forms of assistance. The amount of assistance is determined in a percentage of the basis for calculation, which is determined by the Government of the Republic of Croatia according to the provisions of the Social Welfare Act. The Government determined the present basis in March 2001, and it is HRK 400. The amount of the basis is not connected to living expenses, average salary, lowest pension or some other adequate amount that would condition continuous changes to the amount of the basis.

As Croatia has not conducted any significant research of poverty until 1998, the "Economic Vulnerability and Welfare Study", prepared by a joint team of the Croatian Bureau of Statistics and the World Bank has to a great extent contributed to the understanding of the scope of poverty in Croatia.

The rate of poverty in Croatia was about 10% in 1998 (see Table 15). Considering that there are about 4,350,000 inhabitants in Croatia today, there are about 435 thousand poor people. In comparison to international lines, Croatia's poverty rate is low, especially in comparison to other transitional countries (see Figure 27).

Table 15
Poverty rates in Croatia according to different lines (1998)

Poverty lines	Absolute lines		Relative lines	
	International line USD 4.3 per day (according to purchase power parity)	National line HRK 15,474 per year (per "adult equivalent")	50% of the average	50% medijana
Poverty rate*	4.0%	8.4%	11.3%	7.6%
Poverty rate assessed for the whole of Croatia**	4.8%	10.0%	13.5%	9.1%

Source: World Bank, 2000

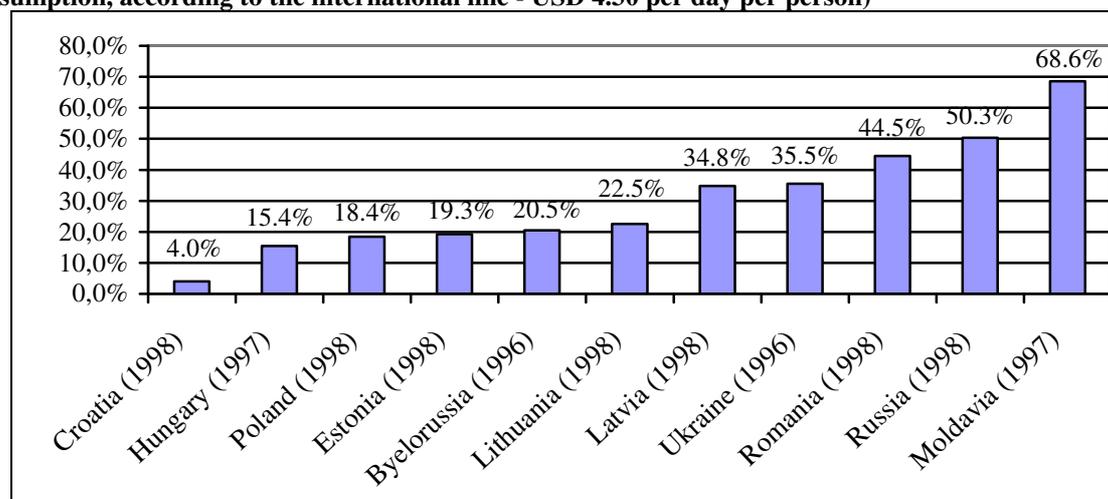
Note: In all assessments of the poverty rate, the OECD equivalent scale was used (first adult member = 1, other adults = 0.7, children = 0.5), except in the case of international lines, where the *per capita* scale was used.

* Poverty rates obtained according to a sample that did not include formerly occupied areas of eastern Slavonia and Dalmatinska zagora. ** The poverty rates in the research were increased by 1/5 (based on the evaluation that the inclusion of formerly occupied areas would raise the rate of poverty by at most one fifth).

In 2003 research, the Croatian Bureau of Statistics collected relative indicators of poverty in Croatia. The indicators were calculated according to the methodology of the European Bureau of Statistics, and were based on the results of the Household Consumption Poll for 2001 and 2002 and the Labor Force Poll for 2001, 2002 and 2003.

The relative poverty indicators in Croatia do not deviate significantly from the poverty indicators in the Member States and candidate countries of the EU. Based on that, we have a relatively low level of poverty (18%). However, that means that about 800,000 citizens, after distribution of social transfers, including pensions, live below the line of poverty, which is HRK 1,604.00 per month for a one-member household. Research shows that social transfers in Croatia have more impact on elimination of poverty than in other countries. Without social transfers and pensions, 40% of citizens in Croatia would be exposed to the risk of poverty. Further development of social statistics will provide data necessary for integration and harmonization of research with the EU countries.

Figure 27. Poverty rates in the selected transitional countries and Croatia (based on household consumption, according to the international line - USD 4.30 per day per person)



Source: Luttmer, 2000.

The social welfare system plays a significant role in the elimination of poverty, as well as in the mitigation of its consequences. The poor, as well as other socially vulnerable groups, such as children, persons with disability, the elderly and the infirm, victims of violence, persons addicted to drugs and other narcotics, victims of trafficking, ethnic minorities, and others, receive various forms of assistance provided by the state. In 2003, 4.7% of the population received some sort of material assistance, of that 2.7% of the population receives support assistance.

In the ongoing Reform of the Social Welfare System, the authorities have begun decentralizing the system (amendments to the Social Welfare Act regarding homes for the elderly and the infirm, and social welfare centers in the part relating to material costs), improving co-operation with non-governmental organizations in the area of humanitarian activities (Humanitarian Assistance Act), raising the level of social contributions, adopting the Program for Fighting Poverty and Social Exclusion obtaining the relative indicators of poverty (research by the Croatian Bureau of Statistics), defining the terms and the scope of implementation of the process of de-institutionalization (Draft of the Study on De-institutionalization of the Social Welfare System in the Republic of Croatia), computerizing the system, and undertaking a number of other activities with the aim of improving the quality of life of children, young people, families and disabled persons. In addition, the Reform includes changes to the overall model of social welfare, especially relating to the decentralization of the system, the scope and combination of financial support and other social welfare services, more intensive co-operation with the civil sector, de-institutionalization, etc., which will surely have impact on the quality of services to beneficiaries.

The abatement and reduction of poverty is at the moment one of the main tasks of Croatia as a social state. The integral strategy has as its goal in the said tasks the implementation of measures in the areas such as employment and protection against unemployment, education, health protection, family policy, housing, social welfare and assistance. In 2003, the Government of the Republic of Croatia adopted the "Strategy of Development of the Republic of Croatia: Croatia in the 21st Century - Strategy of Development of the Pension System and Social Welfare System", setting the overall developmental framework for improving the said systems.

As part of the "Social Welfare Reform", in co-operation with the World Bank, a final report was prepared in June 2003 about the proposals and recommendations relating to the implementation of the social welfare reform. The proposals include the area of fiscal decentralization, better routing of social contributions and better quality social services, dissemination of data about social welfare rights, de-institutionalization, administrative strengthening and the strengthening of co-operation with non-governmental organizations, as well as the improvement of the methodology for monitoring poverty. It is the intention of the social welfare reform to further adjust the system both organizationally and professionally to the criteria applicable in the countries of the European Union. Emphasis is placed on upgrading the educational level of employees in the social welfare system, introducing post-graduate studies, and on permanent education.

Long-term goals of the reform would thus include two categories of measures:

Improving transparency, informational and scientific foundation of the system:

- upgrading the educational level of employees in the social welfare system, introducing post-graduate studies, and permanent education,
- improving the awareness of the public about social rights and social programs, ratification of the European Social Charter.

Modernization and democratization of the system means the following measures:

- establishment of new criteria for the realization of the right in the system of social assistance and welfare,
- decentralization of the social assistance and social welfare systems,
- de-etatization and de-institutionalization of the social assistance and social welfare systems.

One of the priority objectives of the reform of the system of social assistance and social welfare is more intensive co-operation with the civil sector, so in the future social welfare will rely much more on precisely that form of co-operation.

In accordance with the proposals and recommendations contained in the document "Social Welfare Reform", which should be forwarded to the Government of the Republic of Croatia this year, drafts of new legislation will be prepared and drafted. Work will still be made on the harmonization of the system of social welfare with the criteria and standards of the European Union countries.

If the reform is to be implemented, it is necessary to change the infrastructure of the system, which especially encompasses well prepared organizational and financial support. That primarily means ensuring the required funds and further informatization of the system, and implementation of pilot projects, especially the pilot project of restructuring social welfare centers, the pilot project of local social planning and the pilot project of introducing the "voucher system".

In that regard, and for the purpose of improving the present system of record- and document-keeping, measures were taken in the past several years to improve the system technology-wise. In view of the expert and statistical requirements, it is necessary to make a re-organization that should be based on a new normative deed (Rules on Record-keeping) and technologically supported by appropriate uniform software solutions throughout the state, with adequate computer equipment, and the required training of the relevant authorities in social welfare institutions. In that regard, in 2004 and 2005 it is planned to finish the preparation of the Rules on Content and Manner of Keeping Records and Documentation in Social Welfare Centers, define organizational frameworks for implementing the computerization of the records of beneficiaries and social welfare services, introduce the technological basis for connecting all competent authorities in charge of registering beneficiaries, prepare software solutions, install a local computer network in social welfare centers and social welfare homes. Based on the said tasks, presuming they are accomplished within the planned deadlines, it will be possible to establish a central data base at the level of the Ministry, which will provide statistical data about all beneficiaries and members of their families, as well as other specific personal data, as of January 2006.

Generally-speaking, the objective of the reform is to establish a new, more rational and efficient system of social welfare aimed at the socially most threatened citizens, that is, socially vulnerable groups. The document describes the development of the system of social welfare until today. It should be pointed out that the established weaknesses of the present system served as the starting point for defining the directions in which the reform should proceed.

Protection of Children and Families

Protection, affirmation and inclusion of socially vulnerable groups into society, especially into the local community, led to the development of a number of programs covering the area of protection of children, young people, families, disabled persons, persons addicted to drugs and other narcotics, victims of trafficking, ethnic minorities, etc. The documents in question are as follows: National Action Program for Children, Priority Activities relating to the Welfare of Children in the Republic of Croatia 2003-2005, as a supplement to the existing Program for Children, National Action Program for Young People, National Strategy on Combating Drug Abuse, National Plan for Combating Trafficking, National Family Policy, 2003 – 2006 National Strategy of a Uniform Policy for Disabled Persons, National Policy for Promoting Gender Equality, National Program for the Roma, etc.

The Family Act regulates marriage and legal relations in marriage, the relations between parents and children, adoption, guardianship, effects of the extramarital community of man and woman, and procedures of the competent authorities regarding family relations and guardianship.

The new Act of July 2003 went a step further, so apart from the already recognized rights of the child, the Act improved protection in the application of the existing institutes. That is especially visible in the institute of guardianship, in which the child is appointed guardian in cases where his interests are jeopardized, that is, where his interests are contrary to his parents' interests. For example, apart from the option to appoint a guardian in maternity and paternity disputes, the new Act also regulates the procedure for revoking parents' rights as of the moment of submission of such a proposal to the court. It is also important to mention that in the adoption procedure there is only one form of adoption, the unbreakable one, which completely fortifies the position of the child in the adopted family. In addition, the Act anticipates transfer of certain powers from social welfare centers to courts in order to achieve a more efficient protection of the child, in accordance with the provisions of the European Convention on Protection of Human Rights and Fundamental Freedoms.

Measures for implementing anti-discriminatory provisions: the rights of minorities, refugees, the Roma population - present situation and plans, harmonization with the EU *acquis communautaire*

Article 14 of the Constitution of the Republic of Croatia guarantees equality: "Everyone in the Republic of Croatia shall enjoy rights and freedoms, regardless of race, color, gender, language, religion, political or other belief, national or social origin, property, birth, education, social status or other characteristics. All shall be equal before the law."

Article 15 of the Constitution guarantees equality to members of all national minorities. The Constitutional Act on the Rights of National Minorities elaborates on the rights and freedoms of national minorities and prohibits any form of discrimination based on membership in a national minority. Members of national minorities are guaranteed equality before the law and equal legal protection.

The Republic of Croatia, in accordance with the Constitutional Act, guarantees special rights and freedoms to members of national minorities, in particular: freedom to use their language and script, privately, publicly and officially, right to the upbringing and education in the language and script they use, use of their emblems and other symbols, cultural autonomy,

right to religious worship and formation of religious communities, access to the mass media and to public announcements in the language and in the script they use, self-organization and association for the purpose of achieving common interests, representation in the representative bodies at the state and local levels, and in administrative and judicial authorities, participation of members of national minorities in public life and local activities through councils and national minority representatives, protection against any activities jeopardizing or that might jeopardize their survival, realization of rights and freedoms.

Through the Government Office for National Minorities, the Government of the Republic of Croatia, next to other ministries, directly implements all policies in the area of the rights of national minorities. The Program of the Government Office for National Minorities is directed at the affirmation of the rights of national minorities and elimination of all forms of discrimination. It is important to point out that members of national minorities realize most ethnic rights through regular institutions of the Republic of Croatia, just like the majority Croatian people. In such a way they are protected against assimilation and ghettoization and enabled to have cultural and ethnic identity with the aim of their social inclusion.

The Constitutional Act on the Rights of National Minorities improved the rights and position of the members of national minorities in the Republic of Croatia, and at the state level introduced the Council of National Minorities, whose purpose is to enable participation of national minorities in public life and election of councils and representatives of national minorities at the levels of counties, towns and municipalities. The Government Office for National Minorities is continuing with the activities relating to the implementation of the Constitutional Act in the part relating to councils and representatives of national minorities, and is planning to hold 20 seminars that will be organized for the purpose of providing information to regional and local self-government about the manner of work and about ensuring conditions for work of the councils, as well as their mutual co-operation. Apart from these seminars, seminars will also be held about the implementation of international documents important for the improvement of the rights of national minorities, which were ratified by the Republic of Croatia. From 20 to 21 September 2004, Cavtat was the host of a seminar on the implementation of the Framework Convention for the Protection of National Minorities, at which the participants discussed the report submitted by the Government of the Republic of Croatia to the Council of Europe in March 2004.

The Opinion of the European Commission on the application of the Republic of Croatia for membership of the European Union states that special attention should be paid to social inclusion of national minorities, especially the Serb and the Roma national minority.

The Government of the Republic of Croatia, with the aim of realizing the rights guaranteed by the Constitution and the legal system and eliminating all forms of discrimination adopted the National Program for the Roma in 2003. The Government of the Republic of Croatia founded a Commission for Monitoring the Implementation of the National Program for the Roma, headed by the Deputy Prime Minister of the Republic of Croatia, Mrs. Jadranka Kosor. The National Program for the Roma wishes to help the Roma population by a series of short-term, mid-term and long-term measures with the aim of improving their living conditions, and is trying to ensure equality of the members of the Roma national minority with other citizens of the Republic of Croatia. In accordance with the National Program for the Roma, the Office is educating representatives of the Roma population about participation in the decision-making process, realization of rights, their rights under the Convention on the Elimination of All

Forms of Discrimination against Women, Convention on the Rights of the Child and other international standards and more intensive participation in social life.

Based on the measures in the National Program for the Roma, research "The Roma in Croatia: Assimilation or Integration" will be carried out, seminars about the affirmation of the Roma population in the media will be organized, and the Roma will be informed about the negative effects of stereotypes and prejudices, a round table will be organized about the manner of promoting positive aspects and equal reporting about the Roma, with the representatives of the media and the Roma population.

For the purpose of implementing the measures contained in the National Program for the Roma, it is necessary to provide the following funds in the Government Office for National Minorities: in 2005 - HRK 2.630.000, in 2006 - HRK 3.500.000, and in 2007 - HRK 4.500.000. The funds also have to be put aside for the said implementation in other competent ministries in charge of the implementation of the National Program for the Roma.

The Republic of Croatia also began to prepare the Action Plan "A Decade for the Roma from 2005 to 2015", which covers the areas of education, employment, health care and housing. The Action Plan for the Roma is an obligation of the Republic of Croatia, just as the National Program for the Roma. The Government of the Republic of Croatia will determine the text of the Action Plan "A Decade for the Roma" by the end of this year.

The measures to be implemented in the course of the Decade will ensure better living conditions for the Roma: their settlements will be supplied with water, electricity, the sewage system and access roads, they will be provided free pre-school education, better access to the overall education system, better health care, especially for women and children, and better employment opportunities.

4.4. Public Administration Reform

The 2004 National Program for the Integration of the Republic of Croatia into the European Union mentions administrative strengthening for the implementation of the reforms as one of five priorities for 2004.

One of the strategic mid-term goals of the Government of the Republic of Croatia is the reform of public administration. The objective of Government policy in the area of public administration reform is to develop an efficient system of public administration that will be oriented towards citizens, decentralized, transparent, and capable of meeting EU administrative standards. That would include the development of modern electronic operation (e-government).

The overall strategy for public administration reform has still not been developed, but measures for its adoption have been taken. The Government of the Republic of Croatia formed the Commission for Harmonization of State Administration with European Standards in March 2004. The Commission has the task of developing the Program of Harmonization of State Administration with European Standards. The Program needs to determine the bases for creating an efficient system of state administration, meaning its organizational framework, methods of work and human resources.

In the area of state administration reform, the Government has undertaken a number of activities with the goal of upgrading the efficiency of state administration. From the moment of adoption of the new Act on the Organization and Competence of Ministries and State Administrative Organizations (in 2003), by which the number of ministries was reduced from 19 to 14, and the Act on Amendments to the Act on the Government of the Republic of Croatia (in 2003) and the Act on Amendments to the Act on Organization and Competence of Ministries and State Administrative Organizations (in 2004), by which central state administrative offices were formed, the process of consolidating the central bodies of state administration was performed very quickly. In January 2004, the Regulation on the Principles of Internal Organization of State Administrative Bodies, by which the provisions on quotas regarding the number of civil servants in internal organizational units were revoked, and which significantly contributed to more efficient internal organization and better organization of work in the bodies of state administration, was amended, and ordinances on internal organization of the ministries and other central bodies of state administration were passed.

The General Government Administration Office was formed. It is competent to take the so-called "horizontal" measures, that is, measures relating to the overall system of state administration, that is, local and regional self-government and relations amongst public servants. By the implementation of such measures, the General Government Administration Office creates preconditions for upgrading the administrative capacity of all bodies of state administration and local and regional self-government services.

The present structure of state administration is comprised of the central bodies of state administration and of the first-instance bodies of state administration. The central bodies of state administration are the ministries, central state administrative offices and state administrative organizations. The mentioned legislative amendments organize the following:

- **14 ministries** (Ministry of Foreign Affairs, Ministry of Finance, Ministry of Defense, Ministry of the Interior, Ministry of Justice, Ministry of the Economy, Labor and

Entrepreneurship, Ministry of the Sea, Tourism, Transport and Development, Ministry of Agriculture, Forestry and Water Management, Ministry of Environmental Protection, Physical Planning and Construction, Ministry of Health and Social Welfare, Ministry of Science, Education and Sports, Ministry of Culture, Ministry of the Family, Veterans' Affairs and Intergenerational Solidarity, Ministry for European Integration),

- **4 central state administrative offices** (Central State Administrative Office for Public Administration, Central State Administrative Office for e-Croatia, Central State Administrative Office for State Property Management, Central State Administrative Office for the Development Strategy), and
- **8 state administrative organizations** (State Geodetic Directorate, State Weather Bureau, State Intellectual Property Office, State Bureau of Standards and Metrology, Central Bureau of Statistics, State Inspector's Office, State Office for Protection against Radiation, State Directorate for Protection and Rescue

The first-instance bodies of state administration are **central state administrative offices**, which are organized for the performance of state administrative duties in the areas of the units of regional self-government or counties. There are 20 central state administrative offices in the counties (in each county there is one central state administrative office).

Regarding the first-instance bodies of state administration (central state administrative offices in counties), preparations are in progress for the adoption of a new Regulation on the Internal Organization of Central State Administrative Offices in Counties. The objective of the Regulation is administrative strengthening of the services performing economic activities, particularly activities relating to decision-making in matters where citizens are enabled to launch economic activities (the opening of businesses, location and construction permits, use permits, etc.). In that regard, an extensive analysis was carried out of the way in which central state administrative offices in counties operate in order to re-distribute the existing human resources.

A detailed analysis is in progress of the way in which the competent authorities conduct state administrative activities at the level of central and first-instance bodies of state administration. The objective is to decentralize such activities to local and regional units, as well as to re-distribute the activities amongst the central bodies of state administration and the central state administrative offices in counties as first-instance bodies of state administration. The analysis is being conducted in co-operation with all bodies of state administration in order to determine what activities may be decentralized to local units, as well as the activities to be re-distributed amongst the said administrative levels of state administration.

Further activities in the area of public administration reform with the aim of modernizing public administration and approximation to the European standards were continued as part of the CARDS 2001 project - support to the public administration reform, which has three components:

- modernization of the legislation regulating civil service,
- strengthening of the organizational capacity of the Central State Administrative Office for Public Administration and other state administrative bodies for the implementation of reform measures,
- development and establishment of a system for educating civil servants.

The prepared proposal of the new Civil Service Act will be forwarded to the Croatian Parliament for adoption in the fourth trimester of 2004.

The main objectives of the new Civil Service Act are:

- ensuring more expert administration by clear separation between political and administrative positions;
- ensuring a uniform system of planning employment in state administration with the aim of ensuring planned and cost-efficient use of budgetary funds;
- improved and more transparent methods and practice of administration of civil servants, including employment, selection, career management, promotion and salaries.

In the area of development of the system of education of civil servants, the Central Government Office for Public Administration formed the Centre for Professional Training of Civil Servants. The Strategy of Professional Training of Civil Servants has been developed, and it is in the adoption procedure. The Centre however is not fully operative yet. It is not completely equipped or manned. The European Commission issued a public tender for technical equipment in June 2004, which was published in the Official Journal of the European Commission and on the web pages of the European Commission. However, nobody applied and it will be repeated.

Measures Planned for the Period 2005-2007

Further Government goals and measures regarding public administration reform were partly defined in a document adopted by the Croatian Government in July 2004: "Requirements of the Republic of Croatia for Foreign Assistance in the Process of Admission to the EU in the Period from 2004 to 2006". The document includes an analysis of the situation in specific sectors and Croatia's priorities with respect to foreign assistance. In the area of public administration, the document specifies as priority, which will at the same time contribute to the strengthening of administrative capacity in the framework of public administration reform, the following measures:

- development of an overall strategy for public administration for the purpose of preparing its reform;
- preparation and acceptance of the new Civil Service Act to improve human resources management in public administration and increase transparency of the system,
- strengthening of human resources in public administrative bodies, including the engagement of human resources and supply of technical equipment in the Central Government Office for Public Administration,
- strengthening of the Centre for Professional Improvement and Training of Civil Servants;
- preparation, organization and implementation of the training of civil servants in the area of application of information technology and equipment,
- establishment and operation of public information services in accordance with the principle of freedom of access to information,
- determining of the model and solutions for mutual connections between information systems of the bodies of state administration through a uniform telecommunication network in order to strengthen the role of electronic administration in the development of economy,
- strengthening of the system of co-ordination and decision-making, with emphasis on the procedure of analyzing the effect of laws and other regulations.

The objectives and measures of the Government of the Republic of Croatia in the area of public administration reform are included also in the Operative Plan of Implementation of the Program e-Croatia 2007, which was adopted by the Croatian Government in June 2004. This

document follows out of the guidelines of the program e-Europe and the obligation of the Republic of Croatia assumed within the framework of eSSE initiative under the auspices of the Stability Pact. The plan anticipates the following measures with respect to public administration reform:

- informatization of the state administration offices in counties;
- development of a plan to educate civil servants and employees in state administration about information technology;
- establishment of a system for the exchange of experiences and co-ordination of activities amongst IT experts employed in state administration;
- adoption of a new Regulation on Office Operations (adapted to electronic functioning of the administration);
- the project of preparing, forming and publishing in electronic form the official forms of state administration that citizens and business entities may submit by public telecommunications network;
- the structure, form and the rules of action of the central informatically supported register of civil servants.

Within the framework of CARDS projects, the plan is to further implement public administration reform with project goals, and their implementation is expected some time before the end of 2006:

- continued development of the legislative framework for relations between civil servants, especially subordinate legislation, and support in the implementation to the bodies of state administration;
- strengthening of the efficiency, responsibility and transparency in public administration by developing an institutional framework of public service and administrative procedures in accordance with EU standards;
- development of horizontal education of public services in state administration;
- strengthening of the overall institutional and legislative framework connected to the decentralization of state administration;
- support to the bodies of central state authorities in monitoring and coordinating the process of decentralization;
- strengthening of the capacity between civil servants at lower local levels, especially in the counties.

As part of the Programmatic Adjustment Loan (PAL) granted by the World Bank, Croatia plans to take further measures in the area of public administration reform in order to further strengthen administration with emphasis on measures for reducing the size of public administration and promoting its efficiency:

- implementation of functional revisions with the aim of rationalizing organizational structures, adopting new rules on internal organization and accordingly adjusting the procedure for employment of human resources (from 2004 /pilot projects/ to 2006) */presently pending the procedure of selecting an expert team/*
- assessment of the system of salaries and remuneration for the purpose of revising it in order to make the system of awards in state administration more consistent, introducing transparency in the system of salaries and awards and introducing more elements based on merits and work (anticipated in 2004) */presently pending the procedure of selecting an expert team/*, and adopting a new Act on Salaries in Civil Service (anticipated in 2005, and the beginning of implementation of laws anticipated in 2006)

- adoption of amendments to the Standing Orders of the Government of Republic Croatia, according to which the assessment of the fiscal, social and environmental impact of the proposed policies and laws becomes mandatory, and by which the standard methodology for the evaluation of fiscal impact, for immediate implementation, is accepted (adoption of amendments to the Standing Orders is planned in 2004, and the assessment of the fiscal impact of all proposed policies and laws and the test introduction of methodology for assessing social and environmental impact is planned in 2005, while complete implementation of all mentioned methodologies is planned in 2006)
- re-integration of the position of ministry secretary and assistant minister in state service (planned in 2005)
- adoption of subordinate legislation about the system and classification of work posts (planned in 2005)
- establishment of units for human resources management in ministries and administrative units employing more than 50 employees (planned in 2005)
- adoption of the Plan to reduce the number of civil servants in public and state administration (planned in 2005, and implementation of the Plan in 2006)
- adoption of new legislation on the conditions for employment in public service, including provisions on collective negotiating.

The activities and measures anticipated in the area of public administration reform included in the said documents of the Government of the Republic of Croatia "Requirements of the Republic of Croatia for Foreign Assistance in the Process of Admission to the EU in the Period from 2004 to 2006" and the Operative Implementing Plan for the Program e-Croatia 2007 for 2004, as well as the institutional measures for further reform of state administration will be established in detail in the Strategy for the Reform of Public Administration and operative plans for its implementation.

4.5 Agriculture Sector

In view of the unfavorable structure of agricultural farms in the Republic of Croatia (small family farms and large inefficient agricultural complexes owned by the state), it is the goal of the agricultural policy to accelerate structural changes by increasing the amount of support for the implementation of the required structural policy measures - land policy, rural development, enlargement of family farms, diversification of activities on agricultural farms, increase of competitiveness of agricultural farms, development of manufacturing organizations, etc.

Institutional and administrative capacities will be strengthened and the institutional framework for the implementation of agricultural policy measures in accordance with EU requirements will be developed for the purpose of monitoring the situation, reforms and trends of the Common Agricultural Policy and gradual adjustment to the mechanisms of structural, market-pricing and trading policy of the EU.

Development of technical and market infrastructure is an important precondition for the improvement of competitiveness of the agricultural sector. Therefore, the proposal of the State Budget for 2005-2007 anticipates funds for investments relating to the development of the system of irrigation and drainage and the improvement of market infrastructure, especially in the part relating to the storing and distribution of basic agricultural products.

Special attention will be paid to the harmonization of the legislation in the area of safety and quality of food stuffs, as well as the strengthening of administrative capacities of the Food Agency and its services. This will contribute to the strengthening of the Croatian food sector, which will on fulfillment of EU standards enable the placement of products on the European food market.

One of the key measures in the period from 2004 to 2007 is to accelerate the process of finding solutions to the remaining issues relating to the ownership of agricultural land owned by the state and to the creation of conditions for the functioning of the agricultural land market. During the said period, agricultural policy measures will be directed at the development of the agricultural land market, improvement of the system of disposition with agricultural land owned by the state, enlargement of fragmented agricultural land and improvement of the protection of agricultural land. In order to accomplish the mentioned measures in 2005, it will be necessary to start with amendments to the Agricultural Land Act. Harmonization of land books and cadastre records with the actual situation in the field will be of paramount importance for the implementation of measures pertaining to the agricultural land policy. Activities in the forthcoming period will be directed at the strengthening of state administrative capacity to implement the system of disposition with agricultural land owned by the state, and in that regard activities have already begun on the establishment of an information system for disposition with agricultural land owned by the state. In addition, within the framework of bilateral co-operation with Sweden, the Project "Enlargement of Agricultural Land" was initiated, which will define the models of enlargement of agricultural land applicable in various parts of the Republic of Croatia.

In the past period, a major part of agricultural industry was privatized. Privatization of several remaining companies is in progress, and the process should be finished by the end of 2005.

It is the objective of Croatia's agricultural policy to transform the Directorate for Market and Structural Support in Agriculture into an independent Payment Agency as an institutional framework for the implementation of measures pertaining to the Common Agricultural Policy and administration of pre-admission structural funds in accordance with the EU requirements. In 2005, the framework of the future Payment Agency will be set and preliminary activities for its accreditation will be performed.

In parallel with the activities regarding the formation of the Agency, preparations on the establishment of an Integrated Administrative and Control System, as addition to the existing Register of Agricultural Farms, are also in progress. Activities in the period ahead will be directed towards the improvement of procedures of administrative control and inspection, and the establishment of the Geographic Information System (GIS) for controlling payment of support in agriculture.

In late 2003, the Ministry of Agriculture, Forestry and Water Management founded the Directorate for Sustainable Development of Rural Areas. The Strategy of Rural Development in the Republic of Croatia will also be adopted. In early 2004, FAO made proposals for its institutional organization and priority measures. In late 2004, activities were taken to establish the institutional and administrative system for the implementation of the SAPARD program - establishment of the SAPARD agency and development of the Rural Development Plan.

In 2005, activities will be undertaken to establish the Farm Accountancy Data Network (FADN) in accordance with the EU requirements. This instrument serves to evaluate the impact of the agricultural policy on the income of agricultural farms. Based on the sample of agricultural farms in the Republic of Croatia (taking into account the regional aspect, the aspect of size and type of production), accounting data will be gathered every year to calculate the structural and economic indicators and the agricultural policy's impact on the operation of agricultural farms.

In accordance with the provisions of the Wine Act, activities were undertaken in 2003 aimed at the formation of the wine cadastre. Three counties were selected for the beginning of this extensive job. For the purpose of initial screening in the three counties, the State Budget for 2003 has funds in the amount of HRK 2 million. With the progress of work in the three counties, and depending on the funds allocated for the purpose in the State Budget, the wine cadastre will also be launched in the remaining counties. It is estimated that the establishment of the entire wine cadastre will take three more years, that is, that in late 2007 the wine cadastre project in the Republic of Croatia should be completed.

With the aim of bringing veterinary legislation of the Republic of Croatia in line with the EU legislation, the veterinary service and inspection will be re-organized. Further activities will involve improvement of the system of controlling animal health, improvement of the system of veterinary-public health, construction and moving of the laboratory of the Croatian Veterinary Institute, as well as the accreditation of the laboratory, including its regional branch offices, the establishment and organization of regional branch offices of the Croatian Veterinary Institute (Križevci, Vinkovci, Split and Rijeka), specialized centers for discovering, preventing and eliminating animal diseases, depending on their frequency in the region (wild animal diseases, especially dangerous exotic infectious diseases, economically most important animal diseases), continuation of the process of identification and registration of animals and production of animal origin products, rationalization and building of veterinary border crossings and their accreditation by the EU Commission, improvement of

the implementation of animal welfare legislation, improvement of informatization in the veterinary sector, and ensuring of continuing education of veterinarians in the system of state veterinary service.

Regarding veterinary public health, the priorities are the appointment of state veterinary inspectors in approved structures for the production of animals and animal products, as well as changes to the system of collection for the performance of mandatory veterinary-health examinations and controls. With respect to the system of supervision of the health of animals, the priorities are changes to the policy of controlling the swine plague by termination of mandatory vaccination, certification of flocks free of tuberculosis, enzootic leucosis of bovines, brucellosis and other diseases, establishment of registers of all farms for breeding animals, as well as the establishment of an electronic data base on diseases of animals, and improvements to the protocol on gathering and standardization of data and reporting about the movement of diseases and health of animals.

In the phytosanitary area, the already commenced activities of reorganizing the existing service for plant protection and establishing the national plant protection service, which includes administration, inspection and diagnostics, will continue. The existing administrative unit in the Ministry of Agriculture, Forestry and Water Management will be reorganized by strengthening the department in charge of plant protection products and residues, which will also be responsible for future communication with the EC relating to issues of agricultural pesticides and residues, and another department that will be responsible for plant health issues and communication with the EC regarding the health of plants on the single market of the EU. The present Plant Protection Institute will be also be reorganized, as it will have the role of an executive agency. In all phytosanitary segments, intensive efforts will be made on administrative strengthening.

With the aim of boosting the efficiency of work of the agricultural inspection, inspection structures will be re-organized and strengthened in order to achieve a higher degree of protection of legislation and harmonization with EU standards. In addition, human resources in ancillary services will be trained to perform analyses that will have to be carried out in order to bring Croatian legislation in line with the EU requirements (Croatian Institute of Plant Protection in Agriculture and Forestry, Croatian Institute of Viticulture and Enology, Institute for Soil, Institute of Seed and Seedlings, and the Institute for Pomology), and their laboratories will be adequately equipped.

The World Bank is giving support to the reforms through the PAL program that deal with the preparation of a Strategy for improving the business results in the agricultural sector, and for privatizing agriculture companies.

4.6. Other Reforms

4.6.1 Health Care Reform

Health care reform and improving the health of the population

The Ministry of Health and Social Welfare founded a working group with the task of developing a Health Care Development Strategy for a period until 2015 for the purpose of improving the organization of health care and the protection of health in general. The working group has ten working sub-groups that are working on a strategy to develop the most important organizational units divided into implementing sub-programs.

Privatization of the offices of primary health protection has been under way since 1994. Its objective is to introduce market relations and improve availability of the overall quality of services. The basic principle of privatization of the offices of primary health protection was lease by doctors. The doctor lessee would conclude a contract with the Croatian Health Insurance Fund. Until now, 70% of the offices of primary health protection have been privatized. With the aim of improving primary health protection and adapting it to the conditions in health care, the following measures are planned:

- Finish the process of privatization by lease as soon as possible, enable purchase of the offices, provided that the purchaser continues to perform the activity in question, provide credit facilities for renovation of the offices, and accelerate the process of informatization.
- Enable mandatory specialization and a substitute doctor for the duration of the education, ensure more intensive professional engagement of the doctor by introducing payment for services now regarded as specialized, introduce continuing education of doctors and other medical staff, encourage preventive examinations and education about health.
- Allow more than one community health centre per county, increase the number of teams in primary health protection, introduce "found holding" for family medicine.
- Introduce mandatory free preventive dental examinations and introduce payment per dental service.

Policlinic council health protection frequently and unnecessarily replaces primary health protection, resulting in a large number of examinations and long waiting lists. After the screening of the waiting list situation, a program will be prepared that will lead to shorter lists by including, amongst other methods, private offices based on public tenders.

Re-organization of hospital health care began in 1990 when the issues of ownership and operation were determined, but the re-organization proceeded very slowly, so that today it is organizationally falling behind the expertise and quality of work of health care workers. According to operative indicators, hospital health care is characterized by long hospital stays and low incidence of daily hospital. Hygiene is not satisfactory, there are too few investments and there is no uniform development strategy for Croatian hospitals. In addition, hospitals are not licensed for specific medical procedures, and there are no protocols for medical procedures. Supervision of the work of hospitals is sporadic and not efficient enough, that is, there is no systematic access to the supervision of the work of hospitals. The following activities are performed with the aim of improving hospital health care:

- Categorization and accreditation of hospitals and increase of the share of daily hospital in overall work. Efficiency, flow and quality of treatment will thus improve.

- Systematic access to supervision of the work of hospitals through co-operation between the Ministry of Health and Social Welfare and professional chambers.
- Development and adjustment of the strategy for hospital renewal, construction of new hospitals, renewal of old equipment, improvement of hygiene, and better supply with expandable medical materials and medicaments.

Defining and determining the number of required resources in health care

The total of 4,296,955 insured persons, and of that number less than 1/3 actively employed, had the right to health protection out of basic health insurance in 2003.

The health care system is financed out of three sources: out of the budget of the Croatian Health Insurance Fund, the budget of the Ministry of Health and Social Welfare, and out of the budget of the units of regional self-government or counties (decentralized funds intended for investments in health care).

The Croatian Health Insurance Fund provides basic and supplementary health insurance. In 2003, 96.47% of the budget of the Croatian Health Insurance Fund was allocated for settling the costs of basic health insurance, while 3.53% was allocated for settling the costs of supplementary health insurance.

The costs of the Croatian Health Insurance Fund may be divided into two groups: the costs for health protection, which represented 82.84% of all costs in 2003, and the costs for remuneration and other costs, which represented 17.16% of all costs of the Croatian Health Insurance Fund in 2003.

Most costs for health protection are the costs for hospital health protection (35.13%) and the costs for prescription medicaments (21.34%). The quarterly calculation for the first three months of 2004 shows increased spending in the health care system on medicaments, expandable medical materials, capital investments and gross salaries and remuneration, while the obligations of hospitals in the first quarter of 2004 in comparison to the same period in 2003 rose by almost 40%.

With the aim of stabilizing the system of health care and health insurance, and improving fiscal discipline in the system of health care and health insurance, and with the expected result of decreased share of overall spending on health care in GDP and settlement of debts in the health sector without reducing the rights out of health insurance and preserving high quality health services, the Ministry of Health and Social Welfare developed a proposal of short-term and long-term measures, of which the most important ones are as follows:

- Reducing expenditure on medicaments by accelerating the procedure of medicament registration, increasing the share of generic medicaments on the list of medicaments, implementing contracts with limited spending, restrictions on prescriptions, and introducing participation on medicament costs
- Reducing hospital costs by introducing new elements in contracting specialized-council and hospital health protection, establishing responsibility of hospital management for business results, segmenting the hospital budget according to organizational units and introducing monthly analyses of business by organizational units of the hospital

- Amendments to the Health Insurance Act with amendments to the basic package of health services of the Croatian Health Insurance Fund and restructuring of supplementary health insurance
- In addition, the Ministry plans to improve the system of payment which is based on work results under the contract concluded between the Croatian Health Insurance Fund and the medical institution or private health care worker, the system of supply with medicaments and expandable materials, and to reduce costs by outsourcing and service contracting, etc.

In comparison to the countries of the European Union, the Republic of Croatia has one of the lowest rates of the number of doctors of medicine on 100,000 inhabitants. This piece of information is worrisome, because the number of unemployed doctors of medicine in the Republic of Croatia fell to 250 in June 2004 (in December 2002, it was 700), of whom more than 80% were registered in one of the three big urban centers. At the same time, in primary health protection there was a need for 170 doctors of medicine (mostly in rural areas), so more than 400 specializations for doctors of medicine were approved in 2004. Consequently, the Ministry of Health and Social Welfare assumed an active role in human resources management, especially with respect to doctors of medicine who are the bearers of the treatment process, in order to ensure an adequate number of doctors of medicine in all areas of the Republic of Croatia and ensure equal availability of health protection to all citizens, regardless of the place of residence.

One of the ways to manage resources in the system of health care, but also to increase efficiency and speed of work, and the control of work is informatization. The Health Care Computerization Program in the Republic of Croatia is being carried out in several segments. The first two that are presently under way are primary health protection informatization and hospital informatization. Primary health care informatization has already undergone the pilot phase, and is presently in the phase of delivery of the central information system and the equipping of offices with computer equipment. It is planned to finish the informatization process of primary health protection by the end of 2005 and to introduce electronic commerce between doctors of primary health protection and insurers. The informatization project at the hospital level is in the phase of application analysis, so it is planned to proceed with hospital informatization following the informatization of primary health protection. Both systems will be connected through the central information system, and access to data in the central information system will be available next to the insurers and providers of health services also to the Croatian National Institute of Public Health, the Ministry of Health and Social Welfare and other interested parties in accordance with their powers.

Process of harmonization of public health legislation with the EU, situation and plans

The area of health care that the European Union is most interested in regulating at the Union level is the area of public health (specifically: infectious diseases, use of tobacco, etc.), and which is regulated by special laws.

- The Act on the Protection of the Population from Communicable Diseases establishes the system of supervision of infectious diseases. Its legislative basis is eradication of infectious diseases. The Republic of Croatia, by respecting the recommendations and guidelines of the European Union, is working on the adoption of a new act which would define diseases in line with the European Union legislation. It should be pointed out that the proposal of the act extends the list of infectious diseases to 81 infectious diseases and the states of carrying antibodies, and that the Republic of Croatia

included SARS amongst infectious diseases. The adoption process for this act should be completed by 30 June 2005.

- In June 2004, Croatia signed the Convention on Control of Tobacco Products. Maximum permissible values of nicotine, tar and carbon monoxide in tobacco products are in line with the EU Directives, specifically with the Ordinance on Conditions regarding Sanitary Health of Tobacco, Tobacco Products and Smoking Requisites.

According to the said Ordinance, cigarettes may not have more than 10 mg of tar, 10 mg of carbon monoxide per cigarette.

- Regarding blood quality, the competent authorities have prepared a proposal of the draft of the Blood Supply Act, which is fully in line with the EU Directives relating to transfusion (Directive 2002/98/EC; Directive 2001/83/EC)
- The Act on the Extraction of Human Body Parts for Transplantation Purposes, which is in the process of adoption (by the end of 2004) anticipates a number of subordinate legislative deeds that will regulate in more detail the area of quality and safety of tissues and cells, *inter alia*.

In the period 2005-2007, it is planned to prepare subordinate legislation that would regulate in line with the EU Directives on the quality and safety of human tissues and cells the area of gathering, preserving, processing, storing and granting human tissues and cells, as well as determine standards to ensure their safety and quality, and define the system of accreditation and supervision of the banks of tissues and cells.

Investments in health care

The Republic of Croatia reserves funds in the State Budget for investments and investment and everyday maintenance of health institutions it has founded - premises, medical and non-medical equipment and means of transport, and informatization of health care, in accordance with the plan and program of health protection measures in the basic health care network.

The Republic of Croatia is the founder and owner of health institutions at the tertiary level of health activities, such as clinics, clinical hospitals, clinical hospital centers and state health institutes. The Republic of Croatia provides funds for investment maintenance of hospitals and investment maintenance of all health institutions founded by counties or towns, and which are located in the areas of special state concern.

Health institutions founded by the units of regional self-government, such as community health centers, institutions for emergency medical assistance, un-privatized institutions for health care, un-privatized pharmacies, hospitals, health resorts and general and special hospitals receive funds/investments from the units of regional self-government in accordance with the plan and program of health protection measures in the basic health care network.

Once a year the Government of the Republic of Croatia passes a decision on measures required to maintain the standard elements of investments, investment and everyday maintenance, and informatization of health care.

4.6.2. INFORMATION AND COMMUNICATION TECHNOLOGIES

Strategy of development and investments in the infrastructure of electronic communication

In 2002 the Government of the Republic of Croatia adopted the strategy "Information and Communication Technology - Croatia in the 21st Century" (Official Gazette No. 109/2002). The Strategy describes the role of information and communication technologies in overall development and the orientation of the Republic of Croatia towards the development of information society.

The results of implementation of the Strategy until 2003 are included in the National Report on the Implementation of the Strategy Information and Communication Technologies - Croatia in the 21st Century for 2002 and 2003. The implementation of the Strategy in 2004 is included in the Plan of Implementation of the Strategy Information and Communication Technologies for 2004.

The Program "e-Croatia 2007" is one of the priorities of the Program of the Government of the Republic of Croatia in the 2003-2007 mandate. It encourages the development of science, technology and information technology and stimulates entrepreneurship based on knowledge. Its goal is to transform Croatia into a society of knowledge on the basis of efficient application of information technology. The priorities of the Program are:

- (a) informatization and restructuring of state administration to become transparent, fast and efficient service;
- (b) establishment of a network system that will enable all citizens to use the services of public administration, health care, schools and the justice system via Internet;
- (c) informatization of educational and scientific-research institutions and improvement of overall computer literacy;
- (d) encouragement of efficient application of information and communication technologies to increase productivity and competitiveness of the Croatian economy.

Based on the Program, the Government adopted the implementing document "Operative Plan of Implementation of the Program e-Croatia for 2004". The central guidelines of the plan are the introduction of systematic monitoring and measuring of the results of implementation of the implementing documents, the application of European and international standards in the area of information technology, the establishment of common computer communication infrastructure for state administration and of the framework for inter-operability of information systems and computer-communication equipment in state administration, the establishment of joint criteria and recommendations for the security of data and computer-communication network, and the establishment of a technological basis for efficient personal data protection, incentives to the development of information society services with the application of electronic signature infrastructure, especially in the area of public services to citizens and enterprises.

Defining the need to establish electronic communication with the aim of complete harmonization with the EU

The legal framework for the development of information society is set in the Telecommunications Act (Official Gazette No. 122/03), the technical legislation, intellectual property rights, the right to protection of personal data, the right of access to information and the legislation on electronic trading.

The regulation of international relations in the area of information and communication technologies is connected to the implementation of the Convention on Cyber Crime of the Council of Europe signed by the Republic of Croatia on 23 November 2001 (Official Gazette - International Treaties No. 9/02).

The Republic of Croatia also signed the eSEE Agenda on co-operation in the area of development of information society in South East Europe within the framework of the Stability Pact.

With the aim of diminishing the distance between the Republic of Croatia and the EU and creating conditions for efficient functioning of both private and public sectors, the Republic of Croatia opted for the following priorities in the area of development of information and communication infrastructure:

- (a) adopting secondary legislation necessary for the continuation of liberalization of the telecommunications market and efficient regulatory control;
- (b) modernizing the telecommunications network as an infrastructural precondition for the availability of advanced services of information society;
- (c) ensuring open and universal access to the public telecommunications network;
- (d) enabling access to the Internet with broadband transfer of data at accessible prices;
- (e) encouraging the use of information society services (especially of under-represented social groups, for example young people and the elderly, persons with special needs, and women).

Incentives and funds for informatization in the area of public services (schools, scientific institutions, E-Government and other) - situation and plans

If information technology is efficiently applied, modern information and communication infrastructure enables the development of new services based on knowledge (e-education, e-health care, e-business, e-banking, work at home, etc.). In the Republic of Croatia, the level of these services, their efficiency and quality are still below the EU standards. Therefore, the Government of the Republic of Croatia is working on the formulation of a dynamic policy and flexible mechanisms to stimulate the development of information-communication, business and financial services.

The Republic of Croatia systematically makes investments in the informatization of the educational system and scientific institutions. In the area of education, the indicators of development of information society (number of computers per student, availability and speed of access to the Internet) are below the EU level and it is essential to make further investments in school equipment, such as computers, and enable access to the Internet with broadband transfer of data. Priorities in the area include the training of teachers to use information and communication technologies in the teaching process and to create high quality teaching material in Croatian and in electronic form. Universities and scientific institutions are all connected to the Croatian Academic and Research Network (CARNet), and projects are pending which should enable free authenticated and authorized access to CARNet by the end of 2005 to all students living in student homes. In 2004, the project Gigabite CARNet, which raises the speed of data transfer on CARNet to 1 GBps, has entered its implementing stage. The GEANT access point has also been set up in Croatia.

In the area of health care, projects of informatization of primary and hospital health care have been initiated. The project of primary health care normalization is in its implementing phase, while the project of integrated hospital computer system is being revised based on the experiences from pilot implementation projects and is expected to continue in 2005. The project of the Croatian Health Insurance Fund on the introduction of smart-cards is also under way.

With respect to the establishment of state administration information services, a whole number of projects has been launched, which include e-justice, the information system of spatial data (cadastre and land books), and informatization projects of the customs and tax system.

Priorities in the period ahead are:

- (a) establishment of a safe common state administration computer-communication network;
- (b) establishment of the Information System Support Agency as institutional infrastructure for the integration of the state administration information system and the establishment of a central information portal about the work of public administration and public services on the Internet;
- (c) encouragement of the application of electronic signature infrastructure in public administration and the economy;
- (d) promotion of e-business at all levels;
- (e) establishment of mechanisms for systematic measuring and monitoring of information society development indicators in accordance with the monitoring methods used in the implementation of the Operational Plan e-Europe 2005 and EURSTAT standards;
- (f) stimulation of innovations and establishment of companies that will develop new technologies and services based on knowledge;
- (g) development of technological parks and incubators, with support to the companies active in the development and support to e-business, information society services and new technologies.

Planned budgetary funds for investments in information and communication technologies in 2004 are listed in Table 16.

Table 16 Projected investments out of the funds of the State Budget in information and communication technologies for 2004 (*assessment under the presumption that the investments in computer equipment represent 40% of total investments on the budgetary account 4221)

State Budget 2004		83,410,142,292.00
3231	Telephone, postal service and transport	354,158,074.00
3238	Computer services	199,685,531.00
4221	Office equipment and furniture*	88,529,745.20
4123	Licenses	17,284,146.00
4262	Investments in software	73,885,279.00
Total IT activities		733,542,775.20
Share of IT in DP		0.88%

4.6.3 Regional Policy

Chapter VIII of the SAA recognizes regions and regional development as one of the most important areas in which co-operation still has to be intensified. Article 105 of SAA points out that co-operation between Croatia and the EU in regional development will be strengthened with the aim of boosting economic development and reducing regional inequalities.

In order to meet membership conditions, Croatia still has to define a clear strategic and institutional framework for its regional policy, which will ensure balanced development of Croatia's regions/counties.

Croatia still does not have a regional development strategy, although the framework goals of regional development are set in strategic documents of the competent ministries and the Government. Croatia's regions that will have priority in development are the areas afflicted by war, border areas, the islands, mountainous regions, and economically undeveloped areas. Nonetheless, the Government has still not established clear short- and long-term goals of regional development and chief priorities in regional development.

The institutional framework that would act as support to the regional policy is undeveloped. There are no coordinating authorities at the level of central, regional and even local units that should enable harmonization of the policies, instruments and management of regional development.

A territorial statistical division of Croatian regions in line with the EU NUTS standards is in the process of making. The existing 20 Croatian regions (and the City of Zagreb) are being brought in line according to the statistical definition of regions established in the NUTS standards of region categorization. Simultaneously with the determination of the territorial organization according to the NUTS categorization, the calculation of gross domestic product (GDP) in Croatian regions is being calculated.

Regional inequalities. There are specific priority areas (regions) to which the state has ensured tax benefits, direct support, subsidized loans, etc. These areas are the areas of special state concern, the islands, mountainous areas and border undeveloped areas. The degree of development of the areas has still not been determined at the level of central state, just like the size and structure of development needs, and this prevents the implementation of relevant policies and implementing instruments.

Legislation. The existing legislative framework does not include laws or subordinate legislation specifically relating to regional development. True, there are numerous laws and subordinate legislation, but which are not mutually harmonized and which define territorial organization, financing, distribution of powers, etc. However, the existing legislative framework does not enable the competent authorities to determine and execute a harmonized policy of regional development.

Financing. In mid 2001, the process of fiscal decentralization began in Croatia. The state transferred the powers for the financing of primary and secondary education, health care and social welfare, and provided financial means for their financing. In addition, the state provides funds for undeveloped local units through direct support out of the state budget. Unfortunately, three years after the beginning of implementation, the actual fiscal and

economic impact of the Government measures is not known. No analysis and evaluation of the regional inequalities and the effect of financial incentives of the state to the local units have been made.

Regional Development Fund. On 1 January 2002, the Regional Development Fund was founded with the aim of active support to regional development in projects financed out of the state budget. The Fund was founded for the purpose of encouraging uniform regional development in the areas of special state concern, the islands, mountainous regions, especially those with GDP lower than 65% of the average GDP in Croatia. The Fund still does not actively participate in the financing of regional programs and projects financed out of the EU funds. Despite participation in the financing of capital and development projects at the level of regions and local units, the role of the fund has still not been completely clearly defined.

For the purpose of leading a uniform regional development policy, Croatia has to take a number of measures aimed at adjusting the institutional framework for leading an active regional policy.

Defining the strategy of regional development. The Government document titled Principles of Development of the Republic of Croatia, which is a component part of the Development Strategy "Croatia in the 21st Century", states that regional development should take into account regional differences in the Republic of Croatia. The Government program 2004-2007 mandate defines the main objectives of regional development: uniform development of all regions, sustainable use of resources and social cohesion. The development strategy establishes that regional policy has to be gradually decentralized, so that the regions would assume responsibility for the implementation of regional policies. The strategy provides general guidelines for defining regional policy. However, the strategy of regional development that would establish priorities, define the institutional framework, and the implementing mechanism still has to be developed.

The Regional Development Directorate with the Ministry of the Sea, Tourism, Transport and Development (MMTPR) is developing the National Regional Development Strategy and the connected Operational Plan (within the technical assistance program CARDS 2002 "Strategy and Strengthening of Capacities for Regional Development"). The Ministry will prepare the draft of the National Regional Development Strategy by October 2005 in co-operation with all relevant partners (other state administration bodies, regional and local self-government, economic-social partners and non-governmental organizations). In addition, the MMTPR has to prepare a proposal of the act on regional development, presently being worked on in parallel with the Strategy. The proposal of the act should also be prepared by October 2005.

Evaluation of the impact of fiscal decentralization. Following the adoption of the new Act on Local and Regional Self-government, in 2001 Croatia established the framework for structural policy in line with the EU standards. The actual decentralization process, consisting of the transfer of powers and fund sources to the local units, began in mid 2001. The central state decentralized the functions of primary and secondary education, health care and social welfare to the local units (counties, municipalities and towns). For the purpose of uniform development of the local units the state provided funds in the state budget granted in the form of support, but the granting criteria are only generally established. In regional financing, the areas of special state concern, undeveloped local units on the islands and in mountainous areas have priority. Additional funds were provided by dividing of tax between the state and the local units. The problem is that the mechanism of fiscal leveling is not based on a good

evaluation of fiscal inequalities and the established fiscal position of the local units that would take into account quality calculations of fiscal and economic inequalities. Therefore, the Ministry of Finance has to conduct an analysis of the effects of fiscal decentralization on regional development in co-operation with scientific institutions. The undeveloped areas of Croatia, which have to be supported and developed more strongly, have to be particularly determined. Implementation of the project of analyzing the effects of fiscal decentralization should be harmonized with the institutions performing GDP evaluations and a new proposed statistical definition of the area according to the NUTS 2 categorization.

Preparation and adoption of the Regional Development Act. The Act should determine conditions of support to regional development with the main task of reducing regional differences. The Act will be a legislative framework with the established roles and responsibilities of the institutions for financing and implementation of regional policy goals. The Act should define regional organization and establish areas to which the state will provide more economic incentives and ensure uniform development.

Adjustment of the institutional structure. The main institutions dealing with problems of regional policy are the Government, the ministries (Ministry of the Sea, Tourism, Transport and Development, Ministry of Finance, Ministry of Justice, Administration and Local Self-government, Ministry of Environmental Protection and Physical Planning, and other ministries), and the Regional Development Fund. The ministries, in line with their competencies, are directly responsible for the development of regional policies, preparation, evaluation and implementation of development programs at the level of county/regions and local units. The activities are performed in co-operation with the counties/regions or county departments in charge of defining and harmonizing development policies in their area of responsibility and preparing programs and plans for regional development. Development programs are financed and implemented and development plans prepared out of the budget of the counties and local units. There are 30 additional institutions, entrepreneurial centers (offering support to small and medium size enterprises, agencies for local economic development, etc.), which entered into partnerships and co-financing with governmental institutions. However, co-ordination of the activities of the said institutions and co-ordination of implementation of the programs and projects between the ministries, regions and local units is insufficient.

There are no administrative bodies that would co-ordinate policies at the level of central state, county and local units and enable the sharing of information essential for national and regional development, and it is necessary to establish:

- Government Regional Development Office for daily management of regional development, and co-ordinate the preparation of the National Regional Development Policy, define the main guidelines for the preparation of regional plans, and participate in the implementation of regional development plans.
- National Regional Development Agency as the main implementing body of the Government whose main task would be to co-ordinate the preparation of the program and promote regional policy with the aim of balancing regional development.
- regional development agencies at the level of regions/counties that will participate in the implementation of development economic strategies and in co-operation with the central national agency prepare and co-ordinate the preparation and implementation of county development programs.

It is necessary to improve inter-ministerial co-ordination, strengthen partnership structures and include all relevant partners in the planning process (the central authorities, regional and

local self-government, economic-social partners, civil society). Regarding this issue, within the framework of the project of making the National Regional Development Strategy, which is in progress in the Ministry of the Sea, Tourism, Transport and Development, an inter-ministerial co-ordination of groups, consisting of high-ranking representatives of 13 state administrative bodies, was formed. It is anticipated that for the time of duration of the CARDS 2002 project, it will have the role of its Managing Committee and maker of key decisions regarding the preparation of the National Regional Development Strategy and the connected Operational Plan, and of the legal framework for regional policy. In addition, it is anticipated that during the implementation of the project the group will undergo capacity strengthening and training in order to keep it functioning even after the completion of the project and prepare it to take over the role of programming and administering structural funds in the near future.

Adjustment of territorial organization. In accordance with the statistical classification in line with the NUTS standards, the State Bureau of Statistics made a proposal of the plan of territorial statistical organization. Working groups were formed that include representatives of the competent ministries. It was proposed to classify the existing 20 regions and the City of Zagreb into 5 geographical statistical areas with an average number of inhabitants per NUTS 2 (minimum 800,000 inhabitants). The State Bureau of Statistics is also working on the calculation of GDP per region/county. The State Bureau of Statistics will finish the job of calculating GDP for 2002 and 2003 in the existing counties until the end of 2005, but also in line with the NUTS 2 categorization. After the calculation is done and statistical divisions of the territory made according to NUTS 2, the state authorities will together with the EU Commission evaluate the uniformity of regional development and determine the intensity (size) of assistance.

4.6.4 Judicial Reform

The rule of law and legal security, as well as market economy cannot be achieved without an efficient and independent judiciary. An efficient judiciary is also of strategic importance for the realization of the interests and goals of the Republic of Croatia in the process of admission to the European Union. An efficient and unbiased judiciary in accordance with the European standards is the main goal that has to be achieved in the judicial reform.

The Government of the Republic of Croatia adopted the strategy of Judicial Reform in 2003. The Ministry of Justice set as priorities the regulation of ownership relations, reform of the bankruptcy procedure, simplification and acceleration of the enforcement procedure, development of criminal legislation, alleviation of the work load of courts, and faster processing of a large number of unsolved cases, education of judicial civil servants and employees, as well as informatization and capital investments.

Land books reform: The disorderly state of the land books is one of the biggest problems that make legal transactions and business operations between natural and legal persons in Croatia difficult. The obsolete and slow system of manual handling of the land books is inefficient, and so one has to wait several years to be entered as owner in the land books. The land book reform in Croatia began in 1997, and in 2002 the Project received support through a loan from the World Bank. The final objective of the new system of registering real estate is electronic keeping of cadastral and land book data and connecting into a uniform Land Book Data Base for the entire territory of the Republic of Croatia.

In 2004, the Ministry of Justice and the Croatian Geodetic Directorate concluded the Agreement on Organization and Operation of the Land Book Data Base of the Republic of Croatia. They prepared the Ordinance on the Land Book Data Base of the Republic of Croatia that regulates in more detail the organization and operation of the land book data base. The following measures and activities were taken for that purpose:

- monitoring of the application of amendments to the Land Book Registry Act,
- introduction of licensed land book clerks,
- introduction of standardized land book forms,
- the Ministry of Justice and county courts supervise the work of land book departments,
- informatization of land book departments,
- education of land book judges and land book clerks.

The measures and activities taken in 2004 will contribute to a reduction in the number of unsolved land book cases in courts with the largest work load. At the Municipal Court in Zagreb the number of cases will be reduced by 15,000 cases, at the Municipal Court in Split by 7,000 cases, at the Municipal Court in Rijeka by 2,800 cases and at the Municipal Court in Slavonski Brod by 1,300 cases. The backlogged unsolved cases will be processed during 2005 up to the end of 2007, by when the project of land book reform will be completed.

In the period from 2005 to 2006, all land book data will be transformed into digital form in all courts. In 2005, procedures started in 2004 for the reconstruction and establishment of land books in the areas where a new land survey had been carried out will be finished. All land books will be computerized by the end of 2007, and the manually handled land books will be closed. According to a decision of the Government of the Republic of Croatia, the land books for the area of the Neretva valley, the islands, the coastal regions and agricultural land will be put in order. In 2005, the project of registration of apartments in the land books and transfer of data from the book of deposited contracts into the Main Ledger will be performed for three pilot courts, and by the end of 2007 the registration of apartments in the land books will also be finished.

Bankruptcy procedure. In view of the large number of bankruptcy procedures, commercial courts are not able to process the cases speedily and efficiently. The Bankruptcy Act should be reformed in a way to enable creditors to take actual control over the bankruptcy procedure, introduce professional and qualified bankruptcy trustees that would be supervised by creditors, and eliminate the opportunity presently available to the debtor to stall the procedure, as well as to support the modern procedure of involuntary enforcement against unsecured claims. The Ministry of Justice is presently in the process of amending the Bankruptcy Act. The process should be completed in 2004. Judges, bankruptcy trustees and court clerks will undergo professional training.

Enforcement procedure. Municipal and commercial courts have too many enforcement cases. The Enforcement Act will for that reason be amended, and the adoption of the amended act is already in legislative procedure. The amendments will remedy many difficulties in implementing the enforcement procedure. The register of movables will also be formed.

Penal legislation reform. In July 2004, the Croatian Parliament adopted amendments to the Penal Act. The amendments to the Penal Act cover changes that bring substantive penal law in line with the international obligations assumed by the Republic of Croatia in the process of harmonization with international conventions. The existing incrimination of criminal acts has

been changed, and new criminal acts introduced in the area of environmental protection, exploitation of mineral raw materials and computer crime.

Further amendments to the Penal Code will relate to the issue of general and linear stricter repression, introduction of life imprisonment, extension of limitation periods, involuntary collection of fines, etc. The Government of the Republic of Croatia forwarded for legislative procedure the Proposal of the Act on Amendments to the Act on the Office for the Prevention of Corruption and Organized Crime (USKOK). The Proposal includes amendments relating to the security and strengthening of normative presumptions that would ensure the leading role of USKOK in the prevention of organized crime and corruption.

Measures for modernization and more efficient work of Croatian courts. A Twinning Project out of the program of technical assistance EU CARDS 2002 titled "Modernization of the Judiciary - Support to More Efficient and Modern Croatian Courts" began in 2004. This project is based on the joint work of Finnish and Croatian experts and judges. The goal of the project is to improve the efficiency of Croatian courts by introducing more efficient court administration and an integral system of court files management.

Modernization of the High Misdemeanor Court of the Republic of Croatia and selected misdemeanor courts, as well as support to a more efficient and modern Administrative Court of the Republic of Croatia are included in the CARDS 2004, for which proposals of projects have been approved.

The amendments to the Courts Act adopted in March 2004 increased the responsibility of judges during the performance of their official duties. The amendments to the Courts Act enable the president of the Supreme Court of the Republic of Croatia to transfer cases from a court that is not able to review a case and render judgment within a reasonable term, because of a large number of cases, to another competent court. The aim of this amendment is to alleviate the burden of courts with excessive case-load.

The amendments also expanded the powers of court councillors by authorizing them to independently conduct certain court procedures, evaluate evidence and establish facts. This amendment enabled acceleration of individual court procedures and court actions and alleviation of the work load of judges in the adjudication procedure.

The basic decisions and goals to achieve an efficient judiciary are as follows:

- reduce the number of unsolved cases and boost the working pace of courts,
- improve the organization of court work and informatization,
- raise the level of responsibility of judges, clerks and employees.

Measures for achieving the set goals:

- re-distribution of cases from courts with excessive work-load to other competent courts on the basis of a decision of the president of the Supreme Court of the Republic of Croatia (Article 10 of the Courts Act),
- increase of the number of court councillors, provided that the courts with the most excessive case-load have priority, so that the judges do not have to perform duties not requiring judicial knowledge and skills,
- supervision of the work of municipal courts by the Ministry of Justice and county courts, especially those where there is a large number of unsolved cases and against whose work there is a large number of complaints.

The measures will be implemented on a continuous basis and they have already begun in 2004.

The Ministry of Justice will prepare a new way of monitoring statistics about the work of courts by the end of 2004. The work of individual judges and court councillors will be separately monitored. New Framework Standards for the Work of Judges will be drafted in 2005.

Organization of court administration. With the aim of better organization of the work of courts, court presidents received greater powers, so that they could take measures to improve and make courts more efficient. Rationalization of the existing courts in view of actual and territorial competence will be performed in 2005, and an analysis of the work of small courts will also be made.

The Ministry of Justice supervises the work of courts in order to achieve a higher level of responsibility of judicial officials. The Ministry of Justice will appoint court inspectors. The amendments to the Act on the National Judicial Council will specifically include provisions regulating the disciplinary responsibility of judges. The amendments will be adopted in 2005.

Training of court clerks and employees. The Ministry of Justice founded a Judicial Academy. It has to be regularly attended by all judges as a requirement for promotion. In 2004 and 2005, the Judicial Academy will develop programs of training, as well as special programs for the specialization of judges and court attorneys.

Support to the training of judges and other judicial officials began in early 2004 as part of the 2001 CARDS program. The program will be completed at the end of 2005. The 2003 CARDS program anticipates training and education of state attorneys, and the application of the project is planned before the beginning of 2005.

Informatization. The goal of informatization is to develop a uniform judicial information system by establishing a uniform way of monitoring court registers, a single network, as well as uniform organization, in order to achieve faster processing and better control of cases, availability of information about cases and about court practice, as well as more efficient and faster work of court clerk's offices, registers and desks.

The Project establishing an Integrated Case Management System (ICMS), financed out of the support by the World Bank and the 2002 CARDS program of the European Union, is in progress. After technical specifications are prepared, computer equipment and other equipment will be acquired. This Project should be completed in 2006. The introduction of an this automated system of management will also be supported by the World Bank PAL program.

4.6.5. Environmental Protection

Based on the *Opinion of the European Commission on the application of the Republic of Croatia for membership of the European Union - AVIS*, with extensive work on the harmonisation of the legislation with the *acquis communautaire*, the administrative sector responsible for environmental protection will be institutionally strengthened at all levels and investments will increase, especially in the areas of waste management, waste water treatment and water supply.

The policy and the programme of the Government of the Republic of Croatia will give more importance to environmental protection and to the development of economically important sectors whose activities, following substantial investments, have to be brought in line with the high EU standards on environmental protection, and to more intensive integration of the environmental protection policy with the sector policies in early phases of their development. Significant progress will be made following the preparation of the Sustainable Development Strategy and the implementation of strategic environmental impact assessment for programmes, plans and strategies to be regulated in the new Environmental Protection Act (2006) and the implementing legislation. The Environmental Protection Council, formed by the Government of the Republic of Croatia in April 2004, is expected to contribute significantly. The ongoing CARDS projects also provide support to legislative harmonisation and horizontal co-ordination and to the strengthening of co-operation between the ministries, regional and local self-governing units and the private sector.

According to framework evaluations by the World Bank, Croatia will have to make substantially larger investments in environmental protection than now if it wishes to satisfy the EU standards⁵. The evaluation of the cost of harmonisation for the entire *acquis communautaire* of the EU along with financing plans will be made with the support of CARDS projects. Financing of environmental protection projects will be secured out of the public utility funds and remuneration, state budget, municipalities and counties budgets, extra budgetary funds (Fund for Environmental Protection and Energy Efficiency, Hrvatske vode), out of funds of business entities, private-public partnerships, loans foreign investments, and international assistance and donations. Significant progress has been achieved through the establishment of the Fund for Environmental Protection and Energy Efficiency, whose operation started with the beginning of 2004 and it provides additional funds for environmental protection. The first allocations from the revenues realised in 2004 (i.e. from the newly introduced environmental taxes that constitute the Fund's own revenue) were assigned to the rehabilitation of municipal waste disposal sites, while allocations in 2005 will be directed for environmental projects (ca. HRK 223 million) and energy efficiency and renewable energy projects (ca. HRK 77 million). New funding sources for environmental projects are the PHARE and ISPA pre-accession assistance programmes. Project proposals for PHARE 2005 have been developed (in the field of inspection control, air quality, safe chemicals management), while activities related to the development of the ISPA Environmental Strategy are underway, including also the development of potential investment projects for co-financing under the ISPA programme in 2005 and 2006.

⁵ The amount of capital expenditure on environmental protection (basic scenario) in a twenty-year period is estimated from 6.1 to 11.6 billion euro or from 1.390 to 2.680 euro per capita (69 to 134 euro per year), and of that 50% relates to the water sector and the remaining 50% to waste management, protection of air quality and application of the IPPC directive. *Source: Economic Memorandum for Croatia, July 2003.*

Horizontal Measures

The basic act regulating the area of environmental protection is the Environmental Protection Act (Official Gazette No. 82/94 and 128/99). The new Environmental Protection Act will be adopted in 2006 and will be brought in line with the *acquis communautaire* of the EU, especially in relation to:

- access to information, public participation in decision-making process and access to the judiciary in environmental issues,
- environmental impact assessment at the project level ,
- environmental impact assessment relating to plans, programmes, strategies and the legislation (strategic environmental assessment),
- integrated pollution control licences for new and existing production facilities and the eco-management and audit scheme (EMAS),
- environmental protection information systems,
- environmental protection contingency plans.

The Environmental Protection Report will be prepared in 2005 and it will contribute to the improvement of the environmental protection system and to more effective reporting on the state of the environment and on the results of the undertaken measures. The Sustainable Development Strategy will be developed until 2008.

Funds for the adoption and implementation of the planned measures in the period 2005-2007 will be provided out of the State Budget and other sources, and will amount to HRK 16.8.

During the process of harmonisation of the legislation with the *acquis communautaire* and capacity strengthening at the state, county and local level the competent authorities use the support of CARDS and REReP projects.

Air Quality And Climatic Changes

The legal area of the protection of air is regulated by the Environmental Protection Act, the Air Protection Act* (Official Gazette No. 48/95) and international agreements. The legal system of the Republic of Croatia has a number of special laws and other regulations that indirectly include measures for air protection. Harmonisation of the Croatian legislation with the *acquis communautaire* of the European Union is presently under way.

In accordance with the National Environmental Protection Strategy and the National Environmental Action Plan (Official Gazette No. 46/02), the following measures will be implemented in the forthcoming period:

- adoption of the Plan for Air Protection and Improvement,
- adoption of the implementing regulations,
- setting up of a quality system for continuous monitoring of air quality (the state network and local networks),
- categorization of state territory according to air pollution level,
- improvement of a national system for calculating the emissions of greenhouse gases and establishment of a register of the greenhouse gasses emissions and register of technologies for reduction of emissions
- setting up of the national programme for impact assessment and adaptation to climatic changes,

* The draft of the new proposal of the Air Protection Act is in adoption procedure. .

- setting up of a quality system for handling substances that damage the ozone layer, including their recovery, recycling and disposal.

The State Budget and other sources will provide funds in the amount of HRK 32.5 million for the implementation of the planned measures in the period 2005-2007.

Technical and financial support for legislation harmonisation, development of the Plan for Air Quality Protection and Improvement and establishment of part of the national network will be provided under the CARDS programme. Financial support for establishment of part of the national network is asked under the PHARE 2005 programme. Strengthening of the capacities required for the establishment of the national system for greenhouse gas emission inventory will be ensured within the LIFE III Third Countries programme..

Waste Management

Waste management is regulated in the Waste Act* (Official Gazette No. 151/03) and by international agreements (Basel Convention).

The National Environmental Protection Strategy and the National Environmental Action Plan provide that inadequate waste management is one of the biggest environmental problems in Croatia. Croatia has high polluted sites – old hazardous waste landfill sites and industrial facilities which are not operating. In order to remedy the existing situation and create conditions for setting up a waste management system, in 2004 the Government adopted the Programme of Waste Management Measures in the Republic of Croatia, and presently the competent authorities are also working on the Waste Management Strategy and the Waste Management Action Plan. The priorities are measures aimed at reducing waste for disposal. It is planned to establish a smaller number of regional centres for waste management, which will apart from disposal conduct separation, pre-processing, temporary waste storing, processing and other prescribed activities.

Progress has been made following the activities of the Fund for Environmental Protection and Energy Efficiency, which co-finances the recovery of municipal waste landfills. (about HRK 150 million planned annually) out of the generated revenue, and following the introduction of remuneration that is paid by natural and legal persons disposing non-hazardous industrial waste and remuneration paid by producers of hazardous waste. In 2004 activities were also undertaken to recover sites with highly polluted environment - "black spots". These activities will also continue in 2005 and in the course of ensuing years. The State Budget for 2005 plans recovery of the "black spots" (project documents) in the amount of HRK 3.0 million, for 2006 in the amount of HRK 3.7 million and for 2007 in amount of HRK 3.7 million.

For the purpose of adjustment to the requirements of the EU *acquis communautaire* in the area of waste management, mostly of financially demanding heavy) directives, it is necessary to secure large funds on a continuous and long-term basis. The required funds amount to HRK 3.330 million.

Technical assistance for the harmonisation of legislation will be realised primarily under the CARDS programme, and for the development of the waste management information system under the LIFE III Third Countries programme. Under the CARDS programme funds will be provided also for certain infrastructure investments in order to improve waste management at the local level. Strengthening of administrative capacities at the national, county and local

* *The new draft proposal of the Waste Act is in adoption procedure.*

level will be also realised through implementation of CARDS, LIFE III Third Countries and REReP projects

Water quality⁷

In the area of water management the existing legislative framework provides good basis for harmonisation with the *acquis communautaire*. It is planned to work more intensively on the development and harmonisation of the legislation with the EU, as well as on further strengthening of the implementing mechanisms, administrative strengthening, and water management planning. The State Budget plans funds for legislative harmonisation for 2005 - HRK 375,000.00, for 2006 - HRK 400,000.00, and for 2007 - HRK 400,000.00.

Measures relating to water protection are defined in the State Water Protection Plan. It is necessary to intensify implementation of the measures. At the moment, annual investments in the building of infrastructural objects for water protection are insufficient to achieve the EU standards, so it is necessary to secure more funds for the said purposes. The State Budget plans funds for capital projects of protecting waters and the sea against contamination and pollution for 2005 - HRK 70 million, for 2006 - HRK 63.5 million, and for 2007 - HRK 48 million.

Regarding the use of water, at the moment the most important problems are in the area of water supply. Systematic and continuing efforts have to be made to balance and increase the reliability of water supply, if economic elements permit. The State Budget plans to provide for capital projects of water supply for 2005 - HRK 139 million, for 2006 - HRK 209 million, and for 2007 - HRK 260 million.

The area of safety of drinking water is regulated by the provisions of the Food Act (Official Gazette No. 117/03) which prescribes the obligation to adopt implementing deeds regarding the safety of drinking water. The main activities arising out of the implementing regulations are the establishment of the system of self-control for public water supply structures and introduction of the system in practice, monitoring of drinking water, appointment of the Expert Commission for Drinking Water.

The zones of sanitary protection of water springs do not exist at all springs, so it is necessary to improve the safety of springs against contamination and pollution, next to the building of water supply infrastructure. Funds for the above purposes are secured by the units of local self-government.

Losses, because of draughts in the past several years were very high, so it is necessary to put more efforts into making plans for the recovery of the existing and the development of new irrigation systems. The State Budget will provide funds for capital irrigation projects in 2005 - HRK 100 million, 2006 - HRK 100 million, and in 2007 - HRK 100 million.

The system of protection against harmful effects of water is insufficiently developed to ensure the required level of safety, so it is necessary to intensively work on its further development. The State Budget plans funds for capital projects relating to protection against harmful effects of water in 2005 - HRK 93.5 million, in 2006 - HRK 76.5 million and in 2007 - HRK 69.5 million.

CARDS projects provide technical assistance for the harmonisation of the legislation in the area of water management, upgrading of the water information system and strengthening of water management planning. The presently available sources of financing are insufficient, and it is necessary to start with the reform of the existing system of financing and with the preparation of investment strategies and programmes.

Protection Of Nature

According to the Nature Protection Act (Official Gazette No. 162/03), nature protection, next to the protected areas, includes overall biological and landscape diversity.

The sector of nature protection was transferred in early 2004 from the Ministry of Environmental Protection and Physical Planning (now the Ministry of Environmental Protection, Physical Planning and Construction) to the Ministry of Culture. Nature protection should receive out of the State Budget in 2005 - HRK 14.8 million, in 2006 - HRK 16.3 million, and in 2007 – HRK 14.5 million. In 2005 new Nature Protection Act should be adopted.

Protected areas cover about 10% of the territory of Croatia, which should be increased to 15-20%. In 2005, the Lastovo Nature Park will be established. The State Budget will provide HRK 1.2 million for that purpose in the period 2005-2007.

Mechanisms for the protection of biological diversity outside the protected areas will begin to function after the establishment of the National Ecological Network (NATURA 2000).

Revision of the National Strategy and Action Plan for the Protection of Biological and Landscape Diversity will be conducted in 2005. Funds will be provided from the State Budget.

The prepared plans for protected species management will become applicable as of beginning of 2005, for which HRK 2 million was secured in 2005, HRK 3.35 million in 2006, and HRK 2.6 million in 2007.

It is necessary to establish mechanisms for sustainable use of natural resources and incorporate them in all sectors and regulations.

Industrial contamination and risk management⁹

Pursuant to the Environmental Protection Contingency Plan (Official Gazette No. 82/99, 86/99 and 12/01) various sectors started to co-operate in the process of forecasting, monitoring and reporting, which makes a permanent basis for efficient and timely action in the case of emergencies.

Implementation of the measures relating to practical training of the population in self-protection, mutual protection, behavior and actions in case of accidents has begun. The relevant requirements and guidelines of the EU, of the NATO Industrial Planning Committee as part of pre-admission preparations, and of the obligations of the UN/ECE Industrial Accidents Convention have been taken into account. Members of the civil protection service are also obligated to undergo training.. The Republic of Croatia is making protection and rescue plans for the purpose of implementing organized protection and saving people and material goods from danger and the consequences of civilizational and natural catastrophes, which process includes the units of local and regional self-government on the basis of the

Ordinance on the Methodology of Making and on the Content of Protection and Rescue Plans (Official Gazette No. 31/95).

By ratifying the Convention on Transboundary Effects of Industrial Accidents (Official Gazette – International Treaties No. 7/99) and adopting the United Nations Environment Programme – APELL process, the Republic of Croatia committed to harmonise its legal regulations governing the field of prevention and control of industrial pollution with these international documents.

For the purpose of harmonisation with the provisions of Directive 96/82 EC (Seveso II) as well as with the mentioned Convention and APELL process, a new Environmental Protection Contingency Plan will be adopted.

In order to harmonise the operation of industrial processes and energy installations with EU regulations, it is necessary to establish the legal, administrative and financial framework for the implementation of appropriate measures.

The new Environmental Protection Act and the corresponding implementation regulations in line with the provisions of IPPC Directive shall constitute the legal framework for the establishment of an integral system for the prevention and control of environmental pollution.

The State Budget and other sources will provide funds in the amount of HRK 32 million in the period 2005-2007 for the implementation of the planned measures.

Chemicals

In order to set up basis for the establishment of an integral and efficient system of safe chemicals management throughout their life cycle, the area of chemicals has to be better regulated legislatively and institutionally.

The newly adopted Chemicals Act (Official Gazette No. 173/03), to be applicable as of 1 January 2005, has to be supplemented to eliminate the existing "fragmentation". Extensive subordinate legislation also has to be passed. Institutional and personnel infrastructure necessary for integral application of the Chemicals Act has to be developed. The *Chemicals Office* will be set up as a central national body for safe chemicals management. It will keep the register of all chemicals. Communication with business and the public will be intensified, so that these sectors would be educated and informed better about potential hazards and commercial significance of chemicals, in direct co-operation with the Ministry of Environmental Protection, Physical Planning and Construction and other state bodies competent for the implementation of environmental protection intervention plans, the obligations out of the Convention on the Transboundary Effects of Industrial Accidents, and the NATO guidelines of the Industrial Planning Committee.

It is expected that funds in the amount of HRK 18.5 million will be necessary for the implementation of measures planned in 2005. There are preliminary activities to ensure the needed funds within the project "Safe Chemicals Management for Sustainable Development" proposed for the PHARE programme assistance for 2005.

The State Budget funds allocated in 2004 for the purpose of preparations regarding the establishment of the *Chemicals Office* amounted to HRK 250,000.00. For the initial work of the *Chemicals Office* and its most essential technical equipment in 2005 the State Budget

plans funds in the amount of HRK 1 million (additionally in 2006 - HRK 350,000.00, and in 2007 - HRK 350,000.00 as support to its work).

Genetically modified organisms

GMO in food and cattle feed is regulated in the Food Act (Official Gazette No. 117/03). The problems of cross-border transfer and limited use, marketing and production of GMO are regulated in the Nature Protection Act (Official Gazette No. 162/03, Articles 92 through 141). Implementation of the articles is responsibility of the Ministry of Culture, State Office for Nature Protection.

The proposal of the new GMO Act is presently in preparation. It will not significantly change the regulatory provisions of the Nature Protection Act now in force, but it should significantly change the definition of competencies of the individual bodies of administration and inspection

In 2005, depending on the newly defined competencies, the development of an institutional framework for the implementation of the Act will begin. Funds will be provided from the State Budget.

Implementing regulations according to the new GMO Act will be prepared in 2005.

Noise

The area of noise protection is regulated in the Noise Protection Act (Official Gazette No. 20/03). The remaining implementing legislation will be passed on the basis of the said Act.

For the implementation of the above measures, administrative strengthening has to be carried out (training of experts in the procedures of supervision of legal persons performing expert activities relating to protection against noise, keeping the register of legal persons with powers, conducting of professional noise examinations).

By 2007 the National Programme of Health Protection against Noise will be adopted and in this connection it is necessary to develop a situational analysis, to train experts and to establish a system following the example of EU Member States. . In the area of air transport, further harmonisation of the legislation of the Republic of Croatia with the *acquis communautaire* is required

Protection against ionizing radiation

The existing legislative framework (Act on Protection against Ionising Radiation - Official Gazette Nos. 27/99 and 173/03), regulating protection against ionising radiation, is in accordance with the EU requirements. In view of the present situation in the world, and especially lately with the ever increasing threat of terrorist attacks with radioactive material, the existing legislation will be harmonised by reducing to the minimum any consequences of malevolent actions connected to the use of the sources of ionising radiation through internal and international co-operation. Activities are planned for this purpose with the aim of development and harmonisation of the existing legislation and strengthening of implementing mechanisms, as well as strengthening of administrative capacities.

With the aim of achieving the plan, the following funds will be provided:

- in 2005, the amount of HRK 4,170,000.00 for the adoption of the new Act on Protection against Ionising Radiation and its implementing regulations (3 ordinances) and the building of radioactive material warehouses,
- in 2006, the amount of HRK 2,900,000.00 for the preparation and implementation of the State Plan and Programme for Protection against Ionising Radiation, the system for measuring ionising radiation, and the types and activities of radioactive substances in the environment,
- in 2007, the amount of HRK 15,200,000.00 for establishing and equipping checkpoints at border crossings and strategic locations for the supervision of illegal trade with radioactive material.

Administrative Capacities

The Ministry of Environmental Protection, Physical Planning and Construction is the central body of state administration in the area of environmental protection, but there are also other central state bodies competent for specific issues relating to environmental protection (Ministry of Agriculture, Forestry and Water Management, Ministry of the Economy, Labour and Entrepreneurship, Ministry of Culture, Ministry of the Sea, Tourism, Transport and Development, Ministry of Health Care and Social Welfare, State Weather Bureau). Apart from the central bodies of state administration, the following bodies are also active in the area of environmental protection: Environmental Protection Agency, Fund for Environmental Protection and Energy Efficiency, Hrvatske vode (Croatian Waters), National Institute for Protection against Radiation, State Office for Nature Protection. The Ministry of Environmental Protection, Physical Planning and Construction has a Department for EU Integration and International Projects within the Environmental Protection Directorate. Other bodies of state administration also have organisational units dealing with activities regarding EU integration. None of the mentioned bodies has sufficient personnel resources for the performance of such activities, so it is planned to increase and train the personnel in workshops, seminars, etc. in the country and abroad. The strengthening of administrative capacity is a component of the projects out of the programmes CARDS, LIFE III - third countries, REReP and the bilateral projects implemented in the bodies of state administration and at the county and local levels, as anticipated in the proposed projects out of the PHARE programme.

The Ministry of Environmental Protection, Physical Planning and Construction (*horizontal legislation, air and waste*): The Directorate for Environmental Protection plans an increase in the number of employees: in 2005 by 20 (48%), in 2006 additional 12, and in 2007 6 more employees. The Inspection Directorate will also engage more employees in the forthcoming period (until the end of 2005, 25 more employees – compared to 2004, increase of 59.5%), as well as the Independent Legislation Service (in 2005 – 3 more employees). **The Ministry of Agriculture, Forestry and Water Management** (*water quality*): The Directorate for Water Management anticipates the employment of 4 new employees per year in 2005 and 2006. **The Ministry of the Economy, Labour and Entrepreneurship** (*chemicals*): In 2005, it plans to establish the Chemicals Office and engage human resources out of other ministries. In parallel, the relevant institutions will be strengthened in the course of 2005 both with respect to human resources and equipment (for example, authorised control laboratories). **The Ministry of Culture** (*nature protection and genetically modified organisms*): It is planned to increase the number of employees in the national parks and parks of nature: in 2005 by 30 new employees, in 2006 by 8, and in 2007 by 6 new employees. **The Ministry of Health and Social Welfare** (*noise*): In the period 2005-2007, it is planned to

employ 4 new employees. **The State Office for Protection against Ionising Radiation** was formed in 2004. In 2005, the Office intends to hire 3 new employees. The employees of the Office will receive training in projects of technical co-operation with the International Agency for Atomic Energy. **The Agency for Environmental Protection** plans to hire 3 new employees in 2005 (in October 2004 – 11 employees). In the **State Institute for Nature Protection** the employment of further expert staff is planned, specifically, 19 new employees in 2005, 17 new employees in 2006 and 8 new employees in 2007.

4. 6. 6. Education And Science

Science and higher education

In 2003, the Law on Scientific Activity and Higher Education took effect and in 2004. its Revisions with a primary goal of approaching the European legislation in this segment. The primary responsibilities of the Ministry in the next period will be the reorganization of the science and higher education system in accordance with the new law:

- Before December 31. 2004. The Parliament appoints the National Science Council and the National Council for Higher Education.
- The National Science Council and the National Council for Higher Education jointly appoint the Advisory Board for Financing of Scientific Activities and Higher Education, National Council for Science appoints the scientific and artistic regional councils and parent boards (deadline July 1. 2005.).
- Before December 31. 2004. the Government of Croatia establishes the Agency for Science and Higher Education which will begin work no later than March 1. 2005.
- The Parliament, upon the proposal of the Government, appoints the Board of Science and Higher Education Ethics.
- The National Councils are obliged to adopt standing orders on work and areas of joint work. National Science Council gives an initial opinion on the regulation on evaluation of quality and efficiency of scientific institutions and independently adopts the regulation on the composition and method of work of the councils and committees for specific fields, the regulation on the scientific areas, branches and fields and the regulation on the requirements for obtaining scientific grades. National Council for Higher Education gives an initial opinion on the regulation on standards and criteria for evaluation of quality and efficiency of higher education institutions and adopts the regulation on standards and criteria for evaluation curricula and the regulation on standards and criteria for establishment of higher education institutions.

The long term goal is by increase in the state budget and budget allocations from other sources for science and higher education to approach the level of funding in developed European countries, implement internationally recognized system of scientific work evaluation and to train a staff for permanent tracking and evaluation of scientific work according to world standards.

Foreign language instruction in elementary school, current state, plans and improvements

Although this overview addresses compulsory elementary education that is run by elementary schools and lasts eight years *foreign languages are being taught at the pre-school age as a project of early learning of foreign languages* – English (79%), German (15%), French (4%) and Italian language (2%). Approximately 25% of the children of pre-school age are enrolled in the programs of early learning of foreign languages lasting up to five hours per week, and approximately 5% of the children are enrolled in the five-hourly and ten-hourly programs of foreign language learning (children of national minority groups that have mother tongue

education organized in Italian, Czech, Hungarian, German and Serbian language are not enrolled in this program. Roma children of pre-school age have programs in Croatian as well in Roma language because this is crucial for their enrollment into regular elementary school). The system of pre-school education has 43% of pre-school aged children enrolled into regular programs, and in the program of pre-schools (children within a year of starting school) we have a 100% enrollment.

Foreign languages have been implemented into elementary education for the second year running as a project of this Ministry under the name «early learning of foreign languages». All children in the first grade take a foreign language in their first year or regular schooling. In 2004./05. school year the breakdown of foreign languages in the first grade is – English language 85,35%, German language 14,33%, Italian language 0,13% and French language 0,13%. This project will be continuously implemented in following years so that foreign languages could be learned throughout the elementary and high school education.

It should be pointed out that, under the past educational program and curriculum of elementary schools, students in fourth grade were obliged to choose one additional foreign language as an elective course which they continued to study throughout their schooling.

In 2004, the students of fourth grade of elementary school that opted for foreign languages have a similar scope as students of first grade – English language is learned by 68,30% of students, German 26,10%, Italian 4,50% and French 1,10%. In 2004, the elective courses in fourth grade are in German favor, as it is being learned by 49,36% of students. Therefore, the trend of foreign language learning is in constant increase which necessitates new employments of foreign language teachers and additional allocation from the state budget.

All the students who will finish grade eight in 2011 are expected to master two foreign languages and be able to continue to use them competently, and that is also the goal in terms of life-long learning of foreign languages.

Foreign language instruction in high schools, current state, plans and improvements

Foreign language instruction in high schools comprises of living languages instruction. Foreign languages in all the programs in high schools are represented with a 100% in the regular, elective and optional schooling. Out of this number 12,03% falls to classical languages learning (Greek and Latin).

In the Republic of Croatia English language is being taught to 57,30% of high school students, German 31,20%, French 2,84%, Italian 8,22%, Spanish 0,15%, and other languages are being taught by 0,29% of students.

The trend of foreign language learning in high schools is in constant growth. The project of foreign language learning in Croatia will continue and is constantly expanding, but it necessitates new employments of foreign language teachers and additional allocation from the state budget.

Plans concerning the undertaking of adequate measures for the children of migrant workers

In the work of the Ministry so far, this kind of schooling was not sufficiently developed, and in the 2004/2005 school year the Ministry will support a project by the non-governmental

organization „Dvorac srca“. This project envisions the schooling the children of citizens of the Republic of Croatia that are temporarily residing in other countries and their children are no longer within the educational system, they either left school on the level of compulsory education or vocational education.

Croatian system of vocational education and training at the high school level

The vocational courses are being taught in vocational high schools by engineers, economists, lawyers and the like, who do not have additional pedagogical-psychological and teacher training education, which reflects negatively on the quality of instruction. A systematic care should therefore be taken about training the teachers of vocational courses by introducing education departments to the technical and other non-educational faculties. Systematic work should be done on continual professional training of teachers.

The Department for professional education is currently operating at the Institute for Education with only 11 employees. The reform of the Department into a special institution is being planned and its further staffing so that it would become an adequate service to the system of professional education.

There are around 400 specializations in the system of high school education. There have been 37 new programs for the specializations connected with trades introduced in this school year, and they have been modernized and adapted to the new demands of the labor market. New programs for the specializations of nutritionist and agricultural technician have been also made, and changes and additions to the programs for the specializations of forestry technician, ecology technician and railway traffic worker have been made. Several new programs for the elective instruction for the specializations in the motor engineering field have been adopted. It is necessary to continue the work on the changes and additions to the programs for three and four year specializations. The goal of these changes and additions should be the decrease in the number of specializations and modernization of programs and curriculum. Preparations are currently being made for the construction of the new educational model (3+2+2) for the building and civil engineer specializations.

The lack of teaching equipment is a big problem. It is necessary to develop a project of equipping the vocational schools and begin equipping them as soon as possible. This entails the adoption of a pedagogical standard.

There is a lack of textbooks for vocational programs, especially for those courses that enroll a small number of students. It is necessary to allocate financial resources for financing the printing of such textbooks, because the publishers do not find this profitable.

4.6.7 Tourism

The tourism presents one of the most important sectors of the Croatian economy, directly or indirectly contributing significantly to the GNP and employment growth, as illustrated by the following data:

Table Travel & Tourism – US \$ mln

	2000	2001	2002	2003 E	2004 E	2014 P
Visitor Exports	2,835.1	3,439.3	3,951.3	4,577.4	5,342.0	13,114.0
Travel & Tourism Consumption	4,267.2	4,933.1	5,881.0	6,716.1	7,706.8	18,517.3
Travel & Tourism Demand	5,424.8	5,974.4	6,984.5	7,933.6	9,056.8	21,926.4
Travel & Tourism Industry Aggregates (Direct Impact Only in %)						
Employment	11.6	12.7	12.3	13.0	13.8	16.1
Gross Domestic Product	8.7	9.8	9.8	10.6	11.5	15.1
Travel & Tourism Economy Aggregates (Direct & Indirect Impact in %)						
Employment	27.5	27.3	26.2	27.4	29.0	34.4
Gross Domestic Product	19.9	20.8	20.8	22.4	24.3	32.4

Source: World Travel & Tourism Council and its economic consultants/research partners – Oxford Economic Forecasting

WTTC estimates that Croatia Travel & Tourism Demand is expected to generate US \$ 9.1 billion of economic activity in 2004 and to grow by 6.4% per annum, in real terms, between 2004 and 2014. Croatia Travel & Tourism Economy employment is estimated at 317.4 thousand jobs in 2004 and is forecasted to grow by 3.3% per annum by 2014. Croatia Travel & Tourism Economy is expected to contribute 11.5% directly and 24.2% (directly and indirectly) to GDP in 2004 with 6.6% annual growth over the next ten years (by 2014). Tourism being the net exporter, its contribution to the settlement of the balance of payment (80% of the deficit in goods exchange was covered by tourism receipts in 2003).

	International tourist arrivals (in mln)					Receipts from international tourism (in billion USD)				
	2000.	2001.	2002.	2003.	% change 03/00	2000.	2001.	2002.	2003.	% change 03/00.
World	687.3	684.1	702.6	694.0	+1	473	460	474	514	+9%
Europe	392.7	390.8	399.8	401.5	+2	235	230	241	282	+20%
Croatia	5.8	6.5	6.9	7.4	+27	2.8	3.3	3.8	6.4	+129%

Source: World Tourism Organization (WTO), Croatian Bureau of Statistics, Croatian National Bank

In spite of an unstable and uncertain international tourism market that has caused the stagnation of the total world tourism in period 2000-2003, Croatian tourism has recorded an exceptionally high volume and revenue growth. Such results have been achieved thanks to :

- the image of Croatia as a peaceful, safe and attractive tourist country
- the considerable improvement in traffic infrastructure (the completion of the highway Zagreb-Goričan and Zagreb-Rijeka, new partitions of the Zagreb-Macelj and Zagreb-Split highways, the acquisition of new ferry liners and higher intensity of lines kept by passenger vessels and ferries of the national maritime company «Jadrolinija» and other private maritime companies, the growth of the fleet and more intensive regular and charter traffic of the Croatia airlines etc.)

- the enlargement of accommodation capacity and considerable upgrading of standards and quality of the hotel and other type of accommodation
- the higher diversity and quality of the destinations total offer (sports, entertainment, cultural events and happenings etc.)
- the improvement of the local public utilities and infrastructure in tourist resorts (water supply, sewage, local transportation, beach and walkways care etc.)

- 2 -

Tourist traffic

	Tourist arrivals in 000				Overnights in 000				Share (%)			
	2000.	2003.	Index 03/00	I-VII 2004.	2000.	2003.	Index 03/00	I-VII. 2004.	Arrivals		Overnights	
									2000.	2003.	2000.	2003.
EU countries	3,071	4,289	139.7	2,449	17,810	24,222	136.0	12,442	43.0	48.3	45.4	51.9
Countries that joined EU in 2004.	2,289	2,437	106.5	1,385	14,263	14,282	100.1	7,575	32.1	24.5	36.4	30.6
Other countries	471	682	144.8	437	1,972	2,891	146.6	1,694	6.6	7.7	5.0	6.1
Total foreign	5,831	7,409	127.1	4,271	34,045	41,323	121.4	21,711	81.7	83.5	86.8	88.6
Domestic	1,305	1,469	112.6	879	5,167	5,312	102.8	2,969	18.3	16.6	13.2	11.4
Total	7,137	8,878	124.4	5,150	39,213	46,635	118.9	24,680	100.0	100.0	100.0	100.0

Source: Central Bureau of Statistics

Croatian tourism is predominantly oriented towards the international market, its share having continuously grown (from 81.7% in 2000 to 88.6% in 2003). The most numerous tourists in Croatia are those coming from the EU (including the countries that joined EU in 2004). Over the first seven months in 2004 the total number of arrivals increased by 6% and the total number of overnights by 1%. Bearing in mind the exceptional attractions, as well as comparative and competitive advantages of Croatia, the tourist traffic and the receipts to accrue are expected to keep on growing.

INVESTMENTS IN TOURISM (in mln kn)

ACTIVITIES	1999.	2000.	2001.	2002.	2003.	2004 estimate
Hotels and restaurants	906	520	766	1869	2127	2300
Travel agencies and tour-operators	47	77	87	154	204	220
Marinas	6	11	13	70	124	150
TOTAL	959	608	866	2093	2455	2670

Source: FINA (Financial Agency, Croatia)

Estimate: The Ministry of Tourism

Note: the data pertain to companies, only (legal entities)

Since 1999 an important process of investing in tourism has started in Croatia, especially intensified over the last three years. In the period 1999-2003 Croatian companies invested 6.981 billion kunas (around 950 mln EUROS) and we estimate that in 2004 the additional 360 mln EUROS will be invested. Those investments were primarily directed towards the hotel industry, namely into refurbishing/renewal/modernization of the existing hotels and tourist settlements. Over the last couple of years the construction of small family hotels and boarding houses meeting at least 3* requirements has been intensified with the aim of further developing the small entrepreneurship, increasing the capacities and upgrading the standards/quality of the accommodation offer. Besides, the citizens have invested a lot in rooms and apartments which also represent a large portion of the total accommodation capacity.

Over the last couple of years a substantial upgrading of standards and quality of the accommodation – especially of the hotel capacities has occurred as a result of intensive investment done by business companies and the new compulsory categorization implemented

by the Ministry of the Sea, Tourism, Transport and Development, based on the Rules and Procedures prepared in cooperation with the prominent international consultancy firm (THR, Barcelona).

Over the period 2001 - 2004 the share of 1* and 2* hotels dropped from 49.1% to 34.2%, and the share of 3*, 4* and 5* hotels leaped from 50.9% to 65.8%. The legal act providing for the eradication of 1* attribution to the existing hotels, while the new hotels have to comply with the requirements of at least the 3* will further contribute to the upgrading of the quality of whole accommodation capacity. Arrival of prominent foreign hotel chains to Croatia (Hilton, Sheraton, Starwood – Westin and Four Points, Club Mediterranee, Riu, Iberostar, Regent, Kempinski etc.), as well as other foreign investors arrival will also contribute to quality improvement, the goal being that some 50% of all the hotel capacities acquire the 4* and 5* by the year 2010.

In view of the changes that have occurred on the global tourist market, both on the demand and the supply side, and in accordance with its significant tourist resources, Croatia has decided to abandon its image of a mass tourist and innovate its tourist products. Thus, the new strategic goals were defined:

- high quality tourism based on the principles of sustainable development
- maximum level of protection and rational use of land
- preservation and protection of natural and other tourist resources and environment
- renovation, modernization and upgrading of existing hotels
- controlled development of new hotels and other types of accommodation
- development of new competitive products (golf, wellness, cultural, rural, nautical and other selective type of tourism)

4.6.8. Public Procurements

As an introduction it should be pointed out that public procurement in the Republic of Croatia is relatively new, since the procedure of publishing tenders for public procurement was promoted to a legislative legal norm only in 1997 following the adoption of the first Act on Procurement of Goods, Services and Works Assignment (Official Gazette No. 142/97), meaning that Croatia has a short tradition in regulating this area. It is still necessary to point out the consequences of introducing the system of public procurement in practice. It should especially be pointed out that public procurement had significant impact on the relevant market of bidders who after the legislative regulation of the area had to start acting in a relatively different, but also in a more complex way, which was far away from the practice of concluding contracts between the state and the private sector until that time. By introducing the legal regulation of the area, Croatia tried to guarantee more competitiveness and prevent discrimination against bidders, and at the same time achieve more transparency in the business operations regarding property-legal relations, that is, more rational spending of public funds. The effects of public procurement would at the same time have to be reflected in other areas important for normal functioning of the state, as well as in improved trust of the public towards the state and prevention of corruption.

In 2001, the new Public Procurement Act (Official Gazette No. 117/01) was adopted, which is presently in force. It had to harmonize the area of public procurement with the regulations of the European communities. The obligation of harmonization was assumed in the Agreement between the Republic of Croatia and the European communities and their Member States. This was one of the first laws in the procedure of harmonization of the legislation, in which the Republic of Croatia tried to incorporate EU guidelines.

In 2003, the Act on the State Commission for Public Procurement Control entered into force. This Act is also one of the new institutional forms and conditions out of the guidelines which require mandatory independence of the controlling mechanism and separation of the advisory role of the Public Procurement Office from the supervisory function of the State Commission for Public Procurement Control. The World Bank also insisted on the separation of these two incompatible functions in its 1999 report.

Amendments to the Public Procurement Act are taking place under extremely complex circumstances of a transitional period and at a time when other members of the EC are also in the adjustment phase, due to new guidelines adopted in March 2004:

2004/18/EC - a guideline that connects the so-called classic area of the procurement of goods, services and construction, which were before the subject of three guidelines, into a single consolidated guideline, and

2004/17/EZ - a guideline for procurement procedures relating to goods, performance of construction works and services of subjects active in water, energy and transport sectors.

The proposal of amendments should be summarized into three basic tasks, in view of the objectives:

- harmonization of the Act with the legal order of the European communities,
- elimination of administrative obstacles and rationalization of procedures,
- introduction of the system of electronic procurement in practice and the possibility of centralization of public procurement

A special part of the adjustment to the EU legislation will be the second phase of harmonization of procedures relating to the protection of the rights of parties in public procurement and the Act on the State Commission for Public Procurement Control, and the implementation of the practice of the European Court.

PROPOSAL OF THE PLAN OF ACTIVITIES TO IMPROVE THE SYSTEM OF PUBLIC PROCUREMENT IN THE REPUBLIC OF CROATIA FOR THE PERIOD 2004-2005

- | | |
|---|---------------------|
| 1. Drawing of the Public Procurement Act | 1st quarter of 2005 |
| 2. Drawing of subordinate legislation - implementing regulations for procurement procedures of small value, publication of CPV and CPC norm | 2nd quarter of 2005 |
| 3. Institutional changes and internal restructuring of the Public Procurement Office | 2nd quarter of 2005 |
| 4. Creation of Internet web pages for Public Procurement Announcement Site for all procurement procedures in the Republic of Croatia | 2nd quarter of 2005 |
| 5. Drawing of implementing regulations for the introduction of a qualifications list in the Republic of Croatia | 3rd quarter of 2005 |
| 6. Beginning of the twinning project (CARDS) | during 2005 |
| 7. Program of monthly training of the personnel for procurement and supervision | during 2005 |
| 8. Development of the system of electronic procurement | during 2005 |

4.6.9 Transport And Communications

Road transport

Regarding road transport, and in order to harmonize the legislation of the Republic of Croatia with the *acquis communautaire* of the European Union, the Ministry of the Sea, Tourism, Transport and Development forwarded to the Government of the Republic of Croatia the Draft of the Proposal of the Act on Transport on Public Roads. Furthermore, yet another act to be harmonized is the Public Roads Act, which will be forwarded to the Government of the Republic of Croatia by the end of 2004. On the basis of the new legislative solutions in the area of transport and public roads, the Republic of Croatia is getting closer and closer to the solutions and practice of the Member States of the European Union.

The Road Transport Act, which is one of the acts to be harmonized with the EU *acquis communautaire*, was also forwarded to the Croatian Parliament for procedure. The mentioned Act regulates terms and conditions of transporting passengers and cargo by road, with the intention of introducing the elements of market competition through public tenders and the strengthening of financial discipline of commercial entities by reducing administration.

The Directorate for Road Transport and the Directorate for Strategic Infrastructural Projects were formed for the performance of administrative and expert activities related to transport in accordance with the Regulation on Internal Organization of the Ministry of the Sea, Tourism, Transport and Development (Official Gazette Nos. 24/04 and 60/04).

The Directorate for Road Transport of the Ministry of the Sea, Tourism, Transport and Development is prepared for the following projects and programs, which will be executed in the period from 2005 to 2007, and for which funds have been allocated in the state budget:

- campaigns relating to safe traffic with the aim of improving the level of safety of road traffic,
- campaigns on traffic safety and campaigns teaching pre-school children and children in primary schools about safe traffic,
- preparations relating to the making of the "White Book", a project with the aim of identifying and marking in a more adequate and visible manner the so-called "black spots" on roads,
- repair of dangerous locations,
- repair of road-railway crossings.

The Strategy of Transport Development of the Republic of Croatia provides for the principal directions of future development of roads, as one of the most important preconditions for good inter-regional connections within Croatia and for the inclusion of Croatia into a wider European area. The three basic features that have strategic importance for a faster development of roads are:

- the construction of high-quality service roads in main European corridors (motorways, semi-motorways and fast roads)
- gradual achievement of the highest standard of maintenance of the road network
- intensification of lesser works on the reconstruction and modernization of the overall network of roads, thus upgrading the level of serviceability - a continuous task.

In the transport of cargo and passengers by road, prices are formed by transporters, so that the state does not have any influence over the formation of prices, the market being the sole price regulator.

According to Hrvatske autoceste d.o.o., the aggregate amount of funds invested in the period from 2001 to 2004:

- in construction - HRK 15.352 billion
- in the repair and extraordinary maintenance - HRK 386.296 million
- in everyday maintenance - HRK 230.918 million

The operative elaboration of the Program of the Croatian Government for the period 2003-2004 regarding transport infrastructure led to the making of a plan to continue the construction of the planned network of motorways and to the development and upgrading of the network of state roads. Further development of the road infrastructure will encourage a faster overall development of the country, especially in certain sectors.

Goals for development of road infrastructure:

1. Through development of infrastructure ensure the necessary conditions for economic development
2. Through construction of regional road infrastructure remove barriers to transport and trade with neighbouring countries and the EU
3. Use the geographical transport position of Croatia through the European corridor network
4. Connect the entire country through a road network
5. Implement technology and systems for combined traffic and gradual introduction of an integrated transport system.

The plans for the development of road infrastructure, in the forthcoming period will focus mainly on efforts in building of highways for the following relations:

- Split – Ploče
- Zagreb – Sisak
- Corridor from Beli Manastir, through Osijek until the border with Bosnia and Herzegovina (BH), as well as south of the border of BH until the port in Ploče.

The construction of mentioned highways will create the recondition for connecting large cities through these highways, with fixing of roads on border crossings

The four year program for 2005-2008, shows numerically the plan to:

- build 315 km of new state roads
- renovate 975 km of existing roads
- that the more important capital objects are:
 - Bridge land – Pelješac 2,3 km
 - Maslenički bridge
 - Jasenovački bridge
 - Bridge across Drava river in Osijek
 - Tunnel Pećine in Rijeka
 - Bridge across Cetine river
 - Building of by pass roads

Railway transport

Until now activities have been undertaken to harmonize the legislation of the Republic of Croatia with the European legislation and measures taken to restructure the railway system in the Republic of Croatia, with the following principal objectives:

1. Liberalization of the railway market by opening the railway infrastructure to both domestic and foreign transporters under the same conditions,
2. In the transitional phase, training national railway transporters for operation under the conditions of market competition and pronounced competition, restructuring of business activities of the railway transporters and lowering of operative ratios (operative ratios are defined as: business costs before amortization divided by business revenues, excluding revenues from public service commitments).
3. Modernization of the infrastructure would contribute to the prospects of the company as it would be more attractive to potential customers, and which would result in more traffic, reduction of maintenance costs, reduction of the number of employees, traffic safety, etc., and one of the preconditions for approximation to the European standards and inclusion in the integrated European railway network would also be met,
4. Promotion of railway as an acceptable transporter with pronounced advantages over other forms of transport.

In view of the present monopolistic position of the national railway transporter, HŽ-Hrvatske željeznice, the company is undergoing a restructuring process for the time being by division into core and non-core activities and by preparing its subsidiaries performing non-core activities for privatization. In further stages other forms of restructuring are also planned, primarily in the form of separation of infrastructural business areas and passenger and cargo transport.

At the session of 17 July 2003, and for the purpose of implementing the said measures, the Croatian Parliament adopted a new "Railway Act" (Official Gazette Nos. 1233/03, 194/03 and 30/04), which will become effective on 1 January 2006. The new Railway Act regulates the following issues:

- organization of the railway system,
- conditions for the performance of railway transport services, conditions for the issuance of licenses and certificates on safety for the performance of transport services,
- railway infrastructure, its status, conditions for access, the procedure for distribution of infrastructural capacities, the manner of operation of the infrastructure and its financing,
- railway transport services of general importance.

The adoption of this Act creates legislative and institutional presumptions for the harmonization of the organizational structure of railway transport and railways as a whole with the guidelines and regulations of the European Union, and enables the use of railway infrastructure and the performance of transport services in railway transport in an open and non-discriminating manner, in line with the requirements of the competitive market of the European Union, by creating conditions and opportunities for the existence of a larger number of railway transporters at the market of railway services.

For the purpose of overall implementation of the set activities of re-organization and restructuring of the railway system, it is necessary to adopt another law, which would ensure appropriate organization of Hrvatske željeznice, and the Act on Railway Transport Safety. The preparation of the relevant subordinate legislation is also one of the preconditions for the application of the said acts.

In the forthcoming period it is necessary to strengthen the administrative, expert and supervisory capacity of the Ministry of the Sea, Tourism, Transport and Development

competent for railway transport in view of the obligations arising out of the said acts, and it is especially necessary to adjust the structures in charge of supervising transport safety to the new safety and supervisory standards.

The Railway Transport Management operates as part of the Ministry of the Sea, Tourism, Transport and Development, and has the following departments: the railway infrastructure department, the railway transport department, the railway inspection department and the traffic safety monitoring department. The Management is in charge of legal and legislative activities, administrative-legal procedures, activities related to the state budget in the part relating to the railway, and financial monitoring and supervision of the way in which HŽ does business, planning-analytical activities, activities of interdepartmental and international co-operation, communication with the Government of the Republic of Croatia and other state institutions, and inspections of the safety of railway transport. Everyday activities of the Railway Transport Management also include direct supervision over the public enterprise HŽ, as it is competent to ensure that the enterprise can function properly and without any obstacles. Most ongoing activities are linked to the structural reform of the railway system and adjustments to the *acquis communautaire* of the EU, and its preparation for competitive participation at the single transport market of the EU.

State aid is regulated by the State Aid Act (Official Gazette No. 47/03) and the Regulation on State Aid (Official Gazette No. 194/03), which is within the competence of the Agency for the Protection of Competition. In accordance with the said Act and the Regulation, state aid granted to the railway (i.e., to HŽ as beneficiary) belongs to the order of permitted aid and to the sector of "inland transport". In our case, we have two forms of state aid: severance pay grants and passenger railway transport grants.

The plans for development of railway infrastructure in the forthcoming period will focus mainly on projects on the following relations:

- Corridor from Hungary – Zagreb - Rijeka
 - Raising the level of service
 - Building of second rail track for sections Botovo - Dugo Selo and Zagreb - Karlovac
 - New section of rail tracks for Karlovac - Rijeka
- Relation from (Hungary; Slovenia-Zagreb) – Oštarije – Knin – Split
 - Reconstruction and raising of level of service
 - Partial new sections of rail tracks
- Relation Austria-Slovenia, Maribor – Pragersko – Zagreb - Rijeka
 - Reconstruction and building of new rail tracks
- Relation from Hungary - Beli Manastir – Vrpolje – BiH – Ploče
 - Raising the level of service

Taking into account the normalizing assumption of political events and the stabilizing of the economic relationships in the region, with the goal of reintegrating railway transport, the guidelines for development of transport point to the following:

- Ljubljana - Zagreb – Belgrade
 - Building of second rail track for sections Zagreb-Sisak and Kutina-Novska
 - New section of rail track for Sisak-Kutina

Inland waterway transport

The main transport resource in the sector of inland waterway transport is the Danube River with its tributaries, the Drava and the Sava. International transport goes through two most

important river ports, Vukovar and Osijek. Although the framework of the Transport Development Strategy of the Republic of Croatia defines amongst other things the development schedule of inland waterway transport, it has not been implemented according to that scenario, as other forms of transport, especially in the part relating to the construction of transport infrastructure, became a priority.

No development efforts led to the decay of inland waterway transport and to decrease of the share of inland waterway transport in total transport below 1%. Although the ports of Vukovar and Osijek marked an increase in transport in the last two years of over 30% per year, because of insufficient capacity and technological limitations they have not been able to achieve the level of operation they could have objectively achieved at the market.

Under the new Ports Act (Official Gazette No. 142/98), ports are organized according to the "landlord" principle, meaning that ports are operated by port management, while commercial activities are left up to port operators on the basis of concession agreements. Port management is in charge of the construction and maintenance of port structures, supervision over the work of port operators, safety and order in the port, environmental protection, and the control and supervision of transport. In addition, port management also passes necessary legal deeds regulating mutual relations and order in the port. The concession model enables the engagement of private domestic and foreign port operators, if there is such interest and if an appropriate development program is presented. The placement of port fees under the control of port management and the publication of port tariffs result in a non-discriminating and transparent relationship towards beneficiaries. At the moment, the biggest obstacle to a faster implementation of this model are still unresolved property-legal relations regarding land and property within the port area, so the solution of this issue is a priority of port management, as the "landlord" model presumes state ownership of the entire land with the relevant infrastructure in the area of the port.

In the development of inland waterway transport, Croatia wants to follow the principles of the European transport policy, which stimulates the use of navigation routes and inland waterway transport as a socially acceptable form of transport and its integration in the intermodal transport network. Key tasks in the realization of this goal are as follows:

1. integration of inland navigation into the single, intermodal transport system
2. creation of conditions beneficial to further development of this form of transport,
3. encouragement of business entities to use this form of transport.

The strategic objectives of inland waterway transport in Croatia are as follows:

1. integration of inland navigation into the single transport system of the EU,
2. intermodality with the railway and sea transport,
3. connecting of the Danube region and the Adriatic, river ports and sea ports as part of a single logistic chain,
4. increase of the share of inland waterway transport in overall transport,
5. improvement of safety by introduction of innovations and new technologies.

Air transport

In the next two years, the Ministry of the Sea, Tourism, Transport and Development plans to keep working on further harmonization of our legislation with the EU legislation, especially in the part relating to airplane arrivals and departures, passengers, baggage and cargo (ground handling) and slot allocation.

The Act on Amendments to the Air Transport Act, which will be passed by the end of 2004, will harmonize amongst other things the organization and competence of an autonomous and functionally independent body for research of the safety and airplane accidents, in accordance with the legislation and practice of the European Union Member States.

In addition, in accordance with the provisions of the State Aid Act (Official Gazette No. 47/03) and the Regulation on State Aid (Official Gazette No. 121/2003), the Air Traffic Directorate asked the Agency for the Protection of Competition for an opinion on three proposals of general state aid for 2005 (Financial Transfers to Publicly Owned Entrepreneurs), which should ensure funds for the supply of equipment and performance of works important for the safety and protection of air transport. The Agency as a body competent for the approval, supervision and refund of state aid will work on full harmonization of the area of state aid and market competition rules with the EU legislation.

By its status of full member of the Joint Aviation Authority, the Republic of Croatia has met one of the preconditions for future admission to the European Union (fulfillment of the safety standard).

As the European Commission has formally requested the Council of Ministers to set the term for the beginning of negotiations with the countries in our region on participation in the European Common Aviation Area - ECAA, it is expected that at the initiative of the European Commission negotiations with the Republic of Croatia on the conclusion of a comprehensive Air Traffic Agreement, which should ensure common access to airplane market, will begin in early 2005. This Agreement would be based on Article 58 of the Stabilization and Association Agreement between the European Union and the Republic of Croatia.

As far as price regulation is concerned, at the moment no regulation of the Republic of Croatia regulates the issue of prices for air transport services. However, bilateral agreements concluded between the Government of the Republic of Croatia and the governments of other countries, which regulate the issue of scheduled air services, basically do regulate the issue of prices of scheduled air services.

Considering that the price of charter air services is a matter of agreement between the air transporter and the customer, the amounts and conditions of application basically cannot be regulated by legislation.

In accordance with the planned schedule of harmonization of the legislation of the Republic of Croatia with the *acquis communautaire* of the European Union, the Air Transport Board anticipated as a legislative measure for 2006 the adoption of an implementing regulation that would fully harmonize the existing legislation with the European Union directives that regulate the issue of prices for air transport services.

Maritime transport. The Republic of Croatia is taking steps regarding maritime transport in the direction of five basic set of goals.

The first goal relates to the enrichment and beginning of competition in the performance of public coastal scheduled maritime transport and the development of passenger maritime transport in national navigation and to a decrease of funds from the state budget of the Republic of Croatia on the grounds of aid for the performance of the said activity.

The second goal is to enable maximum flexibility in the maintenance of international passenger lines.

The third set of goals relates to the sustainability, durability and competitiveness of maritime transport in international market conditions, including activities that should contribute to the engagement of Croatian sailors and shipping companies in international navigation.

The fourth set of goals relates to the rerouting of a part of ground transport from roads to maritime infrastructure with the aim of alleviating inland roads, thus enabling the development of environmentally acceptable forms of transport and introduction of maritime lines that will be tied to the European network of coastal navigation.

The fifth goal are investments in the modernization of infrastructure in ports open to public transport, thus creating competitive business conditions in Croatian ports and increasing both cargo and passenger transport. Privatization of port operators and competitiveness of ports are made possible.

The goals should be achieved following the adoption of an appropriate legislative framework. The Maritime Code is about to be adopted (the 2nd reading in the Parliament; according to expectations, the Code will be adopted by the end of 2004). The new Act on Public Transport in Regular Coastal Maritime Navigation is also planned (planned elaboration and adoption 2004-2005; commencement of application of the Act - 1 January 2006). It will be in line with other special acts regulating the issue at the moment. It is the intention of the future Act to give priority to a shipping company that offers the highest concession fee (on expectedly profitable lines) or the shipping company that asks for the smallest amount of grant out of the State Budget (on unprofitable lines).

In the process of adjustment, it is inevitable to protect domestic passenger shipping companies by gradual introduction of cabotage (as done by other maritime countries; for example, by Italy and Greece). Cabotage would not be possible before the entry of the Republic of Croatia to the European Union, and after that a transitional period for its introduction would be necessary.

An office is planned that would coordinate certain activities with the competent ministries and other institutions of the regional states in order to enable the establishment of regular ship lines.

It is planned to discuss incentives to road transporters who would use alternative maritime routes (transport of vehicles by RO-RO ships), primarily because of environmental reasons, but also to alleviate roads and encourage shipping companies to offer lower maritime freight and stimulate road transporters to use maritime routes.

In the period 2005-2007, further work on the legislation and the completion of technical implementation of the ISPS Code are also expected. Ports will undergo further modernization with respect to environmental standards, and it is expected that a reduction of business costs will lead to a strengthened competitiveness of the port system.

Telecommunications and post

The area of telecommunications in the Republic of Croatia is regulated by the Telecommunications Act (Official Gazette No. 122/03), the Act on Division of Hrvatske pošte and telekomunikacije to Hrvatska pošta and Hrvatske telekomunikacije (Official Gazette No. 101/98), the Electronic Media Act (Official Gazette No. 122/03), and the Hrvatska radiotelevizija Act (Official Gazette No. 25/03).

The Telecommunications Act regulates the field of telecommunications and radio communications, the way and conditions of providing telecommunications services and performing activities, the rights and liabilities of providers and users of telecommunications services, the construction, maintenance and use of the telecommunications infrastructure and equipment, of radio equipment and telecommunications terminal equipment, the management of the radio frequency spectrum, the addressing and numbering space in the Republic of Croatia, the electromagnetic compatibility, data protection in telecommunications, and the

performance of supervision and control in telecommunications. The Act entered into force in August 2003.

The Act regulates the establishment of the Croatian Telecommunications Agency instead of the two (present) regulatory bodies: the Telecommunications Council and the Institute of Telecommunications. The jurisdiction and scope of work of the two bodies were joined into one. The Government of the Republic of Croatia proposed members of the Council of the Croatian Telecommunications Agency in September 2004. The Croatian Parliament appointed members and the president of the Council on 17 September 2004, and the Agency became functional.

The Act provides for the adoption of 31 ordinances. Most ordinances have entered into force, and the rest are in the process of drafting and will be adopted by the end of December 2004 or in early 2005.

Regarding the GSM mobile network, there are two mobile network operators in Croatia: T – Mobile Hrvatska d.o.o. and VIPnet. d.o.o. Penetration of the mobile network is about 63%. There is only one fixed network operator: HT - Hrvatske telekomunikacije d.d. (monopolistic position). The Republic of Croatia has a 49% share in HT-Hrvatske telekomunikacije d.d., and Deutsche Telekom 51%. VIPnet is fully in private ownership. HT - Hrvatske telekomunikacije d.d. provides fixed network services (in monopolistic position) and mobile network services, and VIPnet d.o.o., which provides only mobile network services, is fully in private ownership.)

In August 2004, the Telecommunications Council published a public tender for the award of three concessions in the mobile network of the 2nd generation and four concessions in the mobile network of the 3rd generation. The two GSM companies dictate prices in the mobile network, and they are quite high. Following the entry of new mobile network operators, it is expected that the prices will drop to an acceptable level. However, there is still no interest for the entry of new fixed network operators.

There are twenty (20) registered Internet operators (for the time being not all of them provide services) and they are all privately owned. According to research conducted by the Croatian branch office of IDC, there were a bit over a million Internet users in Croatia in September 2003, that is, about 26%. With the aim of encouraging the use of Internet, the Rules on Payment of Fees state that the application fee for the service of providing Internet access would be at the level of handling costs, and that after the application fee operators do not have to pay remuneration for ensuing years. Over 80% of Internet access is carried out through "dial up".

Eleven companies are registered for VOiP services.

Cable television market became livelier in the past several years. The existing cable TV providers are privately owned. There are 20 concessionaires in Croatia. Mostly they are local concessionaires, with the exception of DCM whose concession rights cover the entire state.

In order to liberalize the telecommunications market as fully and as fast as possible by 2007, the Electronic Communications Act will be passed that will be fully harmonized with the new legislative framework of the EU. In order to achieve that, we have to amend the Electronic Media Act, the Telecommunications Act and the Postal Act.

Following the appointment of the Agency Council, conditions have been met to establish the Council of Telecommunications Services Users as an advisory body which participates in the resolution of disputes between providers and users of public telecommunications services. Members of the Council of Telecommunications Services Users shall be appointed by the Agency Council from representatives of users and providers of public telecommunications

services, competent bodies of the state administration and distinguished experts from the area of telecommunications and consumer protection, where one third of the members of the Council of Telecommunications Services Users must consist of representatives of associations for protection of consumers. The Council shall monitor and analyze the state in the area of public telecommunications services, and particularly the level of the quality and prices of services and, in connection with that, it is entitled to require through the Agency and from the provider of public telecommunications services the necessary data and documentation. The Council is obligated to regularly, and at least once a year, report about its opinions, appraisals and conclusions to the Ministry, the Agency and other competent bodies, and to give suggestions for undertaking measures.

In the next period, the Agency Council will establish regular and intensive co-operation and harmonization with other relevant institutions, and primarily the competent Ministry (Directorate for Telecommunications and Post), the Agency for the Protection of Competition and the Council for Consumer Protection.

By 1 January 2005, it will be necessary to pass amendments to the Rules on Payment of Fees for the Performance of Telecommunications Services and Activities (Official Gazette 49/04 and 57/04), so that the amount of prescribed fees for permits, applications and powers would be in line with the amounts that do not exceed the amount of administrative costs that are incurred in the procedure of issuance of permits or powers, or of submission of applications, and in the operation, control and implementation of the procedure. In such way the implementing regulation will be fully harmonized with the part of the *acquis communautaire* regarding fees.

In the area of international co-operation in telecommunications, the Republic of Croatia has signed all of the most important international conventions and agreements, on the basis of which it has become member of international telecommunications organizations, specifically: International Telecommunication Union - ITU (the ITU Constitution and Convention signed in 1992), the European Conference of Postal and Telecommunications Administrations - CEPT (as of 1992), the European Telecommunications Standards Institute - ETSI (as of 1994), the European Radio communications Office - ERO (the Convention establishing the European Radio communications Office was signed in 1994), international organizations for satellite radio communications (INTELSAT, INMARSAT, EUTELSAT) and others. In the field of electronic media, the Republic of Croatia signed the European Convention on Cross-border Television and the Protocol amending the European Convention on Cross-border Television in 1999 (Act on Ratification of the European Convention on Cross-border Television and the Protocol amending the European Convention on Cross-border Television (Official Gazette No. 11/01)), and in the field of information technology the Republic of Croatia signed the Convention on Cyber Crime in 2001 (Act on Ratification of the Convention on Cyber Crime (Official Gazette No. 9/02)).

Presently, the Convention establishing the European Communications Office (ECO), which will replace the until now valid Convention establishing the European Radio communications Office of 1994 is in the process of signing. The aim is to establish a new single expert body within the CEPT, in accordance with the implemented structural changes in that European organization, joined by the Republic of Croatia in 1992.

The area of post and postal services is regulated by the Postal Act (Official Gazette Nos. 172/03 and 15/04) and the Act on Division of Hrvatske pošte and telekomunikacije to Hrvatska pošta and Hrvatske telekomunikacije (Official Gazette No. 101/98).

The new Postal Act harmonizes the provisions in the area of post and postal services with the requirements of the European Union for the purpose of initiating gradual liberalization of the

postal services market. It also introduces postal services and conditions under which the services will be performed at the free market, but also provides for reserved postal services over which Hrvatska pošta d.d. will retain exclusive rights until 2007, primarily with the aim of ensuring a specific necessary scope of postal services of specified quality for all customers throughout the territory of the Republic of Croatia and under the same conditions. Postal services with added value are performed in the Republic of Croatia by seven operators on the basis of applications. The operators are INTEREUROPA SAJAM, DPD CROATIA d.o.o. , IN TIME d.o.o., DHL- INTERNATIONAL, Rhea Express d.o.o., Lagermax AED Croatia d.o.o. and NULA JEDAN- BRZA POŠTA d.o.o.

The new Postal Act creates a stimulating normative framework and preconditions needed to promote the already accepted European standards that should contribute to a further improvement of the postal sector in the Republic of Croatia and its integration in the European and world postal infrastructure.

The Croatian Parliament appointed the Postal Services Council, at the proposal of the Government of the Republic of Croatia, on 9 September 2004. The Council was appointed for a term of five years. The president and deputy president of the Council were appointed by the Croatian Parliament from amongst the ranks of members of the Council. The president of the Postal Services Council represents the Council and is the only member of the Council who performs his duties on a professional basis. The Act specifically states conditions to be met by persons who are appointed as members of the Council, duties that are not compatible with membership in the Council, and conditions for recall of members of the Council before the end of their term of office.

The Postal Services Council will have an expert service that will perform administrative, expert and technical duties for the needs of the Council, as well as technical examinations.

4.6.10 Shipbuilding Sector

Shipbuilding is a strategically important industrial activity for the Croatian economy, because in the current degree of Croatian economic development, it represents a strong export branch with over 1000 Croatian equipment and service companies standing behind its the final product – the ship.

Undeniably, the Croatian shipbuilding industry has its place in the world market for ships, ensuring employment in this sector. Out of total world orders, Croatian shipbuilders take up from 1,5 to 2,3 %, placing Croatia as the 5th or 6th largest shipbuilding industry in the world. Shipbuilding, with an annual export of 500 - 700 mil USD, participates in the total exports of the Republic of Croatia with 12% to 15%, so it significantly contributes to the balance of payments of the country.

Many of the current problems in the shipbuilding industry stem from the war period in Croatia, when shipbuilding companies, which had been regarded as trustworthy partners, lost many buyers due to high risks. This caused a decrease in employment in this sector, which with high fixed costs "produced" large losses and caused many shipbuilders to fall into total illiquidity.

Experts who analyze and research shipbuilding markets expect that in the coming ten years the demand for new ships, in total, will not be lower but will probably increase due to the unavoidable cyclical movements in the demand for ships, and which leads to the conclusion that Croatian shipbuilding can expect a solid market demand in the forthcoming decade.

A special approach is inevitable regarding the shipbuilding industry in the key forthcoming period leading to 2015, because this industry plays a large role in the total economic development of Croatia.

For successful resistance to market competition, important factors are:

- Increasing the sophistication of products of the shipbuilding industry
- Creating new markets for ships on a commercially founded concept
- Gradual move to design and building of complex ships
- Boosting technology levels
- Increasing efficiency and cost competitiveness
- Using synergy effects on all possible levels (design, development, innovation, marketing and sales, procurement, financing...)

In the following periods Croatian shipbuilding industry should:

- In the period from 2005 to 2010, stabilize its business activity with strict implementation of the restructuring program (financial, organizational, technological and staff), following also the rationalization of business costs according to the program which will be defined by the government of the Republic of Croatia. In this transitional period the legislation of RH needs to conform to that of the European Union.
- Following that, ensure the conditions for final privatization of this economic activity.

In order to achieve these goals, it is necessary, in the aforementioned period, that Croatian shipbuilding companies receive support from the government through the following means:

- Government guarantees until sufficient credit standing conditions are achieved
- Subsidies as measures necessary for equalizing conditions with world competition,
- Restructuring (financial, organizational, technological, technical, and of its staff) through use of appropriate EU funds.
- Research, development and innovation in Croatian shipbuilding industry through use of appropriate EU funds.
- Investment in further technological development of shipbuilding with the aim of achieving competitiveness.
- Investment in training of staff.

4.6.11 Investing in Croatia

Aware of the importance of investment for the domestic economy, besides capital which it brings and *know-how*, new markets, modernization of production, increase in competitiveness of the entire economy and employment, the Croatian government in cooperation with Multilateral Investment Guarantee Agency (MIGA) and Foreign Investment Advisory Service (FIAS) is working on removing barriers to investment. The government already started the «*One-Stop Shop*» project, and entrepreneurs will be able to start using One-stop shop services as early as the first half of next year on counters of the Financial Agency (FINA). When the project is complete in 2007, entrepreneurs and citizens will be able to conduct the majority of administrative tasks through this way.

According to its foreign direct investment figures, Croatia belongs to the more successful transition countries (directly behind Poland, the Czech Republic, and Hungary). Those investments, however, are largely related to big privatization activities and sectors which are mainly oriented towards the domestic markets. In particular, the segment (export-oriented) “*greenfield*” investments, which could significantly change the structure of the economy and boost its growth and development, are not present in sufficient amount in Croatia. Therefore, the government of the Republic of Croatia, in scope of the one-stop shop concept, has decided to establish «*InvestCroatia*», an agency for proactive attraction of export-oriented *greenfield* foreign investments.

It is expected that the agency will mostly service investors (provide information and consultation) and generate investments (negotiations with investors, active search for investors, participation in investor conferences), but it would also work on the image of Croatia as an investment- and business-friendly destination, channel experience from work with investors who actively implement economic policy measures, and suggest measures for improving the business environment.

The expected organizational scheme incorporates all currently agreed-upon opinions on the functions of the agency, and besides its central office (with headquarters in Zagreb), it also includes regional offices in Varaždin, Osijek, Rijeka, and Split (detecting regional priorities, contact with key institutions and companies in the region, cooperation with development agencies), and an international network made up of agency employees and foreign consultants with the support of Croatian diplomatic offices.

The agency plans to have ten teams, with three members each, whose work scope will be adjusted to the activities of the agency, and sectoral and geographical division. It is planned, for example, that three teams cover:

- Activities tied to *image building*, promotional activities, organization of seminars, making of promotional materials, catalogues, brochures, promotional CDs, and others.
- Passing on of experience from work with investors who are economic policy makers, detecting advantages and disadvantages of the domestic business environment in relation to neighboring countries, and presentation to potential investors, suggestions to economic policy makers on way to remove existing investment barriers,
- Management and coordination of an internal network (regional offices), liaisons between the Agency and individual regional institutions, and the structure, detecting of possibilities and specific needs of each region, processing of requests at the regional level.

Seven teams will cover servicing of investors, negotiation with new investors, active search for investors, participation in investor conferences, knowledge of the market, knowledge of individual sectors and their needs, following and analysis of world FDI trends, analytical activities, knowledge of investment processes, post-investment problems, detection of problems that arise in the negotiation process and their resolution. At the same time, each of the seven teams will cover a few sectoral and geographical areas (for example, work with European investors in the pharmaceutical or chemical industry sectors).

Preparations for the organization are currently underway, and the Agency is expected to start functioning in early 2005.

5. ECONOMIC POLICY MATRIX

5.1. Entrepreneurial Sector		
5.1.1 Privatisation		
GOAL	POLICY MEASURES	PERIOD
Privatisation of large agricultural firms still owned by the state		
Quality preparation for privatisation Speeding up the process of privatisation	<ul style="list-style-type: none"> • Adoption and implementation of measures for financial consolidation and restructuring of agricultural companies in order to prepare them for privatisation • The Fund is currently preparing a draft model of privatisation of the companies 	end 2004
Privatisation of the tourist portfolio		
Quality preparation for privatisation Speeding up the process of privatisation	<ul style="list-style-type: none"> • Adoption and implementation of measures for financial consolidation and restructuring of hotel and tourism companies in order to prepare them for privatisation • Sale of minority shares through public auction at a faster pace • Adoption and implementation of the Operative plan for privatisation of leftover portfolio 	end 2004 end 2005. Adoption: 2004 Implementation: 2005
Protection of space necessary for sustainable development		
Protection of the sea coast Resolving land property issues which are not in company capital through privatisation of hotel and tourism companies	<ul style="list-style-type: none"> • Adopted an Act on regulation and protection of the sea and the seacoast • Adoption of amendments to the Law on privatisation 	Adopted 2004. To be adopted in 2005.
Privatisation of shipbuilding		
Quality preparation for privatisation Speeding up the process of privatisation	<ul style="list-style-type: none"> • Finalization of the process of financial consolidation as part of the preparation for privatization • Adoption of a master plan of privatisation • Sale of minority shares through public auction at a faster pace 	end 2005. end 2005. end 2005.

5.1.2 COMPETITION		
GOAL	POLICY MEASURES	PERIOD
Plans in the forthcoming time period (2004 – 2007)		
Harmonisation of the national legislation with the EU acquis	<ul style="list-style-type: none"> • adoption of relevant bylaws specifically regulating particular mechanisms as provided for by the Competition Act, and particularly: • Regulation on block exemption granted to certain categories of horizontal agreements • Regulation on block exemption granted to transfer of technology agreements, licensing agreements and know-how; • Regulation on block exemption granted to certain categories of agreements in insurance sector • monitoring of the frequent changes in the EU legislation and their implementation in the corresponding Croatian legislation, including the amendments to the Competition Act; 	<p>2004-2005</p> <p>by the end of 2004.</p> <p>by the end of 2004.</p> <p>early 2005</p> <p>continually</p>
Effective application of competition rules	<ul style="list-style-type: none"> • increase in the expert staff of the CCA and capacity building to ensure effective application of competition rules • establishment of active and permanent co-operation with other regulators in Croatia (Telecommunications Agency, Council for Postal Services, Directorate for the Supervision of Insurance Companies); • establishment of co-operation with consumer protection authorities (Ministry of the economy, Council for Consumer Protection); • increase in the financial resources of the CCA; 	<p>2004-2007</p> <p>initiative in 2004- conclusion of the agreements in 2005</p> <p>2005-2006</p> <p>2004-2007</p>
	<ul style="list-style-type: none"> • awareness raising on the importance of competition issues for the entire national economy, particularly in the business community and public authorities in the form of training, seminars and conferences ; 	2004-2007 (at least two seminars per year)

GOAL	POLICY MEASURES	PERIOD
Competition advocacy	<ul style="list-style-type: none"> • publishing of the annual of the CCA; • publishing of the gazette of the CCA; publishing of all important decisions and statements of the CAA, as well as drafts, professional papers and other sources of competition law and its application in practice in the Republic of Croatia on the official web site of the CAA; • strengthening of the independent status of the CCA with support of the CARDS Programme resources; • international co-operation with competition authorities and within the SEECAN Programme; 	<p>2004-2007 (annually)</p> <p>2004-2007 (quarterly)</p> <p>2004-2007 (continually)</p> <p>2003 until Croatia full membership in the EU</p> <p>2004-2007</p>
STATE AID		
Harmonisation of the national legislation with the EU acquis and transparency in decision making	<ul style="list-style-type: none"> • drafting of amendments to the State Aid Act; • adoption of the amendments to the State Aid Act; • drafting and adoption of the amendments to the Regulation on state aid with the objective to completely harmonise it with the EU acquis communautaire; • drafting of the notification form, establishing of the procedure concerning the authorisation, monitoring and keeping the register of state aid; • drafting of guidelines on horizontal aid and certain categories of sectoral aid; 	<p>krajem 2004.</p> <p>2005</p> <p>2005-2007</p> <p>2005</p> <p>2005</p>
	<ul style="list-style-type: none"> • laying down the procedure for filing complaints by the interested parties; 	2005

GOAL	POLICY MEASURES	PERIOD
Effective application of state aid rules	<ul style="list-style-type: none"> • monitoring of the frequent changes in the EU legislation and their implementation in the corresponding Croatian legislation; • compilation of the final list of the existing state aid schemes by providers; • adjustment of the state aid programmes in compliance with the criteria stipulated under the SAA and the state aid system within the EU; • increase in the expert staff of the CCA and further capacity building for effective application of state aid rules; • establishing of the state aid inventory and the state aid register; • purchase of IT equipment (hardware and software) and development of a computer data base for monitoring state aid, supported by the resources from the CARDS Programme; • increase in the financial resources of the CCA from the state budget; • use of the resources from the CARDS Programme for strengthening the performance and the regulatory activities of the CCA; • training of the CCA staff in the EU member states within the twinning project ; 	<p>continually</p> <p>2005</p> <p>2005</p> <p>2005-2007</p> <p>2005</p> <p>2005</p> <p>2005-2007</p> <p>by Croatia membership in the EU</p> <p>2005-2006</p>
State aid advocacy	<p>awareness raising, especially among state aid providers, on the importance of</p> <ul style="list-style-type: none"> • the adjustment of state aid within the specified time limits and regular and timely notification of new state aid proposals to the CCA; • including state aid on the local level. 	<p>continually</p> <p>2005</p>

GOAL	POLICY MEASURES	PERIOD
5.1.3 Public Utilities - Energy Sector		
Liberalisation of the Energy Market		
Harmonisation of the legislative framework with the EU <i>acquis communautaire</i>	<ul style="list-style-type: none"> ● adoption of amendments to the package of energy acts ● strengthening of the Energy Directorate in the Ministry ● strengthening of the Energy Activities Regulatory Council ● Restructuring of HEP ● Restructuring of INA with emphasis on gas storage ● Restructuring of gas distributors in accordance with the Directives 	2005 continuous 2006 2007
Achieving the goal of having a 4.5% share of renewable sources in overall electricity consumption	<ul style="list-style-type: none"> ● Adjustments to the legal-institutional framework ● Establishment of the Agency for Renewable Sources and Energy Efficiency Financing by state aid from the Environmental Protection and Energy Efficiency Fund, by guaranteed redemption prices for OIE, and by international EU projects and funds	2010. continuous 2005→
More efficient use of energy	<ul style="list-style-type: none"> ● Adjustments to the legal-institutional framework ● Establishment of the Agency for Renewable Sources and Energy Efficiency ● Adoption and implementation of the energy efficiency programme of the Croatian Government and of local/regional self-government ● Financing by state aid from the Environmental Protection and Energy Efficiency Fund, and by international EU projects and funds 	2010 continuous 2006 2005

GOAL	POLICY MEASURES	PERIOD
Ensuring adequate oil and oil derivatives reserves (reducing the required oil and oil derivatives reserves to the 90-day level, including the fact that RC satisfies 25% of its overall consumption out of domestic sources)	<ul style="list-style-type: none"> Increasing the reserves to 75 days (reduced by 25% of domestic production) 	2006
	<ul style="list-style-type: none"> Increasing the reserves to 90 days (reduced by 25% of domestic production) 	2007
Harmonisation	<ul style="list-style-type: none"> Monitoring EU legislation 	continuous
Commencement of operation of the State Institute for Nuclear Safety	<ul style="list-style-type: none"> Adoption of the Regulation on Internal Organisation and other decisions/deeds needed for the beginning of work 	2004
	<ul style="list-style-type: none"> Acquisition of equipment 	2004
	<ul style="list-style-type: none"> Finding the premises 	2004
Subordinate legislation according to the Nuclear Safety Act	<ul style="list-style-type: none"> Ordinance on the Control of Nuclear Material and Special Equipment (Art. 4, 7, 16 and 17) 	2005
	<ul style="list-style-type: none"> Ordinance on the Conditions for the Performance of Activities from the Area of Nuclear Safety (Art. 24) 	2005
	<ul style="list-style-type: none"> Ordinance on the Location, Design, Construction, Use and Dismantling of Structures in which Nuclear Activities are Performed (Art. 8) 	2005
Intensifying the control of nuclear material	<ul style="list-style-type: none"> Intensifying of co-operation between various departments and further programme of acquiring the needed equipment 	2004
	<ul style="list-style-type: none"> Assembly of the acquired stationary equipment 	2005
	<ul style="list-style-type: none"> Trial work with new personal and manual equipment at new locations 	2005
	<ul style="list-style-type: none"> Trial work with new portable equipment 	2006
Upgrading the level of alertness in case of a nuclear accident	<ul style="list-style-type: none"> Development of preconditions for access and application of the EURDEP/ECURIE/RODOS systems 	2004
	<ul style="list-style-type: none"> Re-establishment of the national timely radiological warning system (SPRU) 	2005-2007
Harmonisation	<ul style="list-style-type: none"> Monitoring EU legislation 	Permanently

GOAL	POLICY MEASURES	PERIOD
5.1.4 Small and Medium Size Entrepreneurship		
Production incentives - products, innovations, connections to science		
<p>Modernisation of technological processes, higher level of product finalizing, mutual connecting between small and medium size enterprises, development of new products and new processes, as well as application of new technologies, reduction of import dependency, application of science in production</p>	<ul style="list-style-type: none"> ● Subsidies, aid, donations, sovereign guarantees and awards ● Co-financing in the form of outright aid for the coverage of costs and of interest subsidies on entrepreneurial loans ● incentives to specific economic activities and specific economic areas ● initial investments and opening of new work places ● granting of loans, international fairs and exhibitions ● research and development - agreement on co-operation with the Ministry of Science, Education and Sports 	2004 – 2008
Incentives for education		
<p>Improvement of the existing and acquisition of new knowledge and skills necessary for more successful business in small entrepreneurship</p>	<p>Subsidies, aid, donations, assistance</p> <p>Purpose:</p> <ul style="list-style-type: none"> ● co-financing and financing of the entrepreneurial infrastructure, outright aid for counselling, training and improvement of professional skills 	2004 – 2008
Incentives to the entrepreneurial infrastructure		
<p>Faster regional and local development and creation of conditions to enable the local and regional self-government to create conditions for the development of business entities through such support institutions with the aim of uniform development of the economy of Republic of Croatia</p>	<p>Subsidies, aid, capital assistance, assistance, donations</p> <p>Purpose:</p> <ul style="list-style-type: none"> ● co-financing of initial investments, incentives to specific economic activities and specific economic areas, creation of new work places, increase of the number of business enterprises in small entrepreneurship 	2004 – 2008
Subsidies for interest on loans and aid		

GOAL	POLICY MEASURES	PERIOD
Change of the structure of activities in small entrepreneurship in favour of production, faster inclusion in the economy of special target groups (youth, women, veterans), increase in the number of business enterprises and newly-employed workers in small and medium size companies, co-operatives, crafts and other forms of small entrepreneurship	Subsidies to financial institutions outside state administration, outright aid Purpose: <ul style="list-style-type: none"> • co-financing through interest subsidies on entrepreneurial loans, state aid of small value 	2004 – 2008
Promotion of entrepreneurship		
Promotion of entrepreneurial spirit Raising the level of entrepreneurial culture Creation of a positive entrepreneurial environment	<ul style="list-style-type: none"> • through media as support to Croatia's economic and social goals • presentation of successful individuals and subjects, and programmes and institutions implementing them • * state aid of small value 	2004 – 2008
Incentives for social target groups		
Raising the general level of entrepreneurial knowledge and skills, creating a stimulating environment with the aim of accepting entrepreneurship as a way of life as well as the starting point and moving force behind positive activities in all segments of society	<ul style="list-style-type: none"> • Subsidies, aid, sovereign guarantees, awards * outright aid for the coverage of costs in the form of state aid of small value 	2004 – 2008
Incentives for the cooperative system		
Incentives for the cooperative system with the aim of boosting employment, raising the living standard, and developing the economy as a whole, in accordance with the Programme of the Government of RC and the Programme of Incentives to Small and Medium Size Entrepreneurship	Subsidies, aid, donations, assistance Co-financing for <ul style="list-style-type: none"> • * initial investments and opening of new work posts * encouragement of environmentally friendly production and eco-knowledge 	2004 – 2008
Incentives for marketing activities		
Incentives for the development of entrepreneurs, promotion of products and creation of conditions for better quality co-operation and connections with other entities on the market.	Subsidies, aid, donations <ul style="list-style-type: none"> • Purpose: * co-financing of costs in the form of state aid of small value 	2004 – 2008

GOAL	POLICY MEASURES	PERIOD
International activities of entrepreneurs		
Encourage export by small size entrepreneurs and increase the export of products and services through incentives that stimulate business, develop new export products and services, find export markets and improve and upgrade export programmes in which small size entrepreneurial sector had good results.	<p>Subsidies, aid, donations, sovereign guarantees</p> <p>Purpose:</p> <ul style="list-style-type: none"> * co-financing of costs in the form of state aid of small value * agreements with the Croatian Bank for Reconstruction and Development on more favourable terms for crediting export 	2004 – 2008
Harmonisation of the legislative framework with the EU acquis		
Harmonisation	<ul style="list-style-type: none"> Monitoring EU legislation 	continuous
5.2 Financial Sector		
5.2.1. Banking System		
Policy Goal	Implementing Measures	Time
Harmonisation of the legislation according to the EU legislation	<p>The following subordinate deeds have been adopted and implemented: Decision on Capital Adequacy, Decision on Limitation of Exposure of Banks to Foreign Currency Risk, Decision on Classification of Placements and Potential Obligations of Banks, Decision on Consolidated Financial Statements of a</p> <ul style="list-style-type: none"> Group of Banks, Decision on the Audit of Financial Statements and Business Functions of Banks, Decision on the Protection of Competition within the Banking Sector, and the Decision on the Application of the Provisions of Laws and other Legislation within the Competence of the Croatian National Bank to Banks in Liquidation. 	Adopted in 2003
Assessment of the stability of the overall domestic financial system	<p>Development of an analysis of early warning indicators with respect to difficulties in the business of banks, and an analysis of the sensitivity of the</p> <ul style="list-style-type: none"> banking system as a whole to macroeconomic indicators, and finally a macro solvency analysis 	continuous
Protection of consumers in the banking sector	<ul style="list-style-type: none"> Adoption of the Act on Interest 	Adopted in 2004

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> Adoption of regulations on the amount of interest rates based on the Act on Interest 	October 2004
Payment system reform	<ul style="list-style-type: none"> Adoption of the act on the payment system in the country <p>With the goal of improving the payment system in the country and establishing co-operation between various institutions in the area of payment, the Croatian National Bank established the National Payment System Committee. Members of the Committee are representatives of the Croatian National Bank, the Ministry of Finance, the Croatian Association of Banks and the Croatian Chamber of Economy.</p>	<p>Adopted in 2001, and became applicable in</p> <p>The Committee was formed in 2003</p>
5.2.2. Capital Market		
Further harmonisation of the legislation with the EU legislation	<p>Making of a new Investment Funds Act and amendments to the existing acts in accordance with the amended EU Directives (especially the Securities Market</p> <ul style="list-style-type: none"> Act in the part relating to the making of the prospectus, as well as the Act on the Takeover of Joint Stock Companies) and thus contributing to the legislative initiative of harmonisation with the EU <i>acquis communautaire</i>. 	Adoption 2005-2007
5.2.3. Insurance Sector		
Harmonisation of the legislation with the EU legislation and administrative strengthening	<ul style="list-style-type: none"> Making of a new Insurance Act 	Adoption 2005
5.2.4. Regulation of the Foreign Currency System		
Evaluation of the situation and further liberalisation of the capital account	<ul style="list-style-type: none"> Revocation of certain provisions of the Foreign Exchange Operations Act and subordinate legislation 	In line with deadlines given by the SSP

GOAL	POLICY MEASURES	PERIOD
5.2.5. Supervision of the Non-banking Sector		
Development of mutual co-operation between supervisory institutions and further unification of supervisory institutions to achieve the most efficient supervision over the financial sector	<ul style="list-style-type: none"> Adoption of the Programme of Supervision over Financial Institutions and the Financial Market on a Consolidated Basis and the formation of a co-ordinating committee for financial institution supervision Unification of institutions for supervision over the non-banking sector 	<p>Adopted in 2003</p> <p>Implementation 2005-2007</p>
5.3 Labour Market		
5.3.1 Employment and Safety at Work		
Policy Goal	Implementing Measures	Time
Creating efficient redundancy programmes for companies undergoing the restructuring process	<ul style="list-style-type: none"> Development of instruments for professional orientation, Formation of a Compulsory Redundancy Fund, Formation of 10 centres for supporting business changes in companies undergoing the restructuring process 	<p>2005</p> <p>2005</p> <p>continuous</p>
Strengthening the synergy of institutions at the local level and the capacity of local players in the implementation of an active employment policy	<ul style="list-style-type: none"> Establishment of local partnerships at the regional level, Selection of promising sectors in the counties and making of an analysis of the employers' needs in the sectors with respect to the skills and knowledge that their employees have to have, Development of a programme for training the unemployed based on the employers' needs. 	<p>2005 and 2006</p> <p>2006</p> <p>2006</p>
Strengthening the adjustment capacity of the Croatian Employment Bureau at all levels	<ul style="list-style-type: none"> Defining of a decentralised organisational structure of the Croatian Employment Bureau and of the operative management guidelines within the new decentralised organisation, 	2005

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> • Development of human resources at key positions within the Croatian Employment Bureau, • Defining of an implementation plan of the new decentralised structure. 	2005 2006
Development of a system for employing sensitive social groups who have more difficulties in finding employment	<ul style="list-style-type: none"> • Adoption, execution and implementation of the National Employment Action Plan, • Amendments to the Act on the Professional Rehabilitation and Employment of Disabled Persons 	2005 2005
Harmonisation	<ul style="list-style-type: none"> • Monitoring the EU legislation 	continuous
Safety at Work		
Harmonisation of the legislative framework with the EU acquis	<ul style="list-style-type: none"> • Adoption of subordinate legislation in line with the guidelines of the EU Directives • Strengthening of the Department for Safety at Work in the Ministry 	2005 continuous
Organisation of a special security system for work-related injuries and professional diseases	<ul style="list-style-type: none"> • Analysis of the justifiability of establishment of a special security system 	2006-2007
5.3.2 Pension System Reform		
Policy Goal	Implementing Measures	Time
Improvement of the Pension System Fiscal and Social Viability		
Change of the way of adjusting pensions by finding a new pension adjustment formula	<ul style="list-style-type: none"> • Analysis of the financial effects of the last amendment to the Pension Insurance Act, which enabled the adjustment of pensions in line with the growth of the average salary of all employed persons 	2005
Revision of parts of the pension insurance system that are not based on contributions	<ul style="list-style-type: none"> • Amendments to the Pension Insurance Act in the part relating to pension adjustment • Analysis of the impact of those parts of the pension system that are not based on contributions and of the benefits granted to special categories of the insured on the fiscal and social viability of the pension system 	2007

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> Amendments to special acts that recognise the rights out of pension insurance to special categories of insured persons 	
Adjustment of the Pension Insurance System to Social, Economic and Demographic Development		
<p>Strengthening social security of those persons who have non-conventional forms of work</p> <p>Creating conditions that will enable the inclusion in pension insurance of the largest possible number of persons who are outside the pension insurance system</p> <p>Simplifying the pension insurance application system</p> <p>Re-evaluating the possibility to impose the same retirement age for men and women, especially in the police and armed forces, and in the long run possibly increase the retirement age and make it the same for both men and women</p> <p>Achieving more efficiency and transparency in certain services of the pension system</p>	<ul style="list-style-type: none"> Creation of a legislative framework for more extensive coverage of persons who have non-conventional forms of work Amendments to the regulations regulating the pension insurance application system Amendments to special acts that regulate the system of pension insurance, and in the long run amendments to the Pension Insurance Act according to the goals stated in the Croatia's Pension System Development Strategy Informatization of the services of the Croatian Pension Insurance Fund and development of a continuous programme of employee training (with the funds received from the World Bank for the Pension System Investment Project (PSIP)) 	<p>2005</p> <p>2006</p> <p>2007</p> <p>2004-2007</p>
Proceeding with the Initiated Pension Reform		
<p>Re-evaluating the application of the institute of the insured years of service with prolonged duration</p>	<ul style="list-style-type: none"> Analysis of the efficiency of application of the institute insured years of service with prolonged duration in the conditions of the started pension reform Development of a comparative analysis of the safety at work of employees exposed to harmful conditions at work and of the working capacity of employees in Croatia and the EU Member States 	<p>2006</p> <p>continuous</p>

GOAL	POLICY MEASURES	PERIOD
Intensifying voluntary pension savings and simplifying access to voluntary insurance funds	<ul style="list-style-type: none"> ● Incentives to the popularisation of voluntary pension funds and encouraging interest in voluntary pension savings ● Amendments to the Act on Mandatory and Voluntary Pension Funds and the Act on Pension Insurance Companies and Payment of Pensions based on Individual Capitalised Savings 	continuous continuous
Encouraging the establishment of closed pension funds and re-evaluating occupational professional pension insurance Re-evaluating available options for investing the means of pension funds, depending on the increase of the available investment instruments in Croatia	<ul style="list-style-type: none"> ● Analysis of pension markets in the conditions of a poorly developed capital market 	continuous
Rationalising and adjusting organisational structures and strengthening administrative structures for the co-ordination of the social security system	<ul style="list-style-type: none"> ● Implementation of the restructuring of the Croatian Pension Insurance Fund, for which purpose the funds from the World Bank Pension System Investment Project (PSIP) are already in use 	2004-2007
Coordination of social security systems with EU member state systems		
Achieving the same or similar degree of social security for persons who during their career work in more than one country Primjena propisa EU na području socijalne sigurnosti	<ul style="list-style-type: none"> ● Revising the benefits for bilateral and multilateral contracts on social security ● Signing of contracts on social security ● Understanding the regulations of the acquis and its review of the degree of harmonization between Croatian regulations regarding pension insurance ● Harmonizing with the Directive 86/378/EEZ of July 24, 1986 on the implementation of the principle of equal treatment of men and women in social security schemes ● Harmonizing with the Directive 98/49/EEZ of June 29, 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community 	Continuous continuous 2006 2006 2005

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> Harmonizing with the Directive 2003/41/EZ of June 3, 2003 on the activities and supervision of institutions for occupational retirement provision. 	In line with given deadlines
5.3.3 Social Welfare Reform		
Policy Goal	Implementing Measures	Time
Improving System Efficiency		
Improving the transparency, information-related, scientific and expert bases of the system	<ul style="list-style-type: none"> Further informatization of the system and introduction of the register of beneficiaries 	2005- 2007
Improving the quality and introducing new forms of education of workers in the system of social welfare	<ul style="list-style-type: none"> Intensification of scientific-research work in the area of social policy 	continuous
Providing more information to the public about social rights and acceptance of European standards	<ul style="list-style-type: none"> Organisation of post-graduate studies and ongoing education of expert workers in the system Systematic education of employees about their social rights Providing more information to the beneficiaries and society about social rights 	continuous continuous continuous
Modernisation and Democratisation of the Social Welfare System		
Establishing new criteria for the realisation of social welfare rights	<ul style="list-style-type: none"> Tie the basis for the realisation of social welfare rights to an appropriate amount which would condition a continuous change of the amount of the basis 	2005 – 2007
Decentralising the system	<ul style="list-style-type: none"> Further decentralisation of management and new distribution of competencies 	continuous
De-etatisation and de-institutionalisation of the social assistance and social welfare systems	<ul style="list-style-type: none"> Partial privatisation of social welfare activities Development of non-institutional forms of welfare 	2005- 2007 continuous

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> Strengthening of co-operation with the non-governmental sector and stimulation of the development of the non-governmental sector Developing the institute of host family as a non-institutional form of welfare 	2005- 2007 continuous
Systematic Protection of the Rights and Interests of Children and Sensitive Groups		
Harmonisation with international standards	<ul style="list-style-type: none"> Implementation of the obligations established in national programmes 	2005- 2007
Rights of Minorities, Refugees and the Roma		
Protection of the rights of national minorities	<ul style="list-style-type: none"> Implementation of the Constitutional Act on the Rights of National Minorities Making of a report on the implementation of the Constitutional Act on the Rights of National Minorities 	continuous 2005
Inclusion of national minorities in social life, participation in public activities and integration in society	<ul style="list-style-type: none"> Co-operation with councils and national minority representatives Organisation of seminars about the education of councils and national minority representatives (until now seminars were held in Zagreb, Dubrovnik and Rijeka) 	continuous 2004, 2005, 2006, 2007
Improving the rights of national minorities in line with the international documents ratified by the Republic of Croatia	<ul style="list-style-type: none"> Monitoring of the application of the Framework Convention for the Protection of National Minorities Seminars on the implementation of the Framework Convention 	continuous 2005, 2006
National Programme for the Roma	<ul style="list-style-type: none"> Monitoring of the Implementation of the National Programme for the Roma 	continuous
Eliminating prejudices	<ul style="list-style-type: none"> Research Assimilation or Integration of the Roma and organisation of seminars for journalists on the affirmation of the Roma in the media 	2005
Creating preconditions for the realisation of the cultural autonomy of the Roma	<ul style="list-style-type: none"> Building of cultural centres 	2005 to 2007

GOAL	POLICY MEASURES	PERIOD
Preventing discrimination against the Roma	<ul style="list-style-type: none"> • Organisation of round tables on the promotion of the positive aspects of equal reporting about the Roma 	2005
Preserving traditional culture	<ul style="list-style-type: none"> • Organisation of seminars on the traditional Roma music and customs 	2005, 2006
Action Plan A Decade for the Roma	<ul style="list-style-type: none"> • Implementation of measures from the Action Plan A Decade for the Roma from the areas of education, employment, health care and housing 	2005 to 2015
5.4 Public Administration		
5.4 Public Administration Reform		
Policy Goal	Implementing Measures	Time
Re-organisation of Public Administration		
Developing an efficient public administration system	<p>The following institutional deeds were adopted and implemented: Act on the Organisation and Competence of Ministries and Government Administration</p> <ul style="list-style-type: none"> • Organisations, Act on Amendments to the Act on the Government of the Republic of Croatia, Regulation on Amendments to the Regulation on the Principles for Internal Organisation of State Administration Bodies 	Adopted and implemented in 2003
Reducing the size of public administration	<ul style="list-style-type: none"> • Adoption of a strategy for public administration reform and operative plans for its implementation 	Adoption: 2004-2005
Transparency, efficiency, orientation of the administration towards citizens	<ul style="list-style-type: none"> • Adoption of the methodology and execute a functional revision of the organisational structures, and accordingly adopt new rules on the internal organisation, and adjust human resources employment plans 	2004-2006
Rationalising organisational structures	<ul style="list-style-type: none"> • Adoption of amendments to the Rules of Procedure of the Government of the Republic of Croatia according to which the assessment of the fiscal, social and environmental effect of the proposed policies and laws becomes mandatory 	Adoption: 2004 Implementation 2005-2006
Improving the consistency of public administration and reduction of the mass of funds for salaries in public sector	<ul style="list-style-type: none"> • Performing an analysis of the performance of the activities of state administration at the level of central and first-instance bodies of state administration 	Implemented: 2004

GOAL	POLICY MEASURES	PERIOD
<p>Ensuring quality and fiscal acceptability of the proposed acts and policies</p> <p>Decentralising the activities of state administration</p> <p>Administrative strengthening in the services performing economic activities at the level of first-instance bodies of state administration</p>	<ul style="list-style-type: none"> ● Adoption of the State Administration Decentralisation Plan (based on the analysis) ● Performing an analysis of the performance of activities in the offices of state administration in the counties for the purpose of a rational re-distribution of human resources in favour of the performance of economic activities ● Adoption of the Regulation on Amendments to the Regulation on the Internal Organisation of County State Administration Offices (based on the analysis) 	<p>Adoption: 2004</p> <p>Implemented: 2004</p> <p>Adoption: 2004 Implementation: 2005</p>
Civil Servants		
<p>Ensuring better expertise of the administration through clear division between political and administrative positions</p> <p>Ensuring a uniform system of employment planning in state administration with the aim of achieving planned and cost-efficient use of budgetary funds</p> <p>Base the employment system in state and public administration on the principles of abilities/merits, expertise and impartiality</p> <p>Improved, more transparent methods and practice of civil servant management, including employment, selection, career management, promotion and salaries</p> <p>Ensuring consistency in the award system in state administration, introducing transparency in the system of salaries and awards, and introducing several elements based on merits and work</p>	<ul style="list-style-type: none"> ● Adoption of the Civil Service Act ● Adoption of subordinate legislation on the system and classification of work places and other implementing regulations for the Act on Civil Servants ● Adoption of the Act on Salaries in Civil Service ● Adoption of the plan of reducing the number of public and civil servants ● Adoption of new legislation on the conditions of employment in civil service, including provisions on collective negotiations 	<p>Adoption: 2004 Implementation: 2006</p> <p>Adoption: 2004</p> <p>Adoption: 2005 Implementation: 2006</p> <p>Adoption: 2005 Implementation: 2006</p> <p>2006</p>
Simplification of Administrative Procedures and Development of Modern Electronic Operations		
<p>Efficiency and expertise in administrative decision-making</p> <p>Shorter administrative procedure</p> <p>Easier realisation of the parties' rights</p>	<ul style="list-style-type: none"> ● Adoption of and implementation of amendments to the General Administrative Procedure Act ● Adoption of a new regulation on office work (adjusted to the electronic functioning of the administration) 	<p>2005-2007</p> <p>2005-2007</p>

GOAL	POLICY MEASURES	PERIOD
Strengthening of the role of electronic administration in the development of the economy	<ul style="list-style-type: none"> • Informatization of state administration offices in the counties 	2005-2007
	<ul style="list-style-type: none"> • Establishing the model and solution of interconnecting information systems of the bodies of state administration in a single telecommunications network for the purpose of strengthening the role of electronic administration in the development of the economy 	2005-2006
	<ul style="list-style-type: none"> • The project of making and publishing official forms of state administration bodies in electronic form, which citizens and business entities may submit in a public telecommunications network • Establishing the structure, forms and rules of action of the central computer register of civil servants 	2005-2006
Expert Training and Education of Civil Servants		
Improvement of the administrative capacity for the accession of Croatia to the EU	<ul style="list-style-type: none"> • Adoption of the Strategy of Expert Training and Education of Civil Servants 	2004
Strengthening of the horizontal education capacity in state administration	<ul style="list-style-type: none"> • Strengthening of the Centre for Expert Training and Education of Civil Servants (meaning the number of attendants and equipment) 	2005 – 2007
	<ul style="list-style-type: none"> • Preparation of a plan for educating civil servants and employees in state administration about computers and training of civil servants in the area of application of information technology and equipment 	2005 - 2007
	<ul style="list-style-type: none"> • Establishment of a system for exchange of experiences and co-ordination of activities of computer experts in state administration 	2005 - 2007
	<ul style="list-style-type: none"> • Accelerated language learning lessons for civil servants participating in the harmonisation of the EU legislation 	continuous
5.5 Agriculture		
5.5. Agricultural Reform		
Policy Goal	Implementing Measures	Time
Land Reform		
Improvement of the use of state-owned agricultural land	<ul style="list-style-type: none"> • Amendments to the Agricultural Land Act 	Adoption 2005
Development of the agricultural land market	<ul style="list-style-type: none"> • Establishment of an information system for the use of state-owned agricultural land 	2005 – 2007

GOAL	POLICY MEASURES	PERIOD
Improvement of the structure of agricultural holdings - enlarge the fragmented and splintered agricultural land	<ul style="list-style-type: none"> • Implementation of the pilot project «Enlargement of Agricultural Land» 	2005 – 2007
Improvement of the protection of agricultural land	<ul style="list-style-type: none"> • Harmonisation of the actual situation with the land books and the cadastre records for state-owned agricultural land 	2005 – 2007
Privatisation of Agro-conglomerates		
Finish the privatisation of agro-conglomerates	<ul style="list-style-type: none"> • Implementation of privatisation tender procedures for the remaining several companies (Croatian Privatisation Fund) 	End of 2005
Adoption of the Mechanisms of the Joint Agricultural Policy		
Form the Payment Agency	<ul style="list-style-type: none"> • Development of a plan of activities for the restructuring of the Directorate for Market and Structural Support in Agriculture in accordance with the standards of the EU Payment Agency and the mechanisms of pre-accession structural funds 	2005
	<ul style="list-style-type: none"> • Establishment of the organisational structure of the Agency 	2005 – 2007
	<ul style="list-style-type: none"> • Submission of the application for the accreditation of the Agency 	2005 – 2006
	<ul style="list-style-type: none"> • Strengthening the administrative capacity required for the performance of all functions of the EU Payment Agency 	continuous
Form the IACS	<ul style="list-style-type: none"> • Improvement and harmonisation of the Register of Agricultural Holdings with the Integrated Administration and Control System (IACS) with the application of GIS and more intensive supervision 	2005 – 2007
Form the FADN	<ul style="list-style-type: none"> • Establishment of the Farm Accountancy Data Network (FADN) 	2005 – 2007
Establishment of mechanisms for the implementation of rural development measures	<ul style="list-style-type: none"> • Development of the Rural Development Programme 	2005.
	<ul style="list-style-type: none"> • Administrative strengthening for the implementation of rural development measures 	2005. - 2007.
Establishment of the vineyard register	<ul style="list-style-type: none"> • Establishment of the Vineyard Register - in co-operation with the Ministry of Agriculture, Forestry and Water Management, Croatian Geodetic Directorate and the Vineyard and Wine Directorate 	2005 - 2007

GOAL	POLICY MEASURES	PERIOD
Harmonisation of Inspection Services with the EU		
Increasing the efficiency of agricultural inspection	<ul style="list-style-type: none"> • Restructuring of the inspection • Strengthening the administrative capacity of agricultural inspection 	2005 – 2007 continuous
Increasing the efficiency of administrative structures in the phytosanitary area	<ul style="list-style-type: none"> • Re-organizing the existing plant protection service • Development of the national plant protection service - unification of the management, inspection and diagnostics 	2005 – 2007 2005 – 2007
	<ul style="list-style-type: none"> • Strengthening administrative structures in all segments of the phytosanitary area • Educating phytosanitary inspectors about the implementation of all elements of phytosanitary control in accordance with the EU standards 	continuous continuous
Increasing the efficiency of administrative structures in the area of public health	<ul style="list-style-type: none"> • Educating agricultural inspectors about the control of the quality of agricultural products in accordance with the EU standards 	continuous
	<ul style="list-style-type: none"> • Acquiring of equipment for the laboratories of institutions for the protection of plants for vine- and wine-growing, for soil, for seeds and seedlings, and for fruit-growing, in accordance with the EU requirements 	2005 – 2007
Increasing the efficiency of administrative structures in the area of veterinary medicine and animal identification	<ul style="list-style-type: none"> • Strengthening administrative structures in all segments of veterinary medicine 	continuous
	<ul style="list-style-type: none"> • Continuation of the process of identification and registration of animals 	2005 – 2007
	<ul style="list-style-type: none"> • Acquiring of equipment and re-organise the laboratory of the Croatian Veterinary Institute in accordance with the EU requirements 	2005 – 2007
5.6 Other Reforms		
5.6.1 Health Care Reform		
Policy Goal	Implementing Measures	Time
Improvement of the Organisation and Operation of Primary Health Protection		
Completion of the privatisation process of doctors' offices	<ul style="list-style-type: none"> • Adoption of the Croatian Health Care Development Strategy until 2015 	2005 – 2007

GOAL	POLICY MEASURES	PERIOD
Completion of the informatization of primary health protection	<ul style="list-style-type: none"> ● Acquiring of computer equipment for doctors' offices and connect 3,000 offices with the central information system 	2005 – 2007
Organizing training for health care workers	<ul style="list-style-type: none"> ● Amendments to the Health Protection Act 	2005 – 2007
Securing financial stimulation of preventive examinations and health awareness	<ul style="list-style-type: none"> ● Amendments to the Health Insurance Act 	2005 – 2007
Re-organising health centres	<ul style="list-style-type: none"> ● Amendments to the implementing deeds of the Croatian Health Insurance Fund 	2005 – 2007
Improvement of the Organisation and Operation of Secondary and Tertiary Health Protection		
Categorisation and accreditation of hospitals	<ul style="list-style-type: none"> ● Adoption of Croatian Health Care Development Strategy until 2015 	2005 – 2007
Increase the efficiency, flow and quality of patient processing	<ul style="list-style-type: none"> ● Adoption of the Ordinance on Hospital Categorisation 	2005 – 2007
Improve the infrastructure and medical equipment	<ul style="list-style-type: none"> ● Adoption of the Ordinance on Hospital Accreditation 	2005 – 2007
Continue the process of informatization of hospital institutions and connecting them to the central information system	<ul style="list-style-type: none"> ● Secure funds for the continuation of the informatization process of hospital institutions, and verify the functionality of workshop solutions of hospital informatization 	2005 – 2007
Improve the work of inspection services	<ul style="list-style-type: none"> ● Analyse the situation regarding medical-technical equipment and adopt the plan of investments in hospital institutions and medical equipment 	2005 – 2007
	<ul style="list-style-type: none"> ● Secure funds for the implementation of health and expert supervision, proceed with the education of human resources 	2005 – 2007
Stabilization of the Systems of Health Care and Health Insurance		
Reducing medical expenditure	<ul style="list-style-type: none"> ● Adopt a number of ordinances regulating the area of medicaments (registration and marketing, price determination, changes to the medicament list, etc.) 	2005 – 2007
Reducing on hospital expenditure	<ul style="list-style-type: none"> ● Amendments to the implementing deeds of the Croatian Health Insurance Fund 	2005 – 2007

GOAL	POLICY MEASURES	PERIOD
Changes to the package of health services out of basic health insurance	<ul style="list-style-type: none"> • Amendments to the Health Protection Act 	2005 – 2007
Improving the system of payment for services in hospital institutions	<ul style="list-style-type: none"> • Amendments to the Health Insurance Act • Amendments to the implementing deeds of the Croatian Health Insurance Fund 	2005 – 2007
Taking an Active Role in Human Resources Management with respect to Doctors of Medicine		
Adjustment of the number of doctors of medicine entering the health care system with the actual needs	<ul style="list-style-type: none"> • Adjustment of enrolment quotas at schools of medicine 	2005 – 2007
Enabling internship immediately after graduation	<ul style="list-style-type: none"> • Financial stimulation to health institutions for the employment of interns 	2005 – 2007
Planned approach to the opening of new work posts and approval of specialisations	<ul style="list-style-type: none"> • Preparation of a Specialisation and Sub-specialisation Plan based on the analysis of the needs for specific health care specialists 	2005 – 2007
Harmonisation of Public Health Legislation with the European Union		
	<ul style="list-style-type: none"> • Adoption of the Act on the Protection of the Population against Infectious Diseases 	2005 – 2007
	<ul style="list-style-type: none"> • Harmonisation of the Act on Limited Use of Tobacco Products with the EU Directives 	2005 – 2007
	<ul style="list-style-type: none"> • Adoption of the Blood Supply Act 	2005 – 2007
	<ul style="list-style-type: none"> • Adoption of the Act on the Taking of Human Body Parts for Transplantation Purposes 	2005 – 2007
	<ul style="list-style-type: none"> • Adoption of a number of subordinate deeds regulation transplantation 	2005 – 2007
5.6.2 Information Technology		
Policy Goal	Implementing Measures	Time
Liberalization of the telecommunications market	<ul style="list-style-type: none"> • Adopt the secondary legislation of the EU essential to continue the liberalization process; 	2007
	<ul style="list-style-type: none"> • ensure efficient regulatory control; 	2004

GOAL	POLICY MEASURES	PERIOD
Development of information and communication infrastructure	<ul style="list-style-type: none"> ● apply European and international information technology standards; ● establish the framework for inter-operability of information systems and computer-communication equipment in state administration; ● establish common criteria and recommendations for the security of data and computer-communication equipment; ● establish the Agency for Information System Support as institutional infrastructure for the integration of information systems of state administration and the establishment of the central information portal about the work of public administration and public services on the Internet; ● establish the technological basis for efficient protection of personal data; 	<p>continuous</p> <p>2007</p> <p>2004</p> <p>2005</p> <p>2005</p>
Meeting of infrastructural preconditions for the availability of the advanced services of information society	<ul style="list-style-type: none"> ● modernise the telecommunications network; ● ensure open and universal access to the public telecommunications network; ● enable the application of electronic signature infrastructure, especially in the area of rendering public services to citizens and enterprises; 	<p>continuous</p> <p>continuous</p> <p>2005</p>
Increase in the number of users of information society services	<ul style="list-style-type: none"> ● enable access to the Internet with broadband data transfer at affordable prices; ● encourage the development of information society services and the application of electronic signature infrastructure, especially in the area of rendering public services to citizens and enterprises; ● promote e-trade at all levels; ● adopt incentives, especially for under-represented social groups (the youth and the elderly, women, people with special needs); 	<p>2005</p> <p>continuous</p> <p>continuous</p> <p>2005</p>

GOAL	POLICY MEASURES	PERIOD
Establishment of systematic monitoring and measuring of the results of implementation of implementing documents	<ul style="list-style-type: none"> establishment of mechanisms for systematic measuring and monitoring of information society development indicators in accordance with the methods of measuring the implementation of the Action Plan eEurope 2005 and the EUROSTAT standards; 	2004
Raising the competitiveness of Croatia's economy based on new technologies	<ul style="list-style-type: none"> stimulating innovations and establishing companies that would develop new technologies and services based on knowledge; development of technological parks and incubators; with support to companies active in the development and support to e-trade, information society services and new technologies; 	continuous continuous
5.6.3 Regional Development		
Policy Goal	Implementing Measures	Time
Strategic Framework - Competence: Ministry of the Sea, Tourism, Transport and Development, Ministry of Finance, Government Strategy Office, Ministry of the Economy, Labour and Entrepreneurship, the Counties		
Establish the main principles and goals of regional development	<ul style="list-style-type: none"> Development of the regional development strategy 	2005-2007
Adjust the policies and instruments of regional development	<ul style="list-style-type: none"> Define short-term and long-term goals of regional development 	
Establish the main priorities of regional development	<ul style="list-style-type: none"> Develop regional development programmes and institutions for their implementation 	
Institutional Framework - Competence: Government, the counties		
Establish institutions for the adjustment of the regional development policy	<ul style="list-style-type: none"> Establish the Regional Development Committee as a co-ordinating authority and the Regional Development Council as an advisory body of the Committee 	2005-2007

GOAL	POLICY MEASURES	PERIOD
Adjust regional development policies of the ministries Adjust the policy of the central state with the regions	<ul style="list-style-type: none"> ● Establish the National Agency for Regional Development ● Establish the network of regional agencies at the level of regions/counties according to the NUTS 2 categorization (5 agencies) 	
Legislative Framework - Competence: Ministry of the Sea, Tourism, Transport and Development, Ministry of Finance, central office for state administration, Government, Association of Towns and Municipalities		
Establish clear rules and responsibilities for the implementation of regional policies	<ul style="list-style-type: none"> ● Proposal and making of the Regional Development Act ● Harmonise the existing acts with the Regional Development Act 	2005-2007
Regional Inequalities - Competence: Ministry of the Sea, Tourism, Transport and Development, Ministry of Finance, Ministry of the Economy, Croatian Bureau of Statistics and the Economic Institute		
Balancing regional differences in development More clear definition of the areas whose development the state should stimulate	<ul style="list-style-type: none"> ● Establish the degree of regional economic development ● Define priority regions and local units with GDP below average 	2005
Regional Financing - Competence: Ministry of Finance (department for local budgets and department for macroeconomic analysis)		
Harmonising state and regional budgetary policies Making regional development more uniform and assessment of revenues and expenditures Evaluating fiscal inequalities and determining the criteria for granting state aid Defining low fiscal capacity areas Establishing priority development programmes at the regional level	<ul style="list-style-type: none"> ● Calculation of fiscal capacities of all local units ● Development of the criteria for state budget assistance to the counties and local units ● Calculation of the minimum financial standards for rendering public services for decentralised functions ● Determining the number of regions (counties) and local units and regions to whom the state should provide assistance out of the state budget 	2005
Statistical Regional (Territorial) Units - Competence: Croatian Bureau of Statistics and the Economic Institute		
Determining the framework for supervision of regional development according to NUTS 2	<ul style="list-style-type: none"> ● Define statistical territorial regional units in accordance with the EU NUTS categorization 	2005

GOAL	POLICY MEASURES	PERIOD
Development of a map for distribution of regional assistance from the level of the state and EU funds	<ul style="list-style-type: none"> Calculate regional GDP in line with NUTS 2 for the already existing regions/counties 	
5.6.4 Judicial Reform		
Policy Goal	Implementing Measures	Time
1. Land Registry Reform		
Land Registry Project - Establishment of a single land registry base for the entire territory of the Republic of Croatia	<ul style="list-style-type: none"> Amendments to the Land Registry Act were adopted 	2004
	<ul style="list-style-type: none"> The Ministry of Justice and the Croatian Geodetic Directorate concluded an Agreement on the Organisation and Operation of the Croatian Land Registry Data Base and developed the Ordinance on the Land Registry Data Base 	2004
Electronic entry of data in the land registry	<ul style="list-style-type: none"> Transformation of land registry data into digital form in all courts 	2006
	<ul style="list-style-type: none"> Acquiring information equipment for all land registry departments 	2004-2008
Keeping the data in the land registry updated	<ul style="list-style-type: none"> The Ordinance on Land Registry Forms was adopted 	2004
	<ul style="list-style-type: none"> Instructions for the work of land registry clerks in all land registry departments were made 	
	<ul style="list-style-type: none"> A plan for re-organising the land registry department of the Municipal Court in Zagreb was prepared 	
	<ul style="list-style-type: none"> A plan for processing the land registry backlog was made 	2004-2007
	<ul style="list-style-type: none"> Authorised land registry clerks were introduced 	2004
	<ul style="list-style-type: none"> The Ministry of Justice introduced supervision over the work of land registry departments 	2004
	<ul style="list-style-type: none"> Completion of procedures started in 2004 for the reconstruction and establishment of land registries in areas where a new survey was made 	2005

GOAL	POLICY MEASURES	PERIOD
	<p>Implementation of projects for the entry of apartments and transfer of data from</p> <ul style="list-style-type: none"> the book of deposited contracts into the Main Ledger - 3 pilot courts, until the end of 2007, completion of the project for the entry of apartments in all courts <p>In accordance with the decision of the Government of the Republic of Croatia,</p> <ul style="list-style-type: none"> bringing in order of the land registry for the area of the Neretva Valley, the islands, the coastal region and agricultural land 	<p>2005-2007</p> <p>2005-2007</p>
2. Increase the Efficiency of Creditor Protection and Claim Collection		
<p>Harmonisation with the European standards</p> <p>- making or amendments to the Act</p> <p>Regulation of relations arising out of the law of obligations</p>	<ul style="list-style-type: none"> Formation of a working group for amendments to the Bankruptcy Act Development of a proposal of amendments to the Enforcement Act (in legislative procedure) Development of the Draft of Amendments to the Act of Obligations 	<p>2004- 2005</p> <p>2004</p> <p>2004- 2005</p>
3. Reform of Criminal Legislation		
<p>Harmonisation of substantive criminal legislation with the international conventions accepted by the Republic of Croatia</p>	<p>The amendments to the Penal Act changed the existing incrimination of criminal acts and introduced new criminal acts in the area of environmental protection, exploitation of mineral raw materials and computer crime. The amendments to the Penal Act also covered changes that bring substantive penal law in line with the international conventions.</p>	<p>2004</p>
<p>Elimination of corruption and organised crime</p>	<p>The Government of the Republic of Croatia forwarded for legislative procedure the adoption of amendments to the Act on the Office for the Prevention of Corruption and Organised Crime (USKOK). The amendments ensure the leading role of USKOK in the prevention of organised crime and corruption.</p>	<p>2004- 2005</p>

GOAL	POLICY MEASURES	PERIOD
4. Modernization and More Efficient Work of Croatian Courts		
Establishment of an integrated court case management system	<p>Twinning project from the EU CARDS 2002 technical assistance programme</p> <ul style="list-style-type: none"> ● "Modernization of the Judiciary - Support to More Efficient and Modern Croatian Courts" <p>The project is being implemented by the Ministry of Justice of the Republic of Finland, Ministry of Justice of the Republic of Croatia, Supreme Court of the Republic of Croatia, Judicial Academy and pilot courts (County Courts in Zagreb, Rijeka, Split and Osijek, Municipal Courts in Zagreb, Rijeka, Split, Osijek and Sveti Ivan Zelina).</p> <ul style="list-style-type: none"> ● Models for the functioning of statistical data kept by the courts and the Ministry of Justice are in preparation ● CARDS 2003 continuation of the project after the completion of CARDS 2002 Support to More Efficient and Modern Croatian Courts (25 new pilot courts) ● CARDS 2004 modernization of the High Misdemeanour Court and the selected misdemeanour courts and support to a more efficient Administrative Court of the Republic of Croatia - approved project proposals 	<p>2004- 2005</p> <p>2005 - 2006</p> <p>2004</p>
Reduction of the number of unsolved cases and keeping the courts more updated	<ul style="list-style-type: none"> ● Amendments to the Courts Act were adopted in March 2004. In order to alleviate the work load of courts with an excessive number of cases, the president of the Supreme Court of the Republic of Croatia can transfer to another competent court cases from a court that is not able to review the cases and render a decision within a reasonable time period, because of a large number of cases ● Court counsellors were granted the authority to independently conduct certain court procedures. This alleviates the work load of judges and accelerates the adjudication procedure. 	2004

GOAL	POLICY MEASURES	PERIOD
More modern organisation of court administration	<ul style="list-style-type: none"> The presidents of courts received greater powers for taking measures to speed up the work of judges and make it more efficient. 	2004.
	<ul style="list-style-type: none"> Rationalization of the existing courts in view of actual and territorial competence 	2005 - 2006
	<ul style="list-style-type: none"> Development of Framework Standards for the Work of Judges 	2005
	<ul style="list-style-type: none"> The Ministry of Justice introduced supervision of court administration and financial operations of courts. 	2004.-2007
Training of judges, clerks and employees	<ul style="list-style-type: none"> The Judicial Academy was formed within the Ministry of Justice whose aim is to constantly provide further education to judges, state attorneys and court clerks. 	2004
	<ul style="list-style-type: none"> The preparation of an integrated programme for training judges and state attorneys is under way 	2004.-2007
	<ul style="list-style-type: none"> Support to the expert training of judges is conducted as part of the CARDS 2001 programme 	2004- 2005
	<ul style="list-style-type: none"> Expert training of state attorneys will be implemented in the CARDS 2003 project. 	2005
Informatization of Courts		
Establishment of a uniform way of monitoring court uniform network and organisation	<ul style="list-style-type: none"> The project of establishment of an integrated court management system (ICMS) is under way. It is financed by the World Bank and the European Union <p>CARDS</p>	2004 - 2006
5.6.5 ENVIRONMENTAL REFORM		
Policy Goal	Implementing Measures	Time
Horizontal Legislation		
Improvement of the environmental protection system	<ul style="list-style-type: none"> Adopt a new Environmental Protection Act 	2006

GOAL	POLICY MEASURES	PERIOD
<p>Introduction of integrated prevention and supervision of environmental pollution</p> <p>The integration in the area of environmental protection requires the establishment and implementation of other sector policies with the aim of promoting sustainable development</p> <p>Improving the procedure of environmental impact studies for specific projects</p> <p>Reporting about environmental situation and the results of measures taken to protect the environment</p>	<ul style="list-style-type: none"> ● Incorporate provisions for the application of the IPPC Directive ● Adopt the strategy of sustainable development ● Adopt implementing regulations on the strategic evaluation for the environment ● Adopt implementing regulations on the evaluation of environmental impact for specific projects ● Adoption of the State of the Environment Report 	<p>2006</p> <p>2006-2008</p> <p>2007</p> <p>2007</p> <p>2005 - on a continuous basis every 4 years</p>
Air Quality		
Improve the overall system of air quality management and establish conditions for systematic solving of problems related to climate changes:		
Establish the policy and measures for solving air pollution problems	<ul style="list-style-type: none"> ● Harmonisation of the regulations in the area of atmosphere protection with the EU acquis communautaire ● Development of the draft of the proposal of the Air Protection Act ● Development of subordinate legislation 	<p>2004</p> <p>2005 - 2006</p>
Improve and strengthen the application of measures for the protection of air quality, and the way of organising and implementing the protection and improvement of air quality	<ul style="list-style-type: none"> ● Development of the Plan of Action to Protect and Improve Air Quality (CARDS 2002) 	2005 - 2006
Establish a quality system for permanent monitoring of air quality at the state level	<ul style="list-style-type: none"> ● Building of 22 stations in the state network to permanently monitor air quality <ul style="list-style-type: none"> – 6 stations established in the period 2002-2004 	2004

GOAL	POLICY MEASURES	PERIOD
	– build the remaining 16 stations	2005-2007
Establish a quality system for monitoring air quality at the local level (competencies and financing: units of local self-government)	<ul style="list-style-type: none"> • Adopt a programme for measuring air quality and if necessary build new stations at the local level 	2005-on a continuous basis
Mitigation of climate changes (in accordance with the United Nations Framework Convention on Climate Change), in a way enabling sustainable economic development	<p>Develop a national programme for evaluating the impact and adjustment to climate change and mitigating the consequences of climate change, build a national system for calculating the emission of greenhouse gases, register</p> <ul style="list-style-type: none"> • sources and technologies, and adopt a state plan for the emission of greenhouse gases, inform the local community about the implementation of measures to mitigate climate change, establish an operative part for the implementation of JI projects. 	2005-on a continuous basis
Terminating the use of substances that damage the ozone layer	<ul style="list-style-type: none"> • Establish a system of <i>oporaba</i> of substances that damage the ozone layer 	on a continuous basis
Waste Management		
Harmonisation of Croatian legislation with the EU <i>acquis communautaire</i>	<ul style="list-style-type: none"> • Adopt a new Waste Act 	2004
	<ul style="list-style-type: none"> • Adopt implementing regulations for special categories of waste 	2004-2006
Recovery of "black spots"	<ul style="list-style-type: none"> • Develop recovery programmes and ensure financial funds out of various sources 	2004 - on a continuous basis
Establishment of an integrated waste management system:	<ul style="list-style-type: none"> • Adopt a Waste Management Strategy and Action Plan 	2004- 2005
	<ul style="list-style-type: none"> • Implementation of the Action Plan 	2005-on a continuous basis
	<ul style="list-style-type: none"> • Introduce economic incentives based on Government programmes, including incentives to prevent the appearance of waste at the source 	2005 - on a continuous basis
Establishment of a "network" of waste management centres	<ul style="list-style-type: none"> • Invest in the building of regional centres, including the reconstruction, repair and possible further use of the existing waste dumps 	2004- on a continuous basis

GOAL	POLICY MEASURES	PERIOD
Establishment of complete informatization of the waste management system	<ul style="list-style-type: none"> Develop a waste management information system (quantity, type, procedure, management procedures, etc.) 	2004- on a continuous basis
Strengthening and Establishing the System of Integrated Water Management with More Intensive Investments in the Water Management Infrastructure		
Maintain/achieve good quality of water and eco-systems dependant on water	<ul style="list-style-type: none"> Strengthening/reform of the existing system of financing water management and ensuring more funds per year (amendments/adoption of a new Act on Water Management Financing and the part of subordinate legislation arising out of this Act), (Ministry of Agriculture, Forestry and Water Management) 	2006 and onwards
Recovery and removal of the sources of pollution	<ul style="list-style-type: none"> Strengthening of water management planning (adoption of the Water Management Basis of Croatia and continuation of work on the second phase of water management plans in certain water areas), (Ministry of Agriculture, Forestry and Water Management) 	continuous (2009)
Ensure access of the population to safe drinking water	<ul style="list-style-type: none"> More intensive implementation of water protection measures, especially with respect to the preparation and implementation of infrastructural water protection projects; recovery and completion of the existing and building of new water discharge systems (development of an ISPA strategy regarding the discharge and purification of the effluent in the public sewage system), (Ministry of Agriculture, Forestry and Water Management) 	continuous
Sufficiently developed irrigation systems	<ul style="list-style-type: none"> Reduction of losses in the existing water supply systems and more connections to the public water supply systems (regional water supply systems), recovery and completion of the existing and building of new water supply systems (development of an ISPA strategy relating to water supply), (Ministry of Agriculture, Forestry and Water Management) 	continuous

GOAL	POLICY MEASURES	PERIOD
<p>System of protection from harm caused by water ensures the required safety</p>	<p>Establishment of a self-control system for public water supply facilities (development of guidelines for introducing the system, education about water, education of the sanitary inspection about the system, control, evaluation and verification of the system and making of check lists for inspectors, acquisition of equipment for water disinfection), (Ministry of Health and Social Welfare)</p> <ul style="list-style-type: none"> ● <p>Monitoring of the safety of drinking water, development of an annual monitoring plan, making of the form and system for collecting data about the implementation of monitoring, preparation of an annual report, development of a water quality data base, (Ministry of Health and Social Welfare)</p> <ul style="list-style-type: none"> ● <p>Introduction of the ISO 17025 standard in laboratories (education, technical assistance, equipment), (Ministry of Health and Social Welfare)</p> <ul style="list-style-type: none"> ● <p>Appointment of an Expert Drinking Water Commission (ensuring working conditions), (Ministry of Health and Social Welfare)</p> <ul style="list-style-type: none"> ● <p>Establishment of zones of sanitary protection of drinking water at source and intensification of measures to protect water in such zones (Ministry of Agriculture, Forestry and Water Management)</p> <ul style="list-style-type: none"> ● <p>Reconstruction of the existing and development of new irrigation systems, (Ministry of Agriculture, Forestry and Water Management)</p> <ul style="list-style-type: none"> ● <p>Larger investments in the system of protection from harm caused by water, (Ministry of Agriculture, Forestry and Water Management)</p> <ul style="list-style-type: none"> ● 	<p>continuous (2004-2007)</p> <p>continuous (2004-2007)</p> <p>continuous (2004-2007)</p> <p>continuous (2004-2007)</p> <p>continuous (2008.)</p> <p>continuous</p> <p>continuous</p>
<p>Nature Protection</p>		
<p>Financial and institutional strengthening of the nature protection sector</p>	<ul style="list-style-type: none"> ● More funds from the state and local (county) budget 	<p>2005 – 2007</p>

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> • Administrative strengthening of nature protection institutions at the state and local level 	
Strengthening of the policy of the Government of the Republic of Croatia with respect to nature protection	<ul style="list-style-type: none"> • Revision of the National Strategy for the Protection of Biological and Landscape Diversity • Develop implementing regulations based on the Nature Protection Act 	2005 2005-2006
Incorporation of nature protection in economic sectors	<ul style="list-style-type: none"> • Revision of sector legislation • Development of mechanisms to incorporate nature protection guidelines through co-operation between various sectors • Incentives – implementing regulations (population in the protected areas, agricultural-environmental programmes, tax incentives, etc.) 	2005 – 2007 continuous
Increase of the percentage of protected areas	<ul style="list-style-type: none"> • Protection of new areas (Park of Nature Lastovo) • Establishment NATURA 2000 • Establishment of the National Eco-network 	2005
Protection of endangered wild life outside the protected areas	<ul style="list-style-type: none"> • Adoption of wolf and lynx management plans • Activities relating to the implementation of the CITES 	2005 continuous
Industrial Contamination and Risk Management		
Improve the procedure of implementation of the environmental protection intervention plan, including reporting about the implementation, and bring it fully in line with the new Directives of the EU	<ul style="list-style-type: none"> • Adopt a new environmental protection act based on the Environmental Protection Act • Make a register of dangerous and risk-exposed facilities 	2007 2007

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> Organise expert workshops and make instructions for the implementation of intervention plans at the local level 	2007
Introduction of an integrated system of preventing and supervising environment contamination	<ul style="list-style-type: none"> Adopt implementing regulations of the Environmental Protection Act for the application of provisions on the eco-licence (IPPC Directive) 	2007
Chemicals		
Establishment of the national legislative infrastructure for the whole system of integrated safe chemicals management throughout their life span	<ul style="list-style-type: none"> Amendments to the Chemicals Act and other relevant legislation 	2004
remedy the existing legislative "fragmentation"	<ul style="list-style-type: none"> Initial application of the Chemicals Act 	2005
	<ul style="list-style-type: none"> Development of subordinate legislation for the Chemicals Act (harmonised in line with the EU Guidelines) 	2005 - 2006
Strengthen the institutional infrastructure for safe chemicals management	<ul style="list-style-type: none"> Form the Chemicals Office 	2004- 2005.
Establish mechanisms for co-operation between bodies/institutions	<ul style="list-style-type: none"> Establish the system of registering "new" chemicals Establish a single register of "new" and existing chemicals e-connecting of the Office with relevant bodies/institutions 	2005 - 2006. 2005 - 2007 2005 - 2007
Genetically Modified Organisms		
Defining of Legislative Framework	<ul style="list-style-type: none"> Ensure funds from the State Budget Adopt the GMO Act and the relevant implementing legislation 	2005
Creation of an institutional framework	<ul style="list-style-type: none"> Ensure funds from the State Budget 	2005 – 2007

GOAL	POLICY MEASURES	PERIOD
	<ul style="list-style-type: none"> • Engage experts and additionally train the existing human resources in the competent institutions • Education of competent inspections • Education of supervisory board members • Form the National Mechanism for Data Exchange about Biosafety • Acquire equipment for the competent institutions 	
Adjustment of the existing closed systems to the new legislative criteria	<ul style="list-style-type: none"> • Ensure funds from the State Budget • Re-organisation and additional equipment for laboratories and other closed systems in scientific institutions 	2005 – 2007
Education of the participants and the public about the legislative and institutional framework	<ul style="list-style-type: none"> • Ensure funds from the State Budget • Expert lectures for specific groups of participants, web pages, informative publications • Expert-popular lectures, media presentations, web pages, informative publications 	2005 – 2007
Noise		
Improvement of the system of protection against noise	<ul style="list-style-type: none"> • Adopt the implementing legislation of the Noise Protection Act • Organise supervision of legal entities performing expert activities related to the protection against noise • Establish the register of legal entities performing expert activities related to the protection against noise and supervision 	2004 - 2007

GOAL	POLICY MEASURES	PERIOD
Adoption of the National Programme of Protection against Noise	<ul style="list-style-type: none"> Establish a working group that would prepare a situational analysis for the adoption of the National Programme of Protection of Health against Noise 	2005
	<ul style="list-style-type: none"> Develop the National Programme 	2005-2007
Protection against Ionising Radiation		
Improve the existing system for using the sources of ionising radiation and prescribe safety measures	<ul style="list-style-type: none"> Adopt a new Act on Protection against Ionising Radiation 	first half of 2005
Prescribe the manner of conduct and issuance of certain approvals regarding the performance of activities with the sources of ionising radiation	<ul style="list-style-type: none"> Adopt implementing legislation of the Act on Protection against Ionising Radiation (about 11 ordinances) 	end of 2005
Disposal of radioactive waste and used closed radioactive sources	<ul style="list-style-type: none"> Build radioactive material shelters/dumps 	end of 2005
Establishment of an emergency system connected to the sources of ionising radiation	<ul style="list-style-type: none"> Adopt the Croatian Emergency Plan and Programme of Measures for Protection against Ionising Radiation 	end of 2006
	<ul style="list-style-type: none"> Establishment of a system for the implementation of the Croatian Emergency Plan and Programme of Measures for Protection against Ionising Radiation 	end of 2006
Establishment of a system for analysing ionising radiation and the type and activity of radioactive substances in the environment	<ul style="list-style-type: none"> Adopt the annual measuring plan 	end of 2006
Establishment of a system for supervision of non-permitted trade with radioactive material	<ul style="list-style-type: none"> Set up check points at border crossings and strategic locations 	end of 2007
5.6.6 Science and Education		
Policy Goal	Implementing Measures	Time
ZNANOST I VISOKO OBRAZOVANJE		
Approaching the European legislation in this segment	<ul style="list-style-type: none"> reorganisation of science and higher education as stipulated by the new Law 	2004.-2007.

GOAL	POLICY MEASURES	PERIOD
Increase in the state budget and budget allocations from other sources for science and higher education to approach the level of funding in the developed European countries	<ul style="list-style-type: none"> • introduce the international system of scientific and highly professional work valorization • educate the staff for continual tracking and evaluation of the scientific and highly professional work according to world standards 	2005-2007.
<p>Implementation of the laws and acts</p> <p>Passing of the Regulation to Establish the Agency for Science and Higher Education</p>	<p>The Parliament appoints the National Science Council and the National Council for Higher Education that jointly appoint the Advisory Board for Financing of Scientific Activities and Higher Education</p> <ul style="list-style-type: none"> • The Parliament appoints the National Science Council and the National Council for Higher Education that jointly appoint the Advisory Board for Financing of Scientific Activities and Higher Education • National Science Council appoints councils for respective scientific and artistic areas as well as committees for specific fields • The government of Croatia establishes the Agency for Science and Higher Education • Appointment of the Board of Science and Higher Education Ethics <p>National Science Council:</p> <ul style="list-style-type: none"> • gives an initial opinion on the regulation on evaluation of quality and efficiency of scientific institutions • adoption of the regulation on the composition and method of work of the councils and committees for specific fields • adoption of the regulation on the scientific areas, branches and fields and the regulation on the conditions for the election into the scientific profession <p>National Council for Higher Education:</p> <ul style="list-style-type: none"> • gives an initial opinion on the regulations on standards and criteria for establishing and assessing higher education institutions and programs 	<p>31. december 2004.</p> <p>1. July 2005.</p> <p>1. March 2005.</p> <p>start 2005.</p> <p>throughout 2005</p> <p>throughout 2005</p>

GOAL	POLICY MEASURES	PERIOD
Passing of the Law on recognizing foreign educational qualifications	adoption of the regulation on standards and criteria for evaluation curricula and <ul style="list-style-type: none"> ● the regulation on standards and criteria for establishment of higher education institutions. ● Establishment of ENIC/NARIC Office at the Agency, the reporting center on academic mobility and recognition of higher education qualifications ● implementation of the Bologna declaration guidelines and documents pertaining to the establishment of European higher education area 	1. March 2005. 2005.-2007.
Foreign language instruction in elementary school, current state, plans and improvements		
Early learning of foreign languages with children of pre-school age, from 4 years of age till enrollment in elementary school (12. year of program implementation)	<ul style="list-style-type: none"> ● Training the educators for implementation of early learning of foreign languages program and their further training 	2005-2007
Early learning of foreign languages in elementary school from grade one (third year of program implementation)	<ul style="list-style-type: none"> ● Employ 400 new teachers of foreign languages (800 have already been employed in 2003. and 2004.) 	2005.
Early learning of foreign languages in elementary school from grade one (fourth year of program implementation)	<ul style="list-style-type: none"> ● Employ 400 new teachers of foreign languages (1.200 have already been employed in 2003., 2004. and 2005.) 	2006.
Assure higher expertise and efficiency of foreign language teachers and base the system of employment on advancement and expertise	<ul style="list-style-type: none"> ● Statute on advancement and further training of teachers 	2005. and 2006.
Increase the learning of foreign languages through course curriculum (in a foreign language)	<ul style="list-style-type: none"> ● New project in elementary education system – instruction in a foreign language 	2005. and 2006.
Improving foreign language education through implementation of modern teaching methods	<ul style="list-style-type: none"> ● Adopt a pedagogical standard and begin equipping schools and classrooms 	2005. - 2007.
Foreign language instruction in high schools, current state, plans and improvements		
Assure higher expertise and efficiency of foreign language teachers and base the system of employment on advancement and expertise	<ul style="list-style-type: none"> ● Adopt a Statute on advancement and further training of teachers 	2005. and 2006.

GOAL	POLICY MEASURES	PERIOD
Increase the learning of foreign languages through course curriculum (in a foreign language)	<ul style="list-style-type: none"> Establish the Rules on two-language curriculum in high schools programs 	2005.,2006.
Improving the foreign language education through implementation of modern teaching methods	<ul style="list-style-type: none"> Adopt a pedagogical standard and begin equipping schools and classrooms 	2005-2007.
Plans concerning the undertaking of adequate measures for the children of migrant workers		
Undertaking adequate measures for the children of migrant workers for the purpose of fulfilling special conditions from the EU acquis communautaire	<p>Schooling of children of migrant workers with a special emphasis on schooling the children of citizens of the Republic of Croatia that are temporarily residing in other countries through the non-governmental organisation „Dvorac srca“ project.</p> <ul style="list-style-type: none"> 	School year 2004./2005.
Croatian system of vocational training and education at the high school level		
The lack of skilled professors		
improve the classification structure of the teachers in vocational subject theory and practical subject theory in vocational high schools and to increase the training of teachers for the educational and teaching work	<ul style="list-style-type: none"> bring the received data up to date, perform an analysis and determine the needs for further education of teachers together with the higher education institutions develop a proposal for regular training of teachers of vocational subject theory courses and practical courses for the most critical areas (engineering, electrical engineering and other) together with higher education institutions develop a program and curriculum for the training of teachers of vocational subject theory and practical subject theory begin with training of teachers of vocational subject theory and practical subject theory develop a plan of professional vocational training and education of the existing teachers of vocational subject theory and practical subject theory in vocational high schools 	<p>Implement in 2004. and 2005.</p> <p>Implement 2005.</p> <p>Implement 2005. and 2006.</p> <p>Implement 2006/07. school year</p> <p>Continuous work every year</p>

GOAL	POLICY MEASURES	PERIOD
Vocational training		
Establishment of a separate institution for vocational training by reforming the existing Department for vocational training at the Institute for Education, with a purpose of providing adequate support to the vocational training system	<ul style="list-style-type: none"> • ensure the passing of legal regulations • ensure the material and technical conditions to begin work • assemble the staff 	2005. and 2006. 2005. and 2006. 2007.
Program obsolescence		
to modernize the existing programs and curricula, adapt them to the needs of the labor market, decrease the unnecessary high number of current specialisations, develop programs and curricula for the new specialisations according to demands of the labor market	<ul style="list-style-type: none"> • Continue to modernize the contents of existing programs and curriculums • Continue with the analysis of the needs for particular specialisations and establish the real need for the number of specialisations (work on decreasing their number from 400 to 100-150) • Develop a new model of education (3+2+3) for the specialisations in building and civil engineering and shipbuilding • Continue to develop programs and curricula for the introduction of new specialisations according to the demands of the labor market <p>Note: These measures will be implemented with social partners (chambers, private employers, Employment Bureau, other ministries and others) so as to harmonize the professional standards and vocational training and to lower the unemployment.</p>	During 2005. During 2005. and 2006. During 2005. and 2006. 2005.-2007.
Equipping the vocational high schools		
to systematically work on equipping the vocational high schools with modern teaching tools	Systematically equip vocational high schools according to the developed project, especially the fields of electrical engineering, health, catering and tourism and others	During 2005.
Textbooks		
to ensure textbooks and other literature for the courses that enrol small number of students	Evaluate the need for textbook and other literature that is lacking, above all for courses that serve small numbers of students and are therefore not interesting for the publishers	Appraise the condition 2004. Ensure funding 2005.
Pedagogical standards		

GOAL	POLICY MEASURES	PERIOD
develop a pedagogical standard that will serve as a foundation for equipping the schools and for standardization of equipment, textbooks and other literature	<ul style="list-style-type: none"> Development of the pedagogical standard 	2005.
5.6.7 Tourism		
Policy Goal	Implementing Measures	Time
Further better positioning of Croatian tourism at international tourist market		
strengthen the image of Croatia as a peaceful, safe and attractive tourist destination	<ul style="list-style-type: none"> promotional activities at international tourist market 	continous
complete recovery of traditional generating markets	<ul style="list-style-type: none"> subsidies for organized tourist traffic according to the Law on State Support 	2005.-2007.
winning new generating market		
increase of tourist traffic and revenues		
extension of the tourist season		
Improve the standards and quality of accommodation facilities		
reconstruction and refurbishment/modernization of the existing hotels, tourist villages and other accommodation facilities	<ul style="list-style-type: none"> categorization of accommodation facilities classified as hotels and camps according to the existing Regulation 	continuing
upgrading standards and quality of the accommodation facilities	<ul style="list-style-type: none"> new Regulation for categorization of other accommodation facilities that by law must be categorized 	2005
construction of new, especially small quality hotels and other accommodation facilities of at least 3* category	<ul style="list-style-type: none"> continuation of the programme "Incentive for Success" for the construction of small hotels and other accommodation facilities of at least 3* category 	2005-2007
Development of the selective types of tourism		
development of tourism on the whole territory of Croatia, especially in hinterland	<ul style="list-style-type: none"> encouragement of tourist offer based on traditional, cultural and other heritage 	2005-2007
development of additional offer according to tourist demand and trends at the international tourist market	<ul style="list-style-type: none"> creation of programme of incentives for the development of rural tourism 	2005
creation of unique/authentic tourist offer by including traditional, cultural and other heritage in the tourist offer	<ul style="list-style-type: none"> creation of programme of support for the eco-based programmes in tourism 	2005

GOAL	POLICY MEASURES	PERIOD
development of golf courses as a "new" tourist offer	<ul style="list-style-type: none"> start-up of the master plan for the development of golf in Croatia establishment of the «Golf project» corporation in order to realize the programme of golf courses construction in Croatia 	2005 2005
Development of total tourist destination and operation of travel/tourist companies		
improvement of local infrastructure, public utilities and tourist attractions	<ul style="list-style-type: none"> passing the Tourist Association Laws "package" 	2005
improvement of additional cultural, sport, entertainment and other attractions and different events	<ul style="list-style-type: none"> passing the new Hospitality Law and Tourism Act 	2006
5.6.9 Public Utilities - Transport and Telecommunications		
GOAL	POLICY MEASURES	PERIOD
ROAD TRANSPORT		
Construction of roads with high level of services in basic European corridors and actualization of a full maintenance standard	<ul style="list-style-type: none"> Public Roads Act (the draft of this Act should be forwarded for procedure to the Croatian Government in 2004) 	continuous
Improving market competition		
Strengthening the financial discipline of commercial subjects for the performance of transport activities	<ul style="list-style-type: none"> Act on Transport on Public Roads (forwarded to the Croatian Parliament for procedure, this Act is part of Croatia's legislation being brought in line with the EU <i>acquis communautaire</i>) 	continuous
Reduction of administration		
RAILWAY TRANSPORT		
Harmonisation of the legislation	<ul style="list-style-type: none"> "Railway Act" Adoption of subordinate legislation for the "Railway Act" Adoption of the "Railway Safety Act" 	adopted end of 2005 end of 2005
Liberalisation of the railway market	<ul style="list-style-type: none"> Establishment of a Regulatory Authority Granting of infrastructure routes 	on admission to the EU as of 2006
	<ul style="list-style-type: none"> Strengthening of the administrative competences of the authorities 	continuous

GOAL	POLICY MEASURES	PERIOD
Restructuring and modernising of the national railway company	<ul style="list-style-type: none"> • Adoption of an act that would ensure adequate restructuring of the Croatian Railway (HŽ) • Infrastructure modernisation and resolving of the local railway track status • Privatisation of companies with non-core activities 	end of 2005 continuous end of 2007
Adoption of a national railway infrastructure development programme	<ul style="list-style-type: none"> • Commencement of the drafting of the national railway infrastructure development programme 	end of 2006
RIVER TRANSPORT		
Integration of river transport into the common EU transport system	<ul style="list-style-type: none"> • Establishment of international navigation classes on internal navigable waterways of Republic of Croatia 	2010
Intermodality with railway and maritime transport	<ul style="list-style-type: none"> • Drafting of the concept of intermodality with railway and maritime transport • Technological modernisation of river ports 	2006 continuous
Connecting the Danube region and the Adriatic, river ports and sea ports into a single logistic chain	<ul style="list-style-type: none"> • Drafting of the proposal of the organisational-logistic platform for operative transport management 	2006-2007
Increase the share of river transport in overall transport	<ul style="list-style-type: none"> • Subsidizing river transport on the basis of the actually achieved transport effect according to the principle of non-discrimination • Valorisation of external costs in transport 	2005-2006
Improvement of navigation safety by introduction of innovations and new technologies	<ul style="list-style-type: none"> • Introduction of river information services in Republic of Croatia 	2004-2006
AIR TRANSPORT		
Harmonisation of the legislation with the EU legislation	<ul style="list-style-type: none"> • Amendments to the Air Transport Act • Adoption of the implementing legislation 	2004-2005
Harmonisation of the legislation with the EU legislation	<ul style="list-style-type: none"> • Adoption of the implementing legislation 	2005-2006
Harmonisation with the EU legislation in the area of state aid and competition rules	<ul style="list-style-type: none"> • General state aid for 2005 (financial transfers to publicly owned entrepreneurs) 	2005

GOAL	POLICY MEASURES	PERIOD
Conclusion of the ECAA («European Common Aviation Area») Agreement	<ul style="list-style-type: none"> • Commencement of the negotiations 	2005-2007
MARITIME TRANSPORT		
Expansion and introduction of competition in public transport in regular coastal maritime navigation, and consequently domestic passenger maritime transport, and the reduction of funds from the State Budget of the RC as support for the performance of the mentioned activity	<ul style="list-style-type: none"> • Adoption of a new Act on Public Transport in Regular Coastal Maritime Navigation 	drafting and adoption 2004 – 2005 Applicable as of 01/01/2006
Enabling maximum flexibility in the maintenance of international passenger lines		continuous
Sustainability, survival and competitiveness of maritime transport in international market conditions (employment of Croatian seamen and shippers in international navigation)	<ul style="list-style-type: none"> • The new Maritime Code in the adoption procedure - parliamentary procedure (2nd reading) 	end of 2004
Directing part of land transport from roads to maritime infrastructure with the aim of alleviating the burden of land roads and enabling the development of environmentally acceptable forms of transport and the development of networks of maritime lines that will be connected to the European coastal navigation network.	Establishment of an office that would co-ordinate specific activities with the <ul style="list-style-type: none"> • competent ministries and other institutions of the regional states in order to enable the establishment of regular ship lines. Review of the question of incentives to land transporters who would use such <ul style="list-style-type: none"> • alternative maritime routes, that is, introducing incentives to ships, so that ship freight would not discourage road transporters. 	continuous
Investments in the modernisation of port infrastructure in ports open to public transport create competitive conditions for the business of Croatian ports, and both cargo and passenger transport increases. Privatisation of port operators is made possible, and consequently the competitiveness of ports, as well.	<ul style="list-style-type: none"> • Further work on the legislation • Completion of technical implementation of the ISPS Code. • Further modernisation of ports with respect to environmental standards. 	2004-2007
	<ul style="list-style-type: none"> • Strengthen the competitiveness of the port system by economic measures aimed at reducing business costs. 	

GOAL	POLICY MEASURES	PERIOD
TELECOMMUNICATIONS		
Enabling modern information-communication infrastructure and encouraging the development of telecommunications	<p>Harmonisation of the national legislation (Telecommunications Act) with the EU legislation, according to the 2002 legislation of the Community -</p> <ul style="list-style-type: none"> • preparation and harmonisation according to the new legislative framework of the EU, adoption of urgent measures to liberalise the market and ensure efficient regulatory control over the monopolistic operator. 	2005-2007
POSTAL SERVICE - regulatory bodies in telecommunications and the post		
Consolidation of the Croatian Telecommunications Agency and the Postal Services Council into a single legal entity, thus ensuring rational business operations of the national regulatory body which is completely operational and financially independent - launching of the initiative to transform the Electronic Media Council into a third council of the Croatian Agency.	<p>Harmonisation of the national legislation (Postal Act) with the EU legislation, according to the 2002 legislation of the Community - preparation and</p> <ul style="list-style-type: none"> • harmonisation according to the new legislative framework of the EU, especially in the part relating to the scope of universal services, by opening the sector to market competition in a controlled way 	2005 – 2007

Table 1. Growth and associated factors

Percentages unless otherwise indicated	2003	2004	2005	2006	2007
1. GDP growth at <i>constant</i> market prices	4,3	3,9	4,4	4,5	4,6
2. GDP <i>level</i> at <i>current</i> market prices	193.067	204.817	219.098	233.886	249.694
3. GDP deflator	3,3	2,2	2,6	2,3	2,2
4. CPI change (annual average)	1,8	2,2	2,5	2,3	2,2
5. Employment growth	0,3	-0,7	1,6	1,5	1,5
6. Labour productivity growth	4,5	4,4	2,7	3,0	3,0
7. Investment ratio (% of GDP)	27,5	27,6	27,7	28,1	28,4
Sources of growth: percentage changes at constant prices					
8. Private consumption expenditure	4,1	3,8	4,6	4,3	4,3
9. Government <i>consumption</i> expenditure	-0,3	1,4	0,4	1,5	2,3
10. Gross fixed capital formation	16,8	4,0	5,2	6,2	6,2
11. Changes in inventories and net acquisition of valuables as a % of GDP	-18,0	0,0	0,0	0,0	0,0
12. Exports of goods and services	10,1	4,1	4,9	4,8	5,4
13. Imports of goods and services	10,9	3,3	4,0	4,1	4,8
Contribution to GDP growth					
14. Final domestic demand	6,5	3,9	4,4	4,6	4,8
15. Change in inventories and net acquisition of valuables	-0,7	0,0	0,0	0,0	0,0
16. External balance of goods and services	-1,5	0,0	0,0	-0,1	-0,2
Growth of Gross Value Added					
17. Agriculture	-5,2	0,2	1,0	-0,1	0,1
18. Industry (excluding construction)	4,5	5,1	6,0	6,1	6,3
19. Construction	20,2	4,5	4,6	4,3	4,4
20. Services	5,0	2,6	3,8	3,9	3,9

Source: DZS, Ministry of Finance and Croatian National Bank

Table 2. Labour market developments

Percentages unless otherwise indicated	2003	2004 *	2005 *	2006 *	2007 *
1. Population (thousands)	4443,0	4449,0	4455,0	4461,0	4467,0
2. Population (growth rate in %)	0,1	0,1	0,1	0,1	0,1
3. Working-age population (thousands)	2789,0	2792,8	2796,5	2800,3	2804,1
4. Participation rate (15-64)	62,3	62,0	62,4	62,5	62,6
5. Employment level (thousands)	1483,0	1473,1	1496,5	1518,9	1542,3
6. Employment (growth rate in %)	0,3	-0,7	1,6	1,5	1,5
7. Public sector employment (thousands)	275,4	276,8	276,8	276,8	276,8
8. Public sector employment (growth rate in %)	0,3	0,5	0,0	0,0	0,0
9. Unemployment rate (ILO)	14,7	14,9	14,2	13,3	12,1
10. Average real wage (growth rate in %)	4,2	3,8	3,8	3,8	3,8

Izvor: DZS, and Croatian National Bank

* Croatian National Bank projections.

Table 3. EXTERNAL SECTOR DEVELOPMENTS

Euro mill. unless otherwise indicated	2003	2004	2005	2006	2007
1. Current account balance (% of GDP)	-7,2	-5,6	-5,1	-4,4	-3,8
2. Export of goods	5.571	6.331	6.728	7.267	7.977
3. Import of goods	-12.546	-13.216	-13.866	-14.671	-15.677
4. Trade balance	-6.974	-6.885	-7.138	-7.404	-7.700
5. Export of services	7.668	7.706	8.236	8.648	9.080
6. Import of services	-2.631	-2.769	-3.001	-3.151	-3.308
7. Service balance	5.037	4.936	5.235	5.497	5.772
8. Net interest payments from abroad	-437	-420	-487	-386	-279
9. Other net factor income from abroad	-629	-340	-315	-318	-353
10. Current transfers	1.234	1.192	1.219	1.243	1.299
11. <i>Of which</i> from EU	N.A.	N.A.	N.A.	N.A.	N.A.
12. Current account balance	-1.769	-1.517	-1.486	-1.368	-1.261
13. Foreign direct investment	1.662	855	1.340	1.280	1.300
14. Foreign reserves	6.554	7.327	7.731	8.169	8.701
15. Foreign debt	18.846	21.605	23.055	24.489	25.785
16. <i>Of which</i> : public	6.766	7.460	7.491	7.592	7.689
17. <i>O/w</i> foreign currency denominated	18.437	21.099	23.179	25.267	27.041
18. <i>O/w</i> : repayments due	2.788	3.101	2.595	2.859	2.174
19. Exchange rate vis-a-vis EUR (end year)	7,65	7,65	7,65	7,65	7,65
20. Exchange rate vis-a-vis EUR (annual average)	7,56	7,52	7,52	7,52	7,52
21. Net foreign saving (lines 21-25: percentages of GDP)	7,2	5,6	5,10	4,40	3,80
22. Domestic private saving	19,1	21,1	21,34	22,59	23,12
23. Domestic private investment	22,0	21,1	22,24	22,88	23,13
24. Domestic public saving	1,2	0,9	1,29	1,10	1,53
25. Domestic public investment	5,5	6,5	5,49	5,21	5,32

Table 4. General government budgetary developments

Percentage GDP	2003	2004	2005	2006	2007
Net lending (B9) by sub-sectors					
1. General government	0,8	0,6	0,5	0,6	0,5
2. Central government	0,7	0,5	0,5	0,6	0,5
3. Local government	0,0	0,0	0,0	0,0	0,0
4. Social security funds	0,0	-0,1	0,0	0,0	0,0
General government (S13)					
6. Total revenue	46,4	47,6	47,2	46,8	46,8
7. Total expenditure	52,7	52,1	50,9	50,0	49,7
8. Budget balance	-6,3	-4,5	-3,7	-3,2	-2,9
9. Interest	3,3	2,7	2,4	2,5	2,6
10. Primary Balance	-3,0	-1,9	-1,3	-0,7	-0,3
Components of revenues					
11. Taxes	27,9	28,1	28,3	28,3	28,3
12. Social contributions	14,2	14,5	14,5	14,6	14,6
13. Other	4,2	5,1	4,4	4,0	4,0
14. Total receipts	46,4	47,6	47,2	46,8	46,8
Components of expenditures					
15. Collective consumption	19,7	18,8	18,6	18,2	18,0
16. Social benefits in kind	16,0	14,1	13,7	14,0	14,1
17. Social transfers other than in kind	3,7	5,8	5,8	5,7	5,8
18. Interest	2,1	2,2	2,4	2,5	2,6
19. Subsidies	2,6	3,2	3,4	2,9	2,5
20. Gross fixed capital formation	6,7	6,8	5,7	5,7	5,8
21. Other	1,9	1,2	1,2	1,1	0,9
22. Total expenditures	52,7	52,1	50,9	50,0	49,7

Note: GFS 1986 methodology (IMF)

Reporting according to ESA 95 methodology is planned to begin by the middle of 2005.

Table 5. General government debt developments

Percentages of GDP	2003	2004	2005	2006	2007
1. Gross debt level	51,6	53,8	52,5	52,5	52,0
2. <i>Of which</i> : repayments due	3,4	8,7	5,4	4,1	4,1
3. Change in gross debt	1,2	2,2	-1,3	0,0	-0,5
Contributions to change in gross debt					
4. Primary balance	-3,0	-1,9	-1,3	-0,7	-0,3
5. Interest	2,1	0,0	0,0	0,0	0,0
6. Nominal GDP growth	7,6	6,1	7,0	6,7	6,8
7. Other factors influencing the debt ratio					
8. <i>Of which</i> : Exchange rate change (HRK/EUR)	2,1	-0,6	0,0	0,0	0,0
9. <i>Of which</i> : Privatisation receipts	2,2	0,1	1,9	0,5	0,5
10. p.m. implicit interest rate on debt (%)	NA	NA	NA	NA	NA

Table 6. Assumptions on the external economic environment underlying the PEP framework

VARIABLE (annual growth rates in %, if not otherwise stated)	Assumptions for					COMMENTS
	2003.	2004.	2005.	2006.	2007.	
Interest rates (in % p.a., annual averages)						
Croatia: short-term	5,0	4,6	4,2	4,0	3,8	CNB estimate
Croatia: long-term	6,1	6,0	5,8	5,6	5,3	CNB estimate
Euro area: short term (3-months money markets)	2,3	2,1	2,8	3,0	3,2	ECFIN estimate
Euro area: long term (10-year govt bonds, lowest one prevailing in euro area)	4,1	4,3	4,8	4,9	5,1	ECFIN estimate
USA: short-term (3-months money markets)	1,2	1,2	1,7	2,4	2,5	ECFIN estimate
USA: long term (10-year govt bonds)	4,0	4,2	4,6	4,7	4,9	ECFIN estimate
Exchange rates (p.a., "-" denotes depreciation)						
HRK / EUR	7,56	7,52	7,52	7,52	7,52	estimate
USD / EUR	1,13	1,23	1,23	1,22	1,20	Consensus estimate
Nominal effective exchange rate (index, 2001=100)	94,9	92,3	92,1	92,4	92,9	CNB estimate
Real effective exchange rate (index, 2001=100) *	95,7	92,5	91,7	91,7	91,9	CNB estimate
GDP (in real terms)						
World	3,9	4,9	4,4	4,3	4,3	IMF(WEO, August 2004)
USA	3,0	4,4	3,8	3,4	3,4	IMF(WEO, August 2004)
Japan	2,5	4,5	2,4	1,7	1,7	IMF(WEO, August 2004)
Euro area	0,5	2,0	2,3	2,4	2,4	IMF(WEO, August 2004)
World trade (in real terms)						
Croatia's export markets	3,5	5,1	5,1	5,0	4,6	IMF(GEE, August 2004)
World imports of goods and services	5,0	8,1	7,2	6,7	6,7	IMF(WEO, August 2004)
International prices						
World import prices (goods, in USD) **	11,8	7,4	0,4	0,3	0,8	IMF(WEO, August 2004)
Oil prices (Brent-USD per barrel)	28,5	36,8	35,9	33,6	32,2	Barclays estimate
Non-oil commodity prices (USD) **	7,1	16,8	-3,9	-4,5	-1,7	IMF(WEO, August 2004)

Table 7. Cyclical developments

Percentages of GDP	2003	2004	2005	2006	2007
1. GDP growth at constant prices	4,3	3,9	4,4	4,5	4,6
2. Actual balance	-6,3	-4,5	-3,7	-3,2	-2,9
3. Net interest payments	3,3	2,7	2,4	2,5	2,6
4. Potential GDP growth*	4,0	4,0	4,0	4,0	3,9
5. Output gap*	0,0	-0,3	-0,1	0,5	1,2
6. Cyclical budgetary component	0,0	-0,1	0,0	0,2	0,4
7. Cyclically-adjusted balance (2-6)	-6,3	-4,4	-3,7	-3,4	-3,3
8. Cyclically-adjusted primary balance (7+3)	-3,0	-1,7	-1,3	-0,9	-0,8

Table 9. Long-term sustainability of public finances

Percentages of GDP	2005	2010	2020	2030	2040	2050
1. Total expenditure	50,6	48,7	45,7	43,0	40,4	37,9
2. Old age pensions	10,8	11,0	11,3	11,7	12,0	12,4
3. Health care (including care for the elderly)	8,6	8,4	8,2	7,9	7,7	7,4
4. Interest payments	1,8	1,8	1,7	1,7	1,6	1,6
5. Total revenues	46,9	46,0	44,6	41,9	39,4	37,0
6. <i>of which</i> : from pension contributions	7,4	7,5	7,7	8,0	8,2	8,5
7. National pension fund assets (if any)						
Assumptions						
8. Labor productivity growth	6,0	5,0	5,0	5,0	5,0	5,0
9. Real GDP growth	4,4	4,0	4,0	4,0	4,0	4,0
10. Participation rate males (aged 15-64)						
11. Participation rate females (aged 15-64)						
12. Total participation rates (15-64)						
13. Unemployment rate (ILO definition)	13,8	9,5	8,5	8,0	7,5	7,0

REVISION OF THE NATIONAL BUDGET

During the summer of 2004, the Croatian Government adopted a revision of the national budget increasing revenue by 2,8 billion kuna and expenditure by 1,9 billion kuna. This resulted in a decrease in the budget deficit of 946,9 million kuna (or 622 million kuna according to GFS 1986 methodology which considers net lending and borrowing as an expenditure).

Budget Plan Revision 2004
(in billion of HRK)

	Original Budget	New Budget	Difference
1. Total revenues, <i>GFS 2001</i>	79,445	82,265	2,820
2. Total Expenditures, <i>GFS 2001</i>	81,259	83,197	1,938
3. Total Expenditures and net lending, <i>GFS 1986 (2+3+4)</i>	84,655	86,853	2,198
4. Acquisition of nonfinancial assets	2,152	2,086	-0,065
5. Net lending/borrowing	1,245	1,570	0,324
DEFICIT <i>GFS 2001 (1-2-3)</i>	-3,965	-3,018	0,947
DEFICIT <i>GFS 1986 (1-3)</i>	-5,210	-4,588	0,622

The proposed revision was aimed at slowing down the growth of the external debt and bringing it within acceptable limits. It is also in line with the continuing process of fiscal adjustment and increasing transparency.

The revised New Budget Plan increased revenues from 79,445 billion kuna to 82,265 billion kuna (an increase of 2,8 billion). The change in revenues from the originally planned amount comes mostly from the anticipated 1,83 billion kuna from the sale of the government share of Croatian Telecommunications (HT). The government also envisioned larger revenues from VAT (433 million kuna), social contributions (560 million), income taxes (111 million kuna), rent (289 million kuna), and property tax (9,5 million). At the same time the revision includes a decrease in the revenue from excise taxes (252 million kuna) and profit tax (181 million kuna).

On the expenditure side, the New Budget Plan proposed that expenditures would increase from 81,259 billion kuna to 83,197 billion kuna (increase of 1,9 billion kuna). The majority of the increase is due to subsidies for Croatian Railways (HŽ), which amounted to 1,2 billion kuna and were not previously included in the Budget. The rest of the increase comes from increases in compensation of employees (231 million kuna), social benefits (272 million) and interest (204 million). The only decrease is in use of goods and services which was lowered by 109 million.

Acquisition of net financial assets was lowered from 2,152 billion kuna to 2,086 billion kuna (decrease of 65 million), and net lending/borrowing was increased by 325 million kuna. The deficit was thus lowered from 3,720 billion kuna to 2,773 billion kuna (a decrease of 946,9 million kuna).