



REPUBLIC OF CROATIA



2008 PRE-ACCESSION ECONOMIC PROGRAMME

Zagreb, January 2009

TABLE OF CONTENTS

1	OVERALL POLICY FRAMEWORK AND OBJECTIVES.....	2
2	ECONOMIC OUTLOOK	3
2.1	RECENT ECONOMIC DEVELOPMENTS	3
2.2	MEDIUM-TERM MACROECONOMIC SCENARIO.....	7
2.2.1	Real Sector	8
2.2.2	Inflation	10
2.2.3	Monetary and Exchange Rate Policy	11
2.2.4	External Sector	13
3	PUBLIC FINANCES	16
3.1	GENERAL GOVERNMENT BALANCE AND DEBT	16
3.1.1	Policy Strategy and Medium-Term Objectives	16
3.1.2	Actual Balances and Medium-Term Perspectives	16
3.1.3	Structural Balance	22
3.1.4	Debt Levels and Developments.....	24
3.1.5	Budgetary Implications of Major Structural Reforms.....	26
3.2	SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME	26
3.2.1	Fiscal Risks and Sensitivity Analysis of Deficit and Public Debt	26
3.2.2	Comparison with Previous Programme.....	31
3.3	QUALITY OF PUBLIC FINANCES	33
3.4	SUSTAINABILITY OF PUBLIC FINANCES	35
3.5	INSTITUTIONAL FEATURES OF PUBLIC FINANCES	37
4	STRUCTURAL REFORM OBJECTIVES.....	39
4.1	ENTERPRISE SECTOR.....	39
4.1.1	Competition Policy and State Aid.....	39
4.1.2	Privatisation.....	41
4.1.3	Railway Restructuring.....	42
4.1.4	Restructuring of Shipbuilding Industry.....	45
4.1.5	Energy	47
4.1.6	Small and Medium-Size Enterprises	48
4.1.7	Public-Private Partnership.....	50
4.2	FINANCIAL SECTOR	51
4.2.1	Banking Sector	52
4.2.2	Non-Banking Sector.....	54
4.3	LABOUR MARKET.....	55
4.3.1	Stimulating Employment.....	56
4.3.2	Social Security System.....	57
4.4	AGRICULTURAL SECTOR	64
4.5	ADMINISTRATIVE REFORM	70
4.6	ADDITIONAL REFORM AREAS	72
4.6.1	Development of a Knowledge-Based Society.....	72
4.6.2	Health Care Reform	73
4.6.3	Judicial Reform	74
4.6.4	Environmental Protection.....	76
5	ECONOMIC POLICY MATRIX	80
	Annex I Matrix of Policy Commitments.....	85
	Annex II Statistical Appendix	92
	Annex III Structural Reforms Agenda and Achievements.....	105

1 OVERALL POLICY FRAMEWORK AND OBJECTIVES

The framework and objectives of the economic policy of the Republic of Croatia are defined in a series of strategic documents of the Government of the Republic of Croatia, namely: the Strategic Development Framework for 2006-2013, the Economic and Fiscal Policy Guidelines and the Pre-accession Economic Programmes (PEP). Those documents provide the basis for the implementation of the economic policy in the medium-term period.

The main objective of the economic policy, arising, among other things, from the aforementioned documents, is to maintain macroeconomic stability and ensure sustainable economic growth, along with increasing employment and strengthening competitiveness of the Croatian economy based on knowledge in the context of accession to the EU. The 2008 PEP reflects the set economic policy objective and, in that regard, it sets out in detail macroeconomic developments and projections, further direction of fiscal policy, as well as the key structural reforms in the 2009-2011 period.

This year's PEP was prepared in the conditions of an unfavourable macroeconomic environment and spreading of the world financial crisis, which Croatia is facing relatively well prepared, but adverse effects of which will contribute to a slowing down of the Croatian economic growth in the forthcoming year as a result of external demand weakening and tighter lending conditions. In these unfavourable macroeconomic conditions, fiscal policy remains in the focus of the overall economic policy of the Government of the Republic of Croatia. Accordingly, continued fiscal consolidation and realisation of the balanced budget by 2011 will be the main determinants of the fiscal policy in the forthcoming period.

Macroeconomic and fiscal policy will be supported by the implementation of the key structural reforms in the medium-term period, in accordance with the priorities of the Government of the Republic of Croatia, through implementation of the specific measures for a further development of the Croatian economy. In that context, further measures will be taken, focused on, among other things, strengthening of entrepreneurship and improvement of business climate, restructuring and privatisation of dependent sectors, further development of the financial sector, completion of the reform processes in the field of public administration and judiciary, with a special emphasis on the fight against corruption, development of transport and energy infrastructure, environmental protection, improving quality and flexibility of labour force through education and adapting education to the labour market needs, as well as further ensuring social justice with the condition of financial sustainability of the health care and social security sector.

2 ECONOMIC OUTLOOK

2.1 RECENT ECONOMIC DEVELOPMENTS

The real growth of gross domestic product (GDP) amounted to 5.6% in 2007, which is 0.8 percentage point acceleration in comparison with 2006.¹ The largest contribution to GDP growth in 2007 came from personal consumption and gross fixed capital formation. In 2007, personal consumption recorded a record high real growth since 2002, amounting to 6.2%, and its contribution to overall economic activity growth was 3.7 percentage points. Gross fixed capital formation accounted for 2.0 percentage points of GDP growth in 2007, recording, in the same period, the largest real growth among the GDP components, amounting to 6.5%. The contribution of exports of goods and services was 2.9 percentage points in 2007. Due to a higher negative contribution of imports of goods and services of -3.7 percentage points, the contribution of net exports was negative, amounting to -0.8 percentage points. In 2007, the real growth of imports and exports of goods and services was 5.8% and 5.7%, respectively, and the growth of both categories slowed down relative to 2006. Government consumption also recorded the largest growth since 2002, amounting to 3.4% and contributing to GDP growth with 0.7 percentage points in 2007. Real GDP growth recorded in 2007 was 0.4 percentage points lower compared to the growth projected by the last year's PEP (6.0%), primarily due to a smaller increase in gross fixed capital formation and government consumption relative to the projected one.

In the first three quarters of 2008, real GDP growth amounted to 3.0%, which is the result of a 4.3% real growth in the first, 3.4% growth in the second and 1.6% growth in the third quarter. The main generator of GDP growth in the first three quarters of 2008 was gross fixed capital formation, which grew at an annual rate of 9.7%. A strong real growth of investments of 9.8% recorded in the first quarter additionally accelerated to 12.6% in the second quarter of 2008, only to slow down to 6.6% in the third quarter. Investments are followed by personal consumption with a real growth of 2.3% in the first three quarters of 2008, namely, of 4.3% in the first quarter, 2.2% in the second quarter and 0.4 in the third quarter of 2008. Government consumption grew at a rate of 0.5% in the first quarter, 3.2% in the second quarter and 1.3% in the third quarter, which represents a real year-on-year growth of 1.6% in the first three quarters of 2008. The real growth of exports of goods and services stood at 3.1% in the first three quarters of 2008, whereas imports of goods and services rose by 7.2%. Consequently, contribution of net foreign demand to real GDP growth was negative, amounting to -2.9 percentage points. Growth of imports of goods and services accelerated from 7.0% in the first quarter to 8.1% in the second quarter and amounting to 6.3% in the third quarter of 2008. Exports of goods and services increased in real terms by 3.8% in the first quarter, by 4.6% in the second quarter and by 1.7% in the third quarter of 2008.

The available monthly indicators of economic activity for the beginning of the fourth quarter of 2008 point to a further deceleration of economic activity relative to the first three quarters of the observed year.

Industrial production recorded year-on-year growth rates of 4.7% in the first quarter and 3.8% in the second quarter of 2008. In the third quarter, its growth slowed down to 0.2%, while a 2.1% reduction of industrial production was recorded, on a year-on-year basis, in October and September. The increase in inventories of final industrial products of 6.0% in the first eleven months of 2008 also reflects a weakening of demand for industrial products in 2008. The largest contribution to inventories growth was made by an increase in inventories in the

¹ GDP data for 2005, 2006 and 2007 provided by the Central Bureau of Statistics (CBS) are preliminary and based on quarterly GDP calculation estimates.

manufacture of food products and beverages, manufacture of wood and manufacture of fabricated metal products.

Deceleration of domestic demand growth is also evident in retail trade turnover, which recorded a nominal year-on-year growth of 6.8% in the first eleven months of 2008, whereas it was reduced by 0.1% in real terms². Non-specialised stores with food, beverages or tobacco predominating and automotive fuels recorded the most significant nominal year-on-year growth in retail trade turnover by branches in the first eleven months of 2008, which is partly a consequence of an increase in prices of petroleum and food products.

A year-on-year growth in tourist nights amounted to 2.0% in the first eleven months of 2008. In the first quarter of 2008, tourist nights increased by 21.3% year-on-year, in the second quarter, stagnation in tourist nights was recorded relative to the same period in 2007 and in the third quarter, tourist nights increased by 2.1%. In October and November tourist nights dropped by 0.5% compared to the same period of 2007. According to the balance of payments data, revenues from tourism amounted to EUR 6.8 billion in the first three quarters of 2008, a 9.6% rise against the same period in 2007.

In the first eleven months of 2008, favourable labour market developments continued. Unemployment hit its record low since 1995 and at end-November 2008, registered unemployment at the Croatian Employment Service was reduced by 7.7% relative to the same month in 2007. The Croatian Bureau of Statistics (CBS) preliminary data on employment and the Croatian Pension Insurance Institute data on the number of insured, indicate a continuous year-on-year growth of the total number of employed persons in the first eleven months of 2008. Favourable developments on the labour market led to a reduction in the registered unemployment rate to 13.2% in November, down by 1.0 percentage point against the same month of the previous year. Labour force survey data, presently available only for the first two quarters of 2008, show that the labour force survey average unemployment rate stood at 9.0% in the first half of 2008, representing a 1.2 percentage point fall year-on-year.

The average nominal gross wage increased by 7.2% in the first ten months of 2008, year-on-year, whereas the annual growth of the average real gross wage amounted to 0.7%, which is a deceleration compared to the same period of 2007, when it stood at 3.8%. The average net wage in the first ten months of 2008 recorded a nominal growth of 7.0% and a real growth of 0.4% relative to the same period of 2007. Inflationary pressures strongly influenced the movements of real growth of gross and net wages, but it should be noted that they have not brought about the effect of inflationary spiral. In 2008, the taxation of income also changed, by increasing personal allowance from HRK 1,600 to HRK 1,800, and the Act on Minimum Wage was adopted, setting the minimum wage at HRK 2,747. Both measures, which began to be applied in July 2008, have contributed to an increase in the share of net wage in gross wage.

The average annual rate of inflation was 2.9% in 2007, which is 0.4 percentage point above the inflation projected by the 2007 PEP. The departure from the projected value is primarily a result of unfavourable developments at the end of 2007, relating to the increase in the prices of energy products on the world market and a spillover effect of prices of agricultural products on the prices of food products. A significant carry-over of inflation from end-2007 and a continued increase in prices of food products and refined petroleum products had an impact on a year-on-year growth of consumer price index, which stood at 6.1% in 2008. Core inflation recorded a year-on-year rise of 5.8% in the first eleven months of 2008, primarily as a consequence of an increase in prices of bread, cereals, meat, milk, oil and fat. The industrial producers' price index went up by 8.4% in 2008.

² Real growth of retail trade turnover stood at 2.8% in the first quarter of 2008, at 1.3% in the second quarter, whereas a real decrease of retail trade was recorded in the amount of 2.2% in the third quarter and of 3.3% in October and November.

In 2008, under the influence of mostly imported inflationary pressures, the central bank faced new challenges as regards the fulfilment of its primary objective, stability of prices. Consequently, monetary policy became more restrictive in the observed year, which was reflected in a significantly reduced volume of foreign exchange interventions and reverse repo auctions, as well as in an increase in interest rates at reverse repo auctions. In conditions of increased inflation, the central bank avoided the use of foreign exchange interventions, in order to prevent creation of excessive liquidity. Accordingly, only two foreign exchange interventions were held in 2008.

The application of the Decision on the Purchase of Compulsory CNB Bills, for the purpose of slowing down placement growth, continued into 2008. The permissible growth of bank placements is restricted to 12%, whereas permissible growth rate of placements in the period from 1 to 31 January stands at 1%, increasing in each subsequent calculation period by 1 percentage point. Banks with a placement growth above the permissible level are obliged to subscribe CNB bills in the amount of 75% of the placement growth exceeding the permissible level. In accordance with the prescribed restrictions, developments in the first eleven months of 2008 indicate the slowing down of the lending activity of commercial banks. In the first eleven months of 2008, bank placements to non-banking sector thus recorded an 8.4% growth, which is below the restriction for the same period (11%). The year-on-year rate of growth of total bank placements decelerated from 15.0% at end-2007 to 11.3% in November 2008. Placements to enterprises recorded a year-on-year growth of 13.1% at end-November 2008, whereas placements to households rose by 10.2% or 7.8 percentage point less than at end-2007.

Marginal reserve requirement was another significant monetary policy instrument during 2008, which was introduced in order to slow down an intense foreign borrowing by banks, imposing an obligation on all banks to deposit 55% of the funds acquired abroad with the central bank. That instrument significantly contributed to a growth deceleration of banks' external debt, which has continuously recorded a year-on-year reduction since April 2007, falling from EUR 10.2 billion at end-2006 to EUR 7.9 billion at the end of September 2008. In early October 2008, the Croatian National Bank abolished marginal reserve requirement in order to provide banks with additional foreign exchange liquidity and ensure the smooth fulfilment of their obligations.

As a response to inflationary pressures, the year-on-year growth of monetary aggregates slowed down during 2008. Money (M1), which grew by 19.3% at the end of 2007, recorded a decline of 5.9% in November 2008 at annual level, which can mostly be accounted for by a slow-down in demand deposits' growth. A year-on-year growth of total deposits with commercial banks (including demand deposits) stood at 4.0% in November 2008, which is a 14.9 percentage point fall relative to end-2007. The most important contribution to the growth of total deposits was made by foreign currency deposits, which rose by 12.4% year-on-year in November, primarily due to a growth in foreign currency deposits of households. Total liquid assets (M4) decelerated their year-on-year growth from 18.3% at end-2007 to 5.0% in November 2008.

The average nominal exchange rate of the kuna against the euro was 7.22 HRK/EUR in 2008, which is a 1.5% appreciation compared to 2007. The usual pressures during the tourist season, inflow of foreign exchange from an increased borrowing of companies abroad, inflow of foreign capital for the purpose of buying INA shares and a generally reduced liquidity of the financial system contributed to the kuna exchange rate appreciation. In the first ten months of 2008, the indicators of price competitiveness of domestic exports deteriorated, as the kuna real effective exchange rate appreciated by 6.8% and 4.9%, deflated by consumer prices and producers' prices, respectively.

The balance of payments current account deficit increased from 7.9% in 2006 to 8.6% in 2007. Such developments are primarily the result of an increase in the negative balance in the goods account, which was only partly offset by a large surplus in the services account. Revenues from tourism, which amounted to EUR 6.8 billion in 2007, with a 7.3% growth year-on-year, made the largest contribution to the increase in the services account surplus. The decrease in the current transfers account surplus of 5.8% in 2007 also contributed to the increase in the balance of payments current account deficit. On the other hand, deficit in the income account was reduced by 2.9% in 2007 relative to 2006. The coverage of imports of goods and services by exports of goods and services was 85.3% in 2007, which is a 1.1 percentage point fall compared to 2006. Movements in the financial account were marked by a historically high amount of foreign direct investments of EUR 3.5 billion, i.e. their 34.9% increase in comparison with 2006. An outflow of EUR 5 million was recorded in the portfolio investments account in 2007, whereas an inflow of EUR 1.3 billion was recorded in the other investments account. Net errors and omissions amounted to EUR -890 million in 2007, while international reserves went up by EUR 722 million. The last year's PEP projected current account deficit in 2007 at 8.1% of GDP, but the outturn shows 0.5 percentage point higher share than the projected one. This can primarily be accounted for by an unexpected increase in petroleum prices on the world market at end-2007.

In the first three quarters of 2008, the current account balance of the balance of payments further deteriorated, mostly on account of a continued strengthening of imbalance in foreign trade in goods. Current account deficit stood at EUR 2.5 billion in the first three quarters, an increase of EUR 1.2 billion or 88.2%, year-on-year. Such developments are a consequence of a year-on-year increase in goods account deficit of EUR 1.4 billion, increase in income account deficit of EUR 298 million and decrease in current transfers account surplus of EUR 20 million, which was only partly offset by an increase in services account surplus, amounting to EUR 559 million. Movements in the balance of payments financial account were marked by a reduction in direct investments from EUR 2.8 billion in the first three quarters of 2007 to EUR 2.1 billion in the first three quarters of 2008, which is a 22.7% decrease. Inflow of cash of EUR 46 million was recorded in the portfolio investments account, whereas an inflow of EUR 2.0 billion was recorded in the other investments account, which is almost five times more than in the same period of 2007. The largest contribution to an increase in other investments in the first three quarters of 2008 came from other sectors³.

During 2008 there was a deceleration of a year-on-year growth of goods exports, and an acceleration of growth of goods imports as well as of merchandise trade deficit. In the first eleven months of 2008, goods exports recorded a year-on-year growth of 5.5%, whereas goods imports grew by 9.9%. The coverage of goods imports by goods exports amounted to 45.8% in the first eleven months of 2008. The largest contribution to exports growth was made by manufacture of other transport equipment, chemicals and chemical products, electrical machinery and apparatus and manufacture of coke, refined petroleum products and nuclear fuel. The categories which contributed the most to the increase in goods imports in the first eleven months of 2008 were the following: manufacture of coke, refined petroleum products and nuclear fuel, manufacture of other transport equipment, extraction of crude petroleum and natural gas and manufacture of chemicals and chemical products. It should also be taken into account that imports became more expensive due to the increase in petroleum prices on the world market and that growth in imports of other transport equipment is partly a consequence of temporary imports of ships for repair.

In terms of geographical structure of foreign trade, EU countries accounted for 61.0% of Croatian total goods exports in the first eleven months of 2008, which is a 5.7% increase compared to the same period of 2007. Goods imports from the EU countries were reduced

³ Enterprises constitute the largest part of other sectors.

from 65.1% in the first eleven months of 2007 to 63.9% in the first eleven months of 2008 and the year-on-year growth of imports from the EU countries stood at 8.0%. In terms of individual countries, exports to Italy (19.0%), Bosnia and Herzegovina (15.5%), Germany (10.7%), Slovenia (7.8%) and Austria (5.8%) had the largest share in Croatian total goods exports. In comparison with the same period of 2007, goods exports to Bosnia and Herzegovina increased by 13.8%, to Germany by 12.2% and to Italy by 3.9% in the first eleven months of 2008, whereas exports to Austria dropped by 1.4% and to Slovenia by 0.8%.

According to balance of payments data, which do not include cross-currency changes, international reserves went up by EUR 409 million in the first three quarters of 2008, owing to the growth in allocated foreign exchange reserve requirement by banks, foreign exchange intervention by the central bank in January and the purchase of foreign exchange received by the government under the PAL 2 loan. According to the monetary statistics data, which include cross-currency changes, international reserves increased by 5.4% in the first nine months of 2008, reaching EUR 9.8 billion at end-September.

As of beginning of 2008, a new system of external debt monitoring has been applied, according to which the external debt stock for December 2007 was adjusted. According to the new system, external debt amounted to EUR 33.3 billion in December 2007, which is EUR 337 million more than the previously reported EUR 32.9 billion. In addition, the share of external debt in GDP for 2007 also increased from 87.8% under the old system to 88.7% under the new system. In comparison with 2006, the share of external debt in GDP went up by 3.2 percentage points, whereas the last year's PEP projected a decrease in its share. In compliance with the last year's projections, the borrowing of banks was reduced in 2007, but increased external borrowing of enterprises offset this effect.

At end-September 2008, gross external debt amounted to EUR 36.0 billion according to the preliminary data and in the first nine months of 2008 it rose by EUR 2.7 billion or by 8.3%. The increase in external debt in the first nine months can primarily be accounted for by borrowing of other domestic sectors (enterprises constitute the largest part of that sector), external debt of which went up by EUR 2.9 billion. External debt of ownership-related enterprises through foreign direct investments increased by EUR 718 million and external debt of government increased by EUR 140 million. External debt of banks was reduced by EUR 975 million in the first nine months of 2008. In terms of the external debt structure, the share of the government external debt in total external debt was reduced from 20.2% at end-2007 to 19.1% in September 2008. In the same period, a decrease in the banks' external debt share was also recorded, from 26.8% to 22.1%, while the share of external debt of other sectors went up from 41.3% at end-2007 to 46.1% in September 2008.

2.2 MEDIUM-TERM MACROECONOMIC SCENARIO

Medium-term macroeconomic projections are based on released GDP and balance of payments data for the first three quarters and on other high-frequency indicators of economic activity available for the first eleven months of 2008. The combination of macroeconomic policies on which the programme is based is characterised by a synergy of the fiscal and monetary policies, with an aim of preventing adverse external effects, i.e. preserving macroeconomic stability and fostering economic growth sustainable in the long-term. A continuous fiscal consolidation, which creates a solid foundation for resistance of the public finance system to unfavourable conditions in the environment, has remained the main characteristic of fiscal policy. With the aim of fulfilment of its primary objective, maintaining price stability, the Croatian National Bank pursues monetary policy based on stability of domestic currency exchange rate. In 2008, as a result of inflation acceleration, the central bank was faced with new challenges in achieving its primary objective. However, it

succeeded in mitigating the inflationary pressures by pursuing a more restrictive monetary policy. In the forthcoming period, when the spillover effect of world financial crisis on Croatia is expected to be most pronounced, monetary policy will strive to maintain stability and liquidity of the financial system by using various administrative measures, some of which have already begun to be applied.

2.2.1 Real Sector

The quarterly GDP calculation indicates real year-on-year economic growth of 3.0% in the first three quarters of 2008, as a result of 4.3% growth in the first quarter, 3.4% in the second and 1.6% in the third quarter of 2008. In view of expected more pronounced weakening of economic activity in the last quarter of 2008, the projection for the entire 2008 indicates a 2.5% real GDP growth. The main contribution to the slowdown of economic activity in 2008 is expected to be made by the weakening of household consumption, as well as the decreasing of foreign demand for Croatian products. On the other hand, gross fixed capital formation, stimulated by strong construction activity in 2008⁴, has remained the main generator of economic growth.

The slow down of economic growth, which began in the second half of 2008, is expected to continue in 2009. A further slowing down of personal consumption, as a result of slower growth of disposable income of households, and a real fall of investments, due to, among other things, more difficult financing of the planned capital projects, is anticipated. In addition, the expected weakening of demand for both domestic and foreign products will lead, during 2009, to a reduction of imports and a mild growth of exports of goods and services, which should result in positive contribution of net exports to GDP growth.

The economic growth projection for 2009 is 2.0%, with the main risk of the projected growth being a more pronounced spillover of financial crises on the real sector than expected. In accordance with a gradual recovery of the world economy, the acceleration of economic growth to 3.2% in 2010 and 4.0% in 2011 is expected. A positive contribution to economic growth will also come from continued implementation of structural reforms, which will, through further improvement of the business climate, have an impact on the strengthening of the private sector. Structural reforms will also be supported by a further reduction of fiscal deficit, which will create additional space for the private sector.

Personal consumption, the main generator of economic growth in 2007, decelerated in 2008. In the first three quarters of 2008, personal consumption recorded a real growth of 2.3%, whereas, at the level of entire 2008, it is expected to rise by 1.7%. The deceleration of personal consumption can be explained by a smaller growth of real disposable income of households, which is primarily a result of a considerable increase in consumer prices during the observed year.

Year-on-year growth of employment was 1.1% in the first ten months of 2008 and real growth of average net wage 0.4%. The slowing down of year-on-year growth of loans to households (excluding housing loans) to 8.9% at end-November and unfavourable developments on the capital market, which led to a decrease in the value of households' financial assets thus making the wealth effect, present in earlier years, disappear, also contributed to the deceleration of personal consumption.

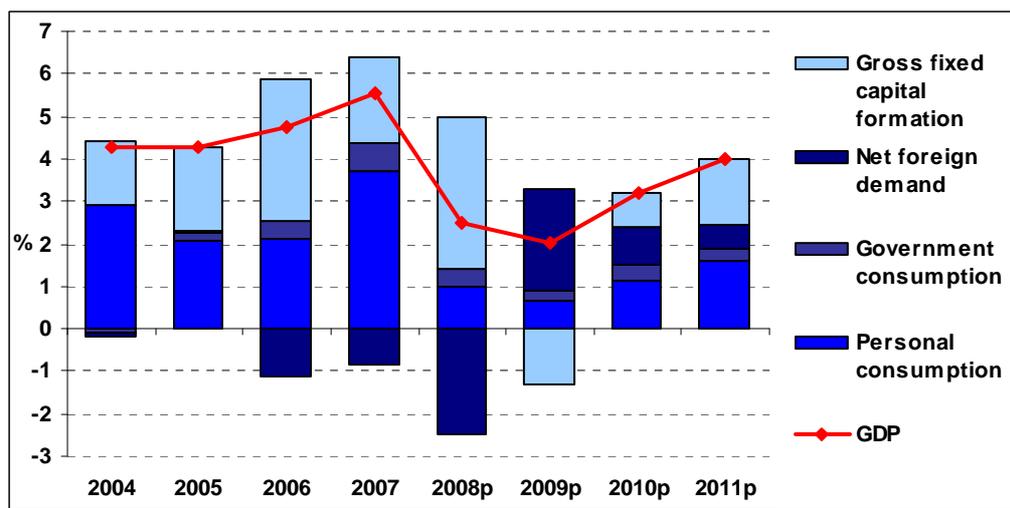
Additional deceleration of real growth of personal consumption to 1.1% is expected in 2009, when, in addition to all the above mentioned factors from 2008, a weak real growth of net wages, despite reduced inflationary pressures, is also expected to have an impact on

⁴ Volume indices of construction works recorded a year-on-year growth of 11.8% in the first ten months of 2008.

consumption, together with a smaller growth of employment. Mild depreciation of the kuna exchange rate against the euro will increase the burden of repayment of existing loans and foreign sources of financing will be less available and considerably more expensive.

In 2010, 1.9% real growth of personal consumption is expected and in 2011 the real growth will stand at 2.7%. In addition to the increase in disposable income, consumer confidence in the observed period could also be positively affected by increased prices of assets, such as real estate and financial assets, as a result of capital market recovery. The aforementioned effect should be taken into account especially in the context of Croatian accession to the EU and related increase in positive expectations.

Figure 1: Contribution of Aggregate Demand Categories to Real GDP Growth



Source: CBS, MF

The projection of government consumption indicates a real growth of government consumption of 2.3% in 2008, whereas a slowing down of government consumption growth to 1.1% is expected in 2009, due to a somewhat slower increase in the number of employed in public administration. The expected real growth of government consumption is 1.7% in 2010 and 1.5% in 2011.

In the first three quarters of 2008, gross fixed capital formation recorded a strong real growth of 9.7%, stimulated by construction activity, primarily investments in sports, commercial and other non-residential facilities. At the level of entire 2008, real growth of investments is expected to amount to 8.1%. A real fall of investments of 1.1% is projected for 2009, as a consequence of contraction of investment activities but also in view of the previous year's high base. Although a moderate slowdown of government investments in capital projects is expected, the most significant reduction in investments in 2009 will refer to their private component, due to more expensive and less available both domestic and foreign sources of financing. In 2010, the projected real growth of investments stands at 2.2% and its acceleration to 4.2% is expected in 2011.

Real year-on-year growth of exports of goods and services amounted to 3.1% in the first three quarters, while the growth for the entire 2008 is estimated at 2.5%. In 2009, real growth of exports of goods and services is projected at 0.6%, since the effects of the global financial crisis are expected to be most strongly pronounced in that year, which will be reflected in deceleration and even stagnation of the economic activity on the main Croatian exports markets (Italy, Germany, Austria and Slovenia). In the forthcoming period, growth acceleration of goods and services exports to 3.0% and 4.0% is expected in 2010 and 2011, respectively. Economic growth recovery of the main foreign trade partners and countries from

which the largest number of tourists arrives, as well as further strengthening of integration processes will contribute to acceleration of exports.

A strong real growth of imports of goods and services of 7.2% in the first three quarters of 2008 and year-on-year decrease in goods imports of 4.9% in October and November resulted in an estimate of real growth of imports of goods and services of 5.9% at the level of entire 2008. In accordance with the expected considerable deceleration of personal consumption, reduced gross fixed capital formation and reduced demand for petroleum due to deceleration of the overall economic activity, a real fall of imports of goods and services of 3.1% is projected for 2009. In the forthcoming period, imports of goods and services will record a real growth of 0.9% and 2.3% in 2010 and 2011, respectively.

The above mentioned analyses imply that net exports of goods and services will make a negative contribution to real GDP growth in 2008. However, in the subsequent years, their contribution will turn positive, especially in 2009, when net exports contribution will stand at 2.4 percentage points.

Favourable labour market developments continued into 2008. The average number of registered unemployed persons was reduced by 10.9% year-on-year in the first eleven months of 2008, whereas the labour force survey unemployment rate stood at 9.0% in the first half of 2008. The labour force survey unemployment rate is estimated at 8.7% for the entire 2008 and its further reduction to 8.5% in 2009, 8.0% in 2010 and 7.4% in 2011 is anticipated. By the end of the projection period, a further growth in the number of employed is expected. However, employment growth will slow down to 0.4% in 2009. In all the years of the projection period, labour productivity growth is expected, but it will be somewhat lower in 2009. Since the labour productivity growth is expected to be faster than real wage growth, a further decrease in the real unit labour cost is projected in all the observed years.

2.2.2 Inflation

Unfavourable factors on the supply side, which relate to the increase in prices of crude petroleum and food raw materials on the world market, as well as drought that struck domestic agricultural production, resulted in the increase in inflation rate to 5.8% in December 2007. The inflation rise at end-2007 was also affected by a significant acceleration of the real annual growth of personal consumption. The postponed impact of domestic demand strengthening on inflation was also felt during 2008. The continuous strengthening of inflationary pressures was present until July 2008, when the annual rate of inflation increased to 8.4%. Afterwards, a reduction in the level of prices was recorded, so that in December 2008 the year-on-year growth of consumer price index stood at 2.9%. The prices dropped after July under the influence of the weakening of the imported inflationary pressures, which was reflected in a decrease in prices of food raw materials and crude petroleum on the world market. This, along with a favourable base effect, has had an impact on the deceleration of the annual growth rate of domestic prices of food and energy since August 2008. Accordingly, the year-on-year increase in food prices slowed down from 14.7% in July to 5.0% in December 2008, whereas the prices of energy, whose year-on-year growth amounted to 16.5% in July, recorded a decline of 1.7% in December.

Table 1: Consumer Price Index, %

	2007	2008	2009 p	2010 p	2011 p
CPI, 2007 PEP	2,5	3,1	2,6	2,5	-
CPI, 2008 PEP	2,9	6,1	3,5	3,2	3,0

Source: CBS, MF

The annual rate of inflation measured by consumer price index stood at 6.1% in 2008, which is a 3 percentage points higher inflation rate than the one projected in the previous PEP. One of the reasons for this was a larger increase in prices than the expected one in the September-December 2007 period, which contributed to a greater carry-over effect of inflation from 2007 into 2008.

The forecast of consumer price movements in 2009 was made under the assumption of a relatively stable exchange rate of the kuna against the euro, which represents the main anchor of the domestic inflationary expectations. Accordingly, an assumption is incorporated into the projection that the average nominal exchange rate of the kuna against the euro will move around 7.27 HRK/EUR in 2009. In accordance with the projected movements of the US dollar against the euro on the world foreign exchange market, a depreciation of the average nominal exchange rate of the kuna against the US dollar is projected in 2009. The weakening of the kuna exchange rate against the US dollar will have an adverse effect on the movements of prices of imported raw materials and finished goods which are paid in the US dollars.

The continuation of the trend of decrease in the index of prices of food raw materials on the world market, which started in the third quarter of 2008, is expected in 2009. Nevertheless, it should be noted that the projected reduction in the level of food raw materials prices for 2009 is somewhat less intense than the previous increases in prices⁵, so that the food prices on the world market will remain at a relatively high level. In addition, IMF analysts anticipate a further fall in metal prices on the world market in 2009 and a decrease in the average crude petroleum price expressed in US dollars by 31.8% compared to year 2008.

Inflationary pressures arising from the developments in domestic demand during 2009 should be mitigated, taking into account foreseen deceleration of domestic demand growth, relative to 2008. In addition, the weakening of the pressures on cost-push inflation is expected in 2009, since a slowing down of the annual growth rate of unit labour cost is expected. However, an increase in administrative prices, which relates to the increase in prices of gas⁶, excise duty on tobacco products⁷ and of health care services due to the implementation of health care reform, will contribute to strengthening of inflationary pressures in 2009. Accordingly, a slowdown of the average annual inflation rate from 6.1% in 2008 to 3.5% in 2009 is projected.

During 2010 and 2011, under the assumption that no new external shocks will occur and that global financial system will recover, a further inflation decrease is projected. The average annual growth of consumer prices of 3.2% is expected in 2010 and its further deceleration to 3.0% in 2011.

2.2.3 Monetary and Exchange Rate Policy

The primary objective of the Croatian National Bank (CNB) is to maintain price stability. In the fulfilment of its primary objective, the CNB pursues monetary policy based on stability of the nominal exchange rate of the kuna against the euro. The choice of such monetary policy arises from the conditions in which the central bank operates. More specifically, Croatia is a small and highly euroised country whose main foreign trade partners are from the euro area. In such conditions, movements of the nominal exchange rate of the domestic currency

⁵ The IMF analysts expect in their forecasts from end-October 2008 that following a 25.7% increase in prices of food raw materials, recorded in 2008, their prices will drop by 18.4% in 2009, relative to the previous year (in terms of US dollars).

⁶ The price of natural gas increased by 20% on average in January 2009.

⁷ Increase in excise duties arises from the requirement to align excise duties with the EU regulations in the following two years.

strongly affect movements of domestic prices, inflationary expectations, stability of the domestic banking system and economic activity as a whole.

On the other hand, pursuing the policy of stable exchange rate in the conditions of free movement of capital restricts the scope of monetary policy. The interest rate transmission mechanism of monetary policy is not developed sufficiently, so the central bank generally uses the open market operations for short-term liquidity management and stabilisation of the domestic money market. In such conditions, the instrument of reserve requirement, which sterilises excessive liquidity, is also very important.

Owing to a strong capital inflow from abroad (revenues from tourism, foreign direct investments, external borrowing, etc.), appreciation pressures and central bank's interventions of purchase of foreign exchange have characterised the foreign exchange market in the last few years. In such conditions, monetary policy based on the exchange rate as the nominal anchor, complemented with other administrative measures, has proved adequate for achieving the primary objective of the central bank.

However, inflation acceleration at end-2007 and in the first half of 2008 set new challenges for the monetary policy. The central bank acted within its competence to mitigate inflationary pressures. Creation of reserve money was limited in that period and the restrictiveness of monetary policy was reflected in a reduced volume of open market operations and in growth of interest rates at reverse repo auctions. In the second and third quarter of 2008, there were no foreign exchange interventions. The tightness of monetary policy resulted in growth deceleration of almost all monetary and credit aggregates and in a mild appreciation of the exchange rate of the kuna against the euro. At the end of the third quarter of 2008, inflation in Croatia slowed down and a continuation of such a trend is expected in the forthcoming period. In the absence of additional external shocks, the existing monetary policy instruments should contribute to a further weakening of inflationary pressures in 2009 as well.

In order to reverse the unfavourable trends of excessive growth of banks' placements, enlargement of balance of payments current account deficit and the increase in total external debt of the Republic of Croatia, the CNB also used various administrative measures in the previous years. The most important ones are the marginal reserve requirement and the purchase of compulsory CNB bills. The former measure, which made the use of foreign capital more expensive for commercial banks, was introduced in 2004 and it resulted in a sharp fall of external debt of commercial banks in the subsequent years. Furthermore, the measure relating to a purchase of compulsory CNB bills, which is aimed at slowing down banks' placement growth, was applied in 2003 and 2007 in a very similar form. The said measure was also effective in year 2008 and it is planned to be in effect in 2009 as well. This measure has proved successful and placement growth decelerated to long-term sustainable levels, from 22.9% in 2006 to 15.0% in 2007, while placements are estimated to grow within the prescribed restriction of 12% in 2008.

In addition, the CNB has continuously amended and complemented various decisions in the field of prudential regulation. All the amendments (of which the most important are the following: introduction of the requirement to monitor foreign exchange exposure of commercial banks' clients, increase in risk weights for placements to clients with a mismatched foreign exchange position, tightening of the prescribed requirement to allocate special reserves for fast-growing banks, tying the realised growth of bank placements to a required capital adequacy level) have resulted in a strong recapitalisation of commercial banks, thus increasing resistance of the domestic banking sector to potential shocks. At the same time, unfavourable developments on the world financial markets and domestic capital market have not so far produced any adverse effect on the Croatian banking sector. In contrast, they stimulated growth in bank deposits in 2008. In addition, the fact that the sold

claims based on the granted loans were also included in the restriction on the banks' placement growth contributed to the reduction of banks' exposure to additional risks.

In view of the fact that in September 2008 the banking and financial crisis spilt over from the USA to Europe, there is a possibility that the world financial crisis, in addition to indirect effects on the economic and financial developments in Croatia, will affect the domestic financial system. In that case, the CNB will strive to mitigate the shocks associated with the financial crisis. With the very intention of improving foreign exchange liquidity of the system, the central bank abolished the marginal reserve requirement in October 2008, providing thus banks with approximately EUR 0.45 billion. In addition, in November 2008, banks' reserve requirement rate was reduced from 17% to 14%, in order to facilitate the financing of government needs on the domestic market, without fear of crowding out the private sector from the sources of financing. The aforementioned decision is also a step towards achieving a long-term gradual reduction of reserve requirement in the process of monetary policy alignment with the EU standards. For the purpose of maintaining exchange rate stability, i.e. restricting depreciation pressures on the kuna against the euro, at the beginning of 2009, the CNB increased the calculated foreign exchange component of reserve requirement which is allocated in kuna from 50% to 75%. It should be noted that the CNB and the financial system as a whole have at their disposal considerable amount of foreign exchange reserves which could mitigate possible shocks. It should also be stressed that administrative and prudential measures, applied in recent years, have resulted in a large increase in banks' capital adequacy and a decrease in their external debt, which has significantly improved resistance of the domestic financial system to shocks.

2.2.4 External Sector

After the year 2008, in which an increase in the balance of payments current account deficit (as a percentage of GDP) is expected due to external shocks, primarily high petroleum prices, in 2009 its strong decline is anticipated. In the years that follow the current account deficit will continue to decrease but at a somewhat slower pace. Current account deficit, after the estimated 10.5% of GDP in 2008, will thus drop to 7.8% of GDP in 2009 and then to the level of 6.4% of GDP in 2011.

As regards the assessment of the balance of payments deficit for 2008, differences in relation to the values from the previous PEP result from much poorer performance in the first half of 2008, especially in merchandise trade. Less optimistic expectations for 2009 can be accounted for by the current financial crisis which has brought pessimism in the expected economic dynamics in the euro area countries which generate the largest part of demand for Croatian export products.

In 2009 a decrease in goods imports is expected, primarily due to the weakening of the economic activity and domestic demand but also as a result of a decrease in the world prices, especially of energy products, agricultural and other raw materials. In addition to a decrease in prices of crude petroleum, which had a significant effect on deterioration of foreign trade deficit in 2008, the weakening of the economic activity in 2009 should also lead to a decline in demand, i.e. imported and exported quantities of that energy product. In the forthcoming years, in accordance with the expected economic recovery, a gradual strengthening of goods imports growth should follow. Nevertheless, that growth could be more moderate than in the previous years, since the world prices are not expected to increase as sharply again as they did in the previous period.

During 2009, a slowing down of goods exports growth is expected, as a result of deceleration and even stagnation of the economic activity in the main Croatian exports markets, whereas,

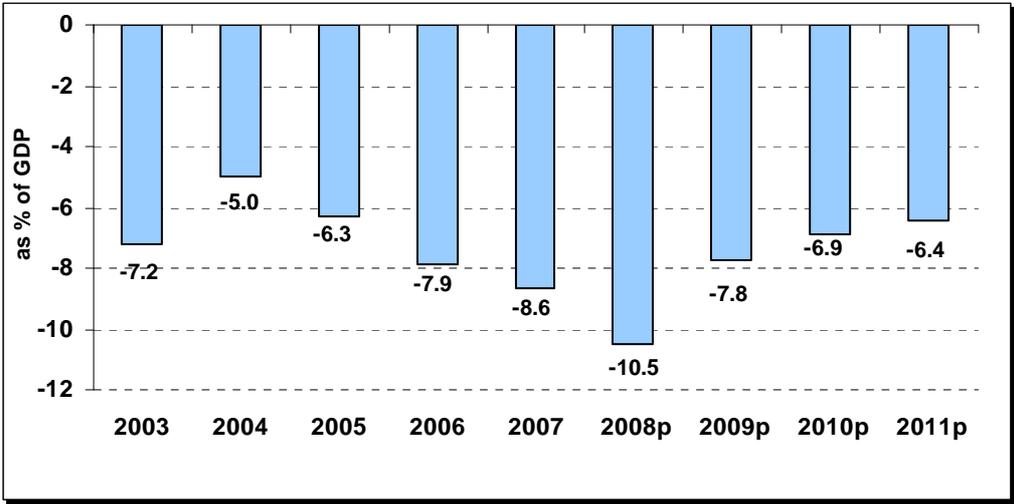
in accordance with the recovery of global demand, a strengthening of Croatian goods exports is expected in the forthcoming years. As a result of a decrease in goods imports and deceleration of exports, a drop in foreign trade deficit is expected in 2009 while its moderate growth is anticipated in the forthcoming years.

Expected movements in international service trade are generally accompanied by forecasts of revenues from tourism. Accordingly, growth recovery of revenues from tourism is expected again following a weaker growth of revenues in 2009, due to a fall in demand in the main tourist generating markets, caused by the economic crisis. Some of the internal factors which could stimulate a faster growth of revenues in that period will include investments in new hotel and apartment capacity and improving the category of the existing accommodation facilities, which will in turn stimulate a larger number of foreign tourist arrivals, especially those of higher income. Positive contributions of the local communities are also expected, especially in the field of environmental care and investment in tourism infrastructure.

After a rather strong growth in factor income account deficit in 2008, that growth is expected to weaken considerably in 2009, primarily as a result of slowing down of expenditure growth. In the forthcoming years, when a gradual economic recovery is expected, an increase in the negative balance of factor income account could speed up again, as the expenditures growth accelerates. With economic recovery, a gradual acceleration of revenues growth is also expected, especially of compensations to employees and revenues from equity investments of residents abroad.

In 2009, a decrease in positive balance of current transfers account is expected, whereat the growth of both current transfers' revenues and expenditures will slow down. In the forthcoming years, revenues from transfers should grow faster with the economic recovery, so that improvement in the positive balance is expected again.

Figure 2: Balance of Payments Current Account



Source: CNB, MF

Following the INA takeover, the largest individual direct investment in Croatia so far, no new large takeovers of domestic companies are expected. However, a larger amount of greenfield investments is anticipated, especially in the activity of trade, but the realization of these investments is expected only after the stabilization of global economic developments. As regards the expected recapitalisation of banks, its amount should be smaller than in the previous years, considering the present large capitalisation of the banking system and under the assumption of further restriction on the growth of their placements. On the other hand, further growth of equity investments, unrelated to the privatisation and recapitalisation of banks, is to be expected, especially after 2009, which will also be favourably affected by

joining the NATO alliance and Croatia's EU accession process, which implies legislative alignment with the *acquis communautaire*, implementation of the required reforms, regulation of land registry and prevention of corruption.

In 2008, the increase in the external debt as a percentage of GDP to 92.4% is expected, primarily due to a significant rise in borrowing of other domestic sectors and ownership-related enterprises through foreign direct investments. In accordance with the expected unfavourable developments and more difficult financing conditions on the world financial markets and taking into account the expected deceleration of domestic economic activity, a considerable slowing down of the Republic of Croatia's gross external debt is expected in 2009. Nevertheless, with the gradual weakening of the world financial crisis, in the following two years foreign sources of financing should become more accessible to the domestic sectors, so that a faster growth of their external debt is expected.

The consequences of the world financial crisis and of the weakening of economic growth in the country could mostly be reflected in a deceleration of enterprises' debt growth, especially in 2009, whereas in the forthcoming period, their debt could grow somewhat faster. However, that growth will still be more moderate than in the previous years, a contribution to which could be made by the expected strengthening of the domestic capital market, which would enable companies to meet their increased needs by greater financing on the domestic market.

As regards commercial banks, a drop in their debt is expected in year 2009, due to the more difficult financing conditions on the foreign markets, while such movements could also continue in the forthcoming years, but less intensely.

The orientation so far on the continuous decreasing of the fiscal deficit and on the domestic sources of financing has had positive impacts on the developments of government as well as total external debt. The share of government in total external debt was thus decreased from 33.0% at end-2003 to 19.1% in September 2008. Following the projections for public sector, it is expected that the share of government in total external debt will slightly decrease in the medium term.

In accordance with the described external debt developments, and taking into account a slower growth of nominal GDP relative to the previous two years, a moderate improvement of the relative indicator of external indebtedness could occur in the projected period, from the projected 90.9% of GDP in 2009 to 90.0% of GDP in 2011.

3 PUBLIC FINANCES

3.1 GENERAL GOVERNMENT BALANCE AND DEBT

3.1.1 Policy Strategy and Medium-Term Objectives

The fiscal policy for the next medium-term period will remain in focus of the overall economic policy of the Government of the Republic of Croatia. The fiscal strategy will continue to be oriented towards further fiscal adjustment, the implementation of which will result in the reduction of the general government deficit and decreased participation of the state in the economy. A significant contribution to these effects will be provided by structural reforms which will complete the economic policy framework and which are described in more detail below.

The abovementioned fiscal policy direction will support the primary objective of the economic policy of the Croatian Government by focusing on:

- Encouraging positive rates of economic growth,
- Reducing unemployment rates and the increase of employment,
- Ensuring social fairness,
- Reducing of the general government deficit towards balancing total revenues and expenditures at the end of the medium-term period,
- Further reduction of public debt and stabilisation of external debt.

To this end, the implementation of the following structural measures aiming at sustainability of public finance and further development of a functioning market economy is of utmost importance:

- Promoting business environment and encouraging the development of entrepreneurship,
- Systematic encouraging of the knowledge-based society, accompanied by channelling resources into education, research, development and life-long learning,
- Restructuring and modernisation of the shipbuilding and railway sector and completing the privatisation process,
- Continuing the reform of the public administration and judicial system, accompanied by the active implementation of measures to fight against corruption,
- Further regional development supported by continued investments into infrastructure, transportation and water and gas supply to all parts of Croatia,
- Improving energy efficiency and energy stability,
- Continuing the care of socially vulnerable groups along with improving of all social security segments targeting,
- Implementation of the reform of the health care system, which will ensure an increased efficiency and financial sustainability of the health care system,
- Completing the process of alignment of Croatian legislation with the *acquis communautaire*.

3.1.2 Actual Balances and Medium-Term Perspectives

Recent Movements in the Consolidated General Government Budget

The fiscal consolidation process, which began in 2004, continued in 2007. A substantial reduction of net lending/borrowing of 1.5 percentage points was noted in 2006 and the trend of its reduction by another 0.8 percentage points, i.e. to the level of 1.6% of GDP, continued

in 2007. Both revenues and expenditures of the consolidated general government were compliant with the planned amounts. The revenues rose by 12.8% year-on-year and the expenditures rose by 10.7% year-on-year.

Table 2: Revenues, Expenditures and Net Lending/Borrowing of the General Government 2004-2007

<i>% of GDP</i>	2004	2005	2006	2007
Net lending/borrowing	-4.3	-4.0	-2.4	-1.6
Total revenue	44.9	44.5	44.8	46.0
Total expenditure	49.2	48.4	47.2	47.6

Source: MF

The favourable fiscal trends continued into the first half of 2008 both on the revenue and on the expenditure side of the budget. In July 2008 Amendments to the State Budget of the Republic of Croatia were adopted, which provides for a planned net lending/borrowing at the level of -1.3% of GDP. The trends in the second part of the year point at achieving the projected level of net lending/borrowing, which is of utmost importance for the further implementation of the fiscal adjustment in the medium-term period.

Medium-Term Fiscal Projections

Consolidated General Government Revenue

Revenues of the consolidated general government for the period 2009-2011 are planned in line with the projections of macroeconomic variables and on the basis of their preceding trends. Also, estimates of introducing new sources of funding intended for the health care sector have been taken into consideration, specifically, introducing a pension insurance contribution at the rate of 3% for those beneficiaries whose pension exceeds the amount of an average salary, as well as co-payments, supplemental health insurance and insurance against civil liability in respect of the use of motor vehicles.

With respect to abovementioned, total revenues of the consolidated general government show a tendency of reduction of their share in GDP from 45.2% in 2009 to 44.8% in 2010, i.e. to 44.4% in 2011, which is determined by the expected economic activity being largely under the influence of global trends.

Accordingly, a year-on-year growth by 4.5% is expected in 2009, as well as higher revenue rates in 2010 (5.8%) and in 2011 (6.5%) as a result of the growth of economic activity.

The structure of the budget consists for the most part of VAT revenues, making up an average share of 14.1% of GDP in the period under review. The planned nominal consumption in the medium-term period was taken into account in their projection, as well as possible risks of the employment rate slowdown, salary developments and employment structure by sectors which could change depending on overall tendencies in development of economy. They are followed by social contributions, which are planned to stand at 13.6% of GDP.

A slight decrease in excises in GDP, namely from 4.1% in 2009 to 3.9% in 2010 and to 3.8% in 2011 has been recorded. Regarding the share in total excises, revenue deriving from excises on petroleum derivatives is the most significant one and is followed by excises on tobacco products and excises on cars. The projection of excises on petroleum derivatives is based on current developments as well as possible effects of decrease in price in the world markets. The projection of excises on tobacco products takes into account effects of amendments to the Act on excises on tobacco products whereby the increase of excises is being aligned with the European Union regulations. The aforementioned amendments to legislation and the

application of the new Act on Restriction of Usage of Tobacco Products in Public Places increase the possibility of decrease in consumption of tobacco products and, consequently, lower revenue collection on the basis of excises on tobacco products.

By the end of 2011 and on the basis of the expected growth in nominal gross wages and in employment, personal income tax revenues are projected at 3.5% of GDP. For the purpose of projecting personal income tax revenues in 2009 the effect of amendments to the Act on Income Tax have been taken into consideration whereby in July 2008 the personal exemption was increased from HRK 1,600 to HRK 1,800.

Profit tax revenue will record a slight decrease of its share from 3.3% of GDP in 2009 to 3.2% of GDP in 2010 and 2011, which is in accordance with the expected trends in economic activity.

The most significant reduction of the share in GDP is that of property revenue, specifically from 0.7% in 2009 to 0.4 in 2010 and 2011.

At the same time, custom fees and duties maintain their share in GDP at the level of 0.6%. It is worth mentioning that no significant changes to foreign trade legislation have been envisaged.

Consolidated General Government Expenditure

Consolidated general government expenditure, in the period 2009-2011, will be affected with the continuing trend of fiscal consolidation, supported for the major part by the continued implementation of structural reforms and the control of the expenditures execution. On the other hand, trends in expenditures will be determined by the implementation of key policies and measures aimed at promoting entrepreneurship, regional development, incentive programmes for the promotion of competitiveness within the agriculture sector, investment into education and science, protection of socially vulnerable groups, as well as maintaining sustainable economic growth and development. Accordingly, it is expected that total expenditures of the consolidated general government in 2009 will be at the level of 46.1% of GDP and will continue to decrease to 44.4% of GDP in 2011.

Expenditure for social benefits, which account for the largest share of total expenditure of the consolidated general government, will decrease its share from 18.0% of GDP in 2009 to the level of 17.7% of GDP in 2011. The dynamics of expenditure for social benefits is closely associated with meeting the needs of the pension insurance and health care systems. To illustrate this: the pension expenditures include the expected effects related to changes to the levels of family and disability pensions as well as the measures for the elimination of differences between the pensions of the “old” and “new” pensioners, aimed at the improvement of their material status. Health care allocations are influenced by the recent reform of the health care system, which has introduced changes to the financing of health care and ensured the funds required in order to optimise the efficiency and allow for the financial sustainability of the health care system, particularly with regard to primary and secondary health care. In addition, this expenditure category includes funds required for exercising rights on the basis of social welfare, material and legal protection of unemployed persons, maternity and child allowance.

Compensation of employees is the second largest expenditure item, the share of which will be reduced from 11.5% of GDP in 2009 to the level of 10.9% of GDP in 2011. For 2009 those expenditures have been planned in line with the application of Agreement on the Base for Calculating Salaries in State and Public Services as of 2006 whereby the 6%-yearly-increase of the base for calculating salaries applicable to the next 3-year period was agreed.

Expenditures for intermediary consumption relate mostly to expenditures for the use of goods and services. In the period under review, their share is expected to average at 5.8% of GDP. It is important to emphasise that trends of these expenditures will be largely determined by programmes related to national security, health care as well as activities and projects associated with the EU accession, which primarily pertain to strengthening administrative capacities.

The share of expenditures for subsidies will continue to decrease from 2.5% of GDP in 2009 to the level of 2.2% of GDP in 2011. Trends of expenditures for subsidies in the medium-term period will be largely determined by subsidies in agriculture, but also by other subsidies (shipyards, railways) with the focus on horizontal subsidies in contrast to sectoral subsidies.

The expenditures for property income will decrease from 1.6% of GDP in 2009 to 1.3% of GDP in 2011. Such trends will be a result of favourable trends of interest expenditure, which is a direct positive consequence of the fiscal consolidation process and the reduction of net lending/borrowing in the consolidated general government budget and needs for its financing. In this context it is important to mention the possibility of risks arising from the increase of the cost of capital, i.e. interests.

The category of other current transfers, which mainly comprises current grants and current donations, is projected to stand on average at the level of 1.5% of GDP, whereas capital transfers, which are comprised of capital grants and capital donations, are planned to stand at 2.5% of GDP during the next medium-term period.

Expenditures for gross fixed capital formation comprise net expenditures for the acquisition of fixed assets, strategic inventories and valuables. Maintaining of the share of these expenditures at the level of 2.7% of GDP by the end of 2011 will be determined by activities associated with road infrastructure and other capital investments in the fields of science, education, judicial system, border-crossings, etc.

Table 3: Revenues, Expenditures and Net Lending/Borrowing of the General Government 2009-2011

ESA 95	% of GDP	2007	2008p	2009p	2010p	2011p
TR	Total revenue	46.0	45.7	45.2	44.8	44.4
	<i>Main components of total revenue:</i>					
P.1	Output	4.7	3.9	4.1	4.0	3.8
D.211	Value-added tax	13.7	14.3	14.0	14.1	14.1
D.61R	Social contributions, receivable	13.7	13.8	13.6	13.6	13.6
	Current taxes on income, wealth etc.,					
D.5R	receivable	7.1	7.2	7.0	6.9	6.9
D.51A	- of which: personal income tax	3.6	3.6	3.5	3.5	3.5
D.51B	corporate income tax	3.2	3.3	3.3	3.2	3.2
D.212	Taxes and duties on imports excluding VAT	0.6	0.6	0.6	0.6	0.6
	Taxes on products, except VAT and import					
D.214	taxes	4.7	4.6	4.5	4.4	4.2
D.214a	- of which: excises	4.4	4.1	4.1	3.9	3.8
D.4R	Property income, receivable	0.8	0.5	0.7	0.4	0.4
TE	Total expenditure	47.6	46.9	46.1	45.4	44.4
	<i>Main components of total expenditure:</i>					
P.2	Intermediate consumption	5.8	6.0	5.8	5.8	5.8
D1.P	Compensation of employees	11.3	11.2	11.5	11.0	10.9
D.3P	Subsidies, payable	2.7	2.9	2.5	2.4	2.2
D.4P	Property income, payable	2.0	1.8	1.6	1.5	1.3
	Social benefits other than social transfers in					
D.62P	kind, payable	14.3	14.4	14.1	13.8	13.5
D.631	Social transfers in kind	3.2	3.3	3.8	4.3	4.2
D.7P	Other current transfers, payable	1.6	1.5	1.5	1.5	1.5
D.9P	Capital transfers, payable	2.0	2.8	2.4	2.5	2.5
P.5	Gross capital formation	4.2	3.0	2.7	2.7	2.7
	Assumption of guarantees	0.2				
B.9	Net lending/borrowing	-1.6	-1.3	-0.9	-0.6	0.0

Source: MF

Net Lending/Borrowing

The process of fiscal consolidation and the resulting decrease in the negative balance of the general government budget (net lending/borrowing) will continue in the next medium-term period. Proceeding with such a policy also entails further attainment of positive economic effects on a larger scale. However, certain risks with regard to the implementation of set objectives of the fiscal policy in the forthcoming period should be taken into account, particularly with regard to unfavourable and uncertain global trends in economic growth and financial market movements. Revenue projections based upon medium-term macroeconomic projections as well as rational planning of expenditures in the forthcoming period will result in continued fiscal consolidation policy and the reduction of the negative balance in the consolidated general government budget towards balancing total revenues and expenditures at the end of the medium-term period.

Continued reduction of the negative balance of the general government budget, which is defined as a difference between revenues and expenditures, is foreseen in the period 2009-2011, while the end of the period under review will see the balancing of total revenues and expenditures. Accordingly, net lending/borrowing in 2009 will be at the level of -0.9% of GDP and -0.6% of GDP in 2010, while as for 2011 the level of 0.0% of GDP is planned. The largest contribution to the above trends of the balance of the general government budget will be provided by the budgetary central government. Namely, balanced budgets for local and regional self-government units are being planned for the entire period in question, whereas a negative balance is recorded with extra-budgetary users at the level of -0.1% of GDP in 2009, i.e. -0.2% of GDP in 2010 and 2011 respectively. The budgetary central government is expected to record a reduction of net lending/borrowing from -0.7% of GDP in 2009 to -0.4% of GDP in 2010, whereas in 2011 revenues will be higher than expenditures, or to be more precise, net lending/borrowing will be at the positive level of 0.2% of GDP.

Table 4: Revenues, Expenditures and Net Lending/Borrowing of the General Government 2007-2011 According to Government Level

% of GDP	2007	2008p	2009p	2010p	2011p
Budgetary central government - unconsolidated					
Total revenue	39.4	39.4	39.2	38.9	38.6
Total expenditure	40.0	40.3	40.0	39.3	38.4
Net lending/borrowing	-0.7	-0.9	-0.7	-0.4	0.2
Extrabudgetary users - unconsolidated					
Total revenue	3.8	2.1	1.9	1.9	1.8
Total expenditure	4.6	2.4	2.0	2.1	2.1
Net lending/borrowing	-0.7	-0.3	-0.1	-0.2	-0.2
Local government - unconsolidated					
Total revenue	5.6	5.6	5.5	5.5	5.5
Total expenditure	5.6	5.7	5.5	5.5	5.5
Net lending/borrowing	0.1	-0.1	0.0	0.0	0.0
Consolidated general government					
Total revenue	46.0	45.7	45.2	44.8	44.4
Total expenditure	47.6	46.9	46.1	45.4	44.4
Net lending/borrowing	-1.6	-1.3	-0.9	-0.6	0.0

Source: MF

Financing of the General Government Budget

The total level of the required financing in the forthcoming medium-term period will be determined by the trends of the fiscal balance, financial assets as well as liabilities maturing in the period under review.

Table 5: Financing of General Government Budget 2009 – 2011

ESA 95	% of GDP	2007	2008p	2009p	2010p	2011p
F.A	Net acquisition of financial assets	-1.1	0.3	0.4	0.5	0.5
F.1	Monetary gold and special drawing rights (SDRs)	0.0	0.0	0.0	0.0	0.0
F.2A	Currency and deposits - assets	-0.5	0.2	0.3	0.2	0.2
F.3A	Securities other than shares - assets	0.0	0.0	0.0	0.0	0.0
F.4A	Loans - assets	0.4	0.2	0.2	0.2	0.2
F.4AA	Loans - assets - acquisitions	0.5	0.3	0.3	0.4	0.4
F.4AD	Loans - assets - disposals	0.1	0.2	0.2	0.2	0.2
F.5A	Shares and other equity - assets	-1.0	-0.1	0.0	0.1	0.1
F.5AA	Shares and other equity - assets - acquisitions	0.1	0.2	0.1	0.1	0.1
F.5AD	Shares and other equity - assets - disposals	1.1	0.3	0.2	0.1	0.0
F.L	Net incurrence of liabilities	0.5	1.5	1.3	1.1	0.5
F.2L	Currency and deposits - liabilities	0.0	0.0	0.0	0.0	0.0
F.3L	Securities other than shares - liabilities	0.5	-0.4	1.7	0.7	-0.2
F.3LR	Securities other than shares - liabilities - repayments	2.1	1.7	1.7	2.1	2.2
	domestic	1.5	1.3	0.1	1.0	0.7
	foreign	0.6	0.4	1.6	1.1	1.5
F.3LI	Securities other than shares - liabilities - incurrence	2.6	1.2	3.3	2.8	2.0
	domestic	2.6	1.2	1.6	1.6	1.2
	foreign	0.0	0.0	1.7	1.2	0.8
F.4L	Loans - liabilities	-0.3	1.9	-0.4	0.4	0.7
F.4LR	Loans - liabilities - repayments	1.5	1.3	1.7	1.4	0.7
	domestic	0.5	0.5	1.0	0.8	0.3
	foreign	1.0	0.8	0.7	0.5	0.4
F.4LI	Loans - liabilities - incurrence	1.2	3.2	1.3	1.8	1.4
	domestic	0.2	2.4	0.8	1.5	1.3
	foreign	1.1	0.9	0.5	0.3	0.2
F.7L	Other accounts receivable/payable - liabilities	0.2	0.0	0.0	0.0	0.0
B.9F	Net lending/borrowing	-1.6	-1.3	-0.9	-0.6	0.0

Source: MF

Along with the completion of the privatisation process, a gradual reduction of privatisation receipts on the financial assets side will occur. In the medium-term period the share in GDP of net incurrence of liabilities will record continuous decrease, specifically from the level of 1.3% of GDP in 2009 to 0.3% of GDP in 2011. The reason for the continuous decrease of net liabilities share in the period under review is twofold. Namely, the first reason is developments concerning fiscal balance, i.e. moving towards balanced general government budget at the end of the period under review. The second reason is decrease in the total level of repayments, specifically from the level of 3.4% of GDP in 2009 to 3.0% of GDP in 2011.

The significant orientation to domestic sources of financing will continue, and as far as borrowing instruments are concerned, the strongest emphasis will be on bonds. Particular attention will be paid to the smoothing of the maturity structure of liabilities and balanced distribution of refinancing burden.

In the forthcoming period, five bond issues will mature, one domestic and four international issues. As regards the domestic bonds, HRK 3 billion, issued in 2005, will mature in March 2010. As far as international issues are concerned, three of them are in Euros and they will mature in an amount of EUR 500 million in February 2009 and 2010 (issues from 2002 and 2003), EUR 750 million in March 2011 (issued in 2001) and one issue in Japanese yen from 2003 totalling JPY 25 billion, which will mature in June 2009.

Table 6: Overview of Bonds Maturing in the Period 2009 – 2011

Bond	Date of issue	Currency	Amount (million)	Interest rate	Maturity
Domestic bonds					
Series 08 D-10	08.03.2005.	HRK	3,000	6.75%	08.03.2010.
International bonds					
Euro-EUR IV 2009	11.02.2002.	EUR	500	6.25%	11.02.2009.
Samurai V 2009	26.06.2003.	JPY	25,000	1.23%	26.06.2009.
Euro-EUR V 2010	24.02.2003.	EUR	500	4.63%	24.02.2010.
Euro-EUR III 2011	06.03.2001.	EUR	750	6.75%	14.03.2011.

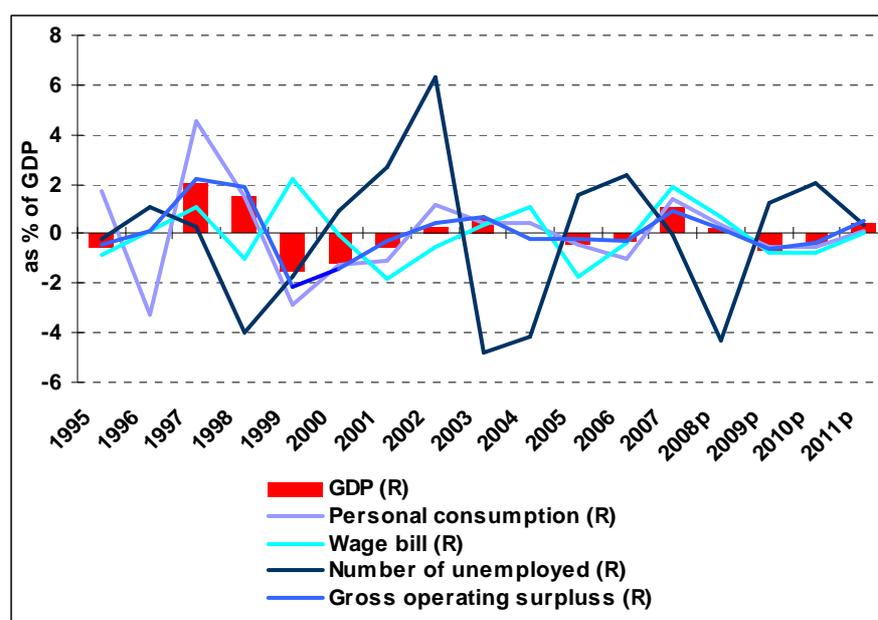
Source: MF

3.1.3 Structural Balance

Estimate of the cyclically adjusted primary deficit was done in three steps. The first was to calculate the deviations of individual macroeconomic bases from their trend values. Next, the elasticity of individual cyclically sensitive components relative to their respective macroeconomic bases was estimated. The last step was to calculate the cyclical deficit using the estimated elasticity of cyclical components and deviations of macroeconomic bases from their trend values, whereas the cyclically adjusted primary balance was calculated as the difference between the primary and the cyclical deficit.

The calculation of cyclically adjusted deficit was based on the method of the European Central Bank. Personal income tax, corporate income tax, VAT, excises and social contributions were observed as cyclically sensitive components on the revenue side whereas, on the expenditure side, unemployment benefits were observed. Wage bill, gross operating surplus, personal consumption and the number of unemployed persons were used as macroeconomic bases for individual cyclical components. Long-term trend values of individual macroeconomic bases were determined by applying the Hodrick–Prescott filter on their quarterly seasonally adjusted values with the chosen smoothing parameter λ of 300.

Figure 3: Deviations of Macroeconomic Bases from their Trend



Source: MF

Elasticity of individual cyclically sensitive components relative to their respective macroeconomic bases was calculated using the following econometric model:

$$\Delta \ln X_t^i = \alpha + \beta(\ln X_{t-1}^i - \gamma \ln V_{t-1}^i + \phi + \delta_i + \dots) + \delta_1 \Delta \ln V_t^i + \delta_2 \Delta \ln V_{t-1}^i + A + \zeta$$

where X_i represents the observed cyclical component and V_i the respective macroeconomic basis, while δ_1 and δ_2 are the short term elasticity of cyclical components relative to the relevant macroeconomic bases in the same and the preceding period.

As the model with the deviation correction is an integral part of the presented equation, the tests of order of integration of individual time series were first to be carried out. They indicate that the order of integration of all series is 1, only the series of the number of unemployed persons has the order of integration of 2. After determining the cointegrational vectors, by evaluation of the described model, short term elasticity of individual cyclically sensitive components relative to their respective macroeconomic bases was derived.

Table 7: Estimated Elasticity of Cyclically Sensitive Budget Components for Croatia

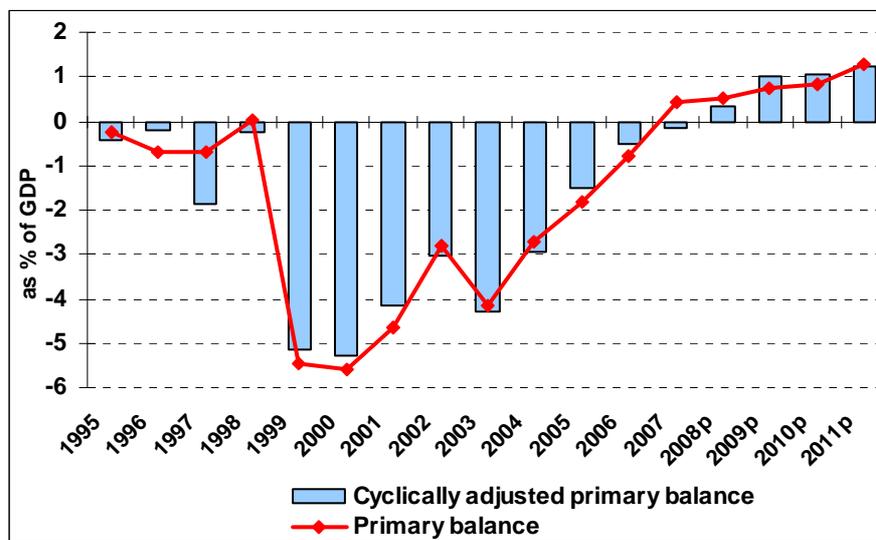
Budget elements (current prices)	Macroeconomic basis (current prices)	Elasticity
Personal income tax	wage bill	1.81
Corporate income tax	gross operating surplus	2.21
VAT	personal consumption	1.16
Excises*	personal consumption	1.00
Social contributions	wage bill	0.49
Unemployment benefits	number of unemployed	1.59

* Short-term elasticity of excises is calibrated

Source: MF

The cyclical component of the chosen revenue and expenditure budget categories is calculated as a product of estimated elasticity and deviation of the respective individual macroeconomic bases from their trend values. The cyclical budget balance is defined as the sum of cyclical components of budget revenues and expenditures, and its calculation enables the determining of the value of cyclically adjusted or structural budget balance. Structural budget balance is the difference between the real budget balance and the cyclical balance. The primary deficit of consolidated general government is used for the calculation of structural budget balance, as the expenses for interest are not the result of current fiscal policy.

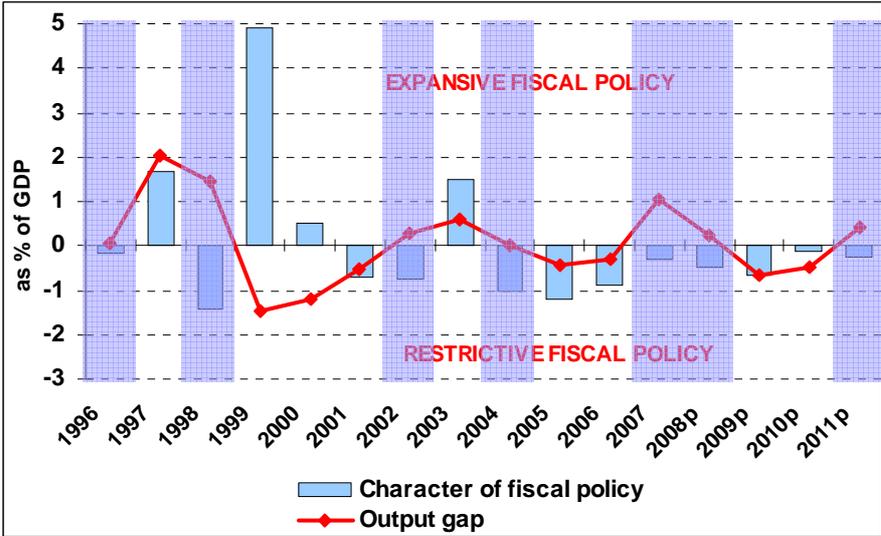
Figure 4: Primary Balance and Cyclically Adjusted Primary Balance



Source: MF

Evaluation of the fiscal policy character, taking into account the imperfections of the Hodrick–Prescott filter, indicates that fiscal policy has changed its cyclical characteristics many times in the analyzed period. Pro-cyclical fiscal policy is characterized by expansive fiscal policy in the period of overheating of the economy, and restrictive fiscal policy in the period of underemployment. Anti-cyclical fiscal policy is characterized by expansive fiscal policy in the period of underemployment and restrictive fiscal policy in the period of overheating of the economy. Analysis shows that in the years 1997, 2001, 2003, 2005 and 2006 fiscal policy was pro-cyclical, while in the years 1996, 1998, 1999, 2000, 2002, 2004 and 2007 it was anti-cyclical. As for the projections, the output gap is expected to be positive with anti-cyclical character of fiscal policy in the years 2008 and 2011, while in the years 2009 and 2010 it is expected to be negative with pro-cyclical character of fiscal policy.

Figure 5: Character of Fiscal Policy



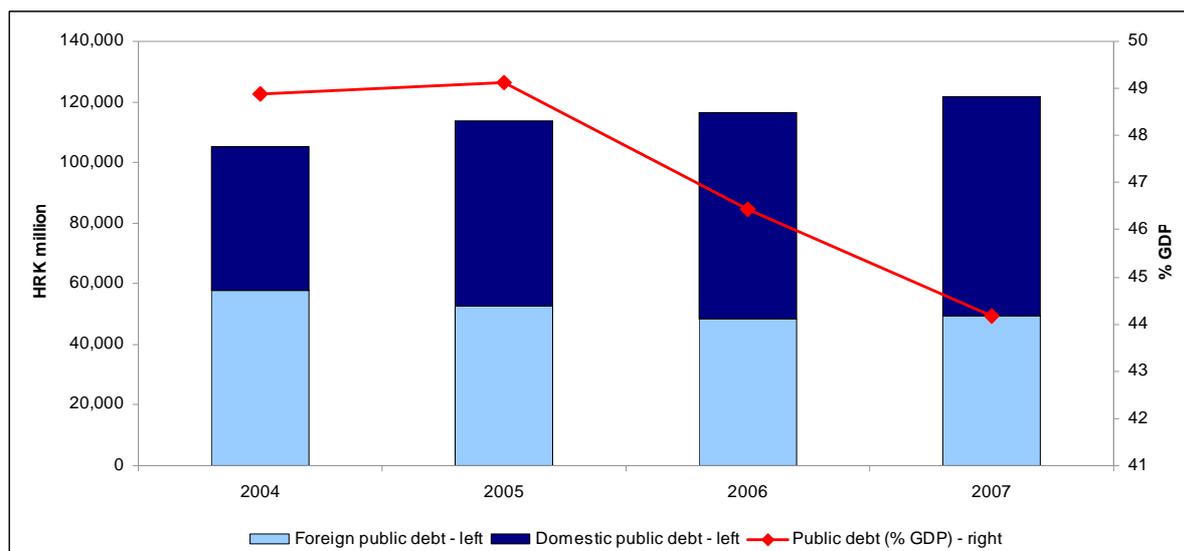
Note: Shaded areas represent periods of anti-cyclical fiscal policy
Source: MF

3.1.4 Debt Levels and Developments

Public debt trends in the period 2004–2007 were characterised by the implementation of fiscal adjustment, which, along with the rationalisation on the expenditure side of the general government budget and positive developments on the revenue side, enabled the level of net lending/borrowing in the period under review to be significantly reduced. The impact of such reduction of the net lending/borrowing levels resulted in the significant public debt reduction expressed as a share of GDP. Consequently, the share of public debt in GDP in 2006 was reduced by as much as 2.7 percentage points in comparison with the preceding year and 2007 saw further decrease of the share by 2.3 percentage points. Public debt in 2007 amounted to 44.2% of GDP, recording thus, when compared to the level of 2004, a decrease by 4.7 percentage points. Out of the total amount of public debt recorded at the end of 2007, 85.6% was attributable to direct borrowing of the various general government levels, while the remainder referred to the Government guarantees.

In addition to the recorded reduction of the share of public debt in GDP, the period under review noted changes in the foreign and domestic components of public debt. The share of the domestic component in the said period has increased continually from 44.8% in 2004 to 59.5% in 2007, while the share of the foreign component in the same period has decreased continually from 55.2% in 2004 to 40.5% in 2007. These developments resulted from the orientation to mostly domestic sources for the purpose of financing the general government deficit.

Figure 6: Public Debt 2004-2007



Source: MF

The majority of the general government debt is associated primarily with bond issues, followed by loan borrowings. The period 2004-2007 was characterised by the Government's orientation towards securing financing through issues in the domestic market, which has helped reduce the dependence on international capital markets. It has also had a positive impact on the country's external debt developments and has contributed to the development of the domestic financial market.

At the end of 2007, most of the general government debt (82.6%) related to the budgetary central government debt, while the remaining part referred to the debt of extra-budgetary users (15.9%) and local government (1.6%). In terms of currency structure, it is important to emphasize that about 4/5 of the debt is denominated in foreign currency, mostly in Euros.

With regard to public debt management in general, it is of great importance to define adequate plans and direction of public debt management, which builds on previous years' public debt management policies and is closely associated with the fiscal and other economic policy plans.

According to the abovementioned facts and the expected development of the fiscal policy in the forthcoming period, further declining of the public debt as a proportion of GDP is expected. Thus, by the end of 2011 public debt is expected at the level of 37.9% of GDP. In particular, the orientation to domestic sources for the purpose of financing the general government's needs in the forthcoming period will be continued.

Table 8: Projections of Net Lending/Borrowing, General Government Debt and Public Debt

% GDP	2007	2008p	2009p	2010p	2011p
Net lending/borrowing	-1.6	-1.3	-0.9	-0.6	0.0
General government debt	37.8	36.1	35.1	33.8	31.8
Foreign	14.4	12.9	12.2	11.2	9.5
Domestic	23.4	23.2	23.0	22.5	22.3
Public debt	44.2	42.3	41.4	40.0	37.9
Foreign	18.0	16.5	15.8	14.8	13.0
Domestic	26.1	25.8	25.6	25.2	24.9

Source: MF

3.1.5 Budgetary Implications of Major Structural Reforms

The fiscal programme in the medium-term period will be supported by the implementation of vital structural reforms, particularly in the enterprise sector, labour market, agriculture, public administration, education and science, health care, social welfare, judicial system and environment protection. In Chapter 4: Structural Reform Objectives, this document provides a detailed description of the goals, measures and activities in each of the areas mentioned, while fiscal effects of the key measures undertaken as part of the structural reforms are shown in Annex I: Matrix of Policy Commitments. Those fiscal effects include allocations of budgetary funds for the purpose of implementing certain measures, and they provide information as to how those measures are financed from loans and EU pre-accession assistance funds.

Accordingly, in the medium-term period 2009-2011, net increase of budgetary allocations for the purpose of implementing certain structural measures will stand at 0.7% of GDP in average, of which the budgetary revenues relating to some of those measures (realised through the use of EU funds and the like) will record an average increase of 0.2% of GDP, while the expenditures will increase by 0.9% of GDP on average.

At this point, it is important to stress the most important measures having fiscal effects in the forthcoming period. The subsidies to shipyards in 2009 will be reduced by HRK 133 million. As regards the subsidies to Croatian Railways (Hrvatske željeznice), they will also be reduced by HRK 98.0 million. With regard to the policy of agricultural state aid, it should be noted that these expenditures will start to decrease, namely by 0.005% of GDP in 2009, 0.07% of GDP in 2010 and 0.04% of GDP in 2011.

In addition, the implementation of the Decision on the Base for Exercising Rights on the Basis of Social Welfare, which provides for the increase of the base by 25%, will have an impact on expenditures of approximately 0.06% of GDP annually in the period 2009-2011. Introduction of a new measure in the field of services and support for families in the frames of the pro-natal policy will have an impact on expenditures of 0.02% of GDP annually. In terms of structural measures it is important to mention the health care reform, which ensures additional sources of financing: supplemental health insurance, co-payments, premium of the civil liability in respect of the use of motor vehicles. Other measures in the enterprise sector, labour market, agricultural sector, public administration, education and science, health care, judicial system and environmental protection will also produce fiscal effects on the expenditure side, which, in principle, exceed the revenues resulting from the utilisation of various EU pre-accession assistance programmes.

3.2 SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME

3.2.1 Fiscal Risks and Sensitivity Analysis of Deficit and Public Debt

Fiscal projections for the medium-term period are based on the macroeconomic assumptions described above and in this respect represent a baseline fiscal projection based upon a baseline projection of macroeconomic assumptions. For the purpose of analysing the trends of fiscal categories under the assumption of alternative scenarios, it is important to take into consideration certain risks and to conduct sensitivity analysis of the deficit and public debt movements to those risks.

Fiscal Risks

Changes in macroeconomic variables certainly have significant implications for the expected direction and result of the fiscal policy. For example, a lower level of a real GDP has a direct impact on the level of expected budgetary revenues and as such may result in increased budgetary deficit than originally planned. In that case, negative effects would also affect the public debt movements, which would, as a result of an increased need for financing, record an increase beyond the one in accordance with the baseline projection. Fiscal risks associated with a weaker economic activity are one of the most important sources of potential obstacles to the baseline fiscal projections, whereas the state conducive to a slower economic growth and lasting for a longer period of time, would result in multiplying negative effects upon the developments of fiscal variables in the forthcoming period.

In view of negative impact on public debt movements in the medium-term period, significant change of the domestic currency rate scenario must be pointed out as a potential threat to this scenario. In view of the fact that approximately 4/5 of public debt is denominated in foreign currencies, the depreciation of the domestic currency (kuna) would lead to a higher level of public debt and would aggravate its servicing.

Debt servicing (principal repayments and interest payments) also presents a fiscal risk because when larger amounts of debt fall due for payment they create pressure on current business operations in that refinancing risk increases, while at the same time posing greater burden on the budget. Public debt management should therefore ensure that debt-servicing burden is evenly distributed.

Apart from the abovementioned risks, there are those that could eventually have a negative impact on the set fiscal policy direction. Such risks can be manifested on both the revenue and expenditure side of the budget and thus jeopardise the process of fiscal consolidation, both with regard to the planned movements of the fiscal deficit and to the overall future organisation of public finance system.

In addition to the abovementioned effects of changed macroeconomic assumptions on the dynamics of collected revenues, there are other risks in this respect, such as inadequate control of revenue collection or increasing of the grey economy, which may have unwanted consequences with regard to the expected revenue movements. With respect to the latter, it is extremely important to continue with the measures to stimulate and increase the efficiency of tax administration and strengthen the control of the overall process of revenue collection.

On the expenditure side, it is necessary to emphasise the risk of non-implementation of structural reforms with the foreseen dynamics, and the absence of rationalisation on the expenditure side due to non-implementation of structural reforms or their inadequate implementation.

Finally, stronger expenditure pressures could be a result of inadequate distribution of investment projects where any upward variance from the infrastructure investment plans would lead to increased expenditures and net lending/borrowing.

Movements which could pose risk to realisation of the planned levels of net lending/borrowing will be addressed by expenditure adjustment but also by strengthening of revenue collection control measures.

The analyses of net lending/borrowing and public debt sensitivity to the most significant risks are described below.

Net Lending/Borrowing Sensitivity Analysis

The analysis of the fiscal balance movement builds on an assumed baseline macroeconomic projection and fiscal projections for the medium-term period. The changes of certain factors have an impact on the final result, i.e. in net lending/borrowing.

All analyses carried out and their results were then compared to the baseline scenario, which is based on medium-term macroeconomic forecasts. While those analyses were carried out on arbitrary assumptions, they still clearly show what effects on net lending/borrowing could be expected in the next medium-term period if the main assumptions moved in an unwanted direction.

An overview is given below of sensitivity analysing of net lending/borrowing, which include the analysis of a lower level of real GDP, the shock of lower revenue than expected and a shock involving an unexpected one-off increase in expenditures.

The analysis of a lower level of real GDP is carried out under the assumption of a lower real growth of GDP in 2009 and 2010. The level of real GDP growth is assumed at the level of 0%, in 2009, i.e. a halved expected real GDP growth for 2010 in comparison with the baseline projection.

Sensitivity analysis results have shown that such developments may cause adverse effects on movements in net lending/borrowing in comparison with the baseline medium-term period projection, leading thus to an increase of net lending/borrowing by 0,6 percentage points in 2009 and by 1.3 percentage points in 2010. After the period of shock, a very moderate recovery follows.

The analysis of reduced revenue lies on the assumption of the revenue growth rate in 2009 and 2010 being twice lower than the one foreseen by the baseline medium-term period projection. These analyses have shown that, in cases of foreseen movements, it would come to significant discrepancies between net lending/borrowing and the baseline projections. Consequently, in the two-year period of a lower revenue growth, in accordance with the assumptions of the analysis conducted, in 2009 net lending/borrowing would be as much as 1 percentage point above the level projected while in 2010 it would be 2.2 percentage points above the level projected. Furthermore, as another drawback of lower revenue growth it should be pointed out that after a period of shock, the recovery is relatively slow.

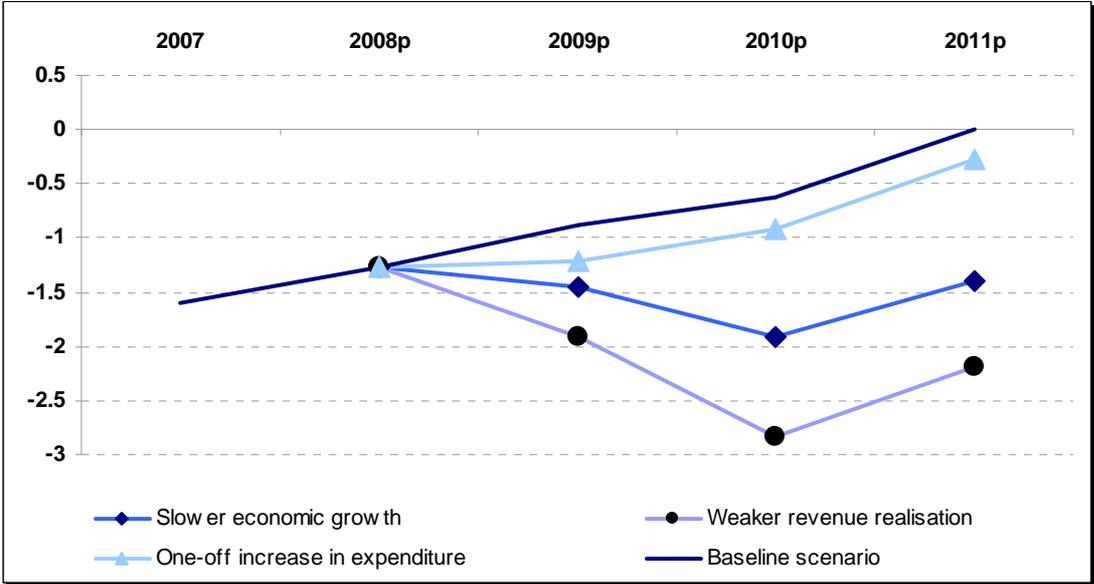
The analysis of a one-off growth of expenditures implies the possibility of the requirement to carry out a higher level of expenditures in relation to the baseline medium-term period projection, which can be a result of expenditures not previously identified (planned or projected) or a result of the non-implementation of key structural reforms, on the basis of which certain savings have been projected in the baseline scenario or guarantees have been assumed that – under the baseline scenario – should have only been contingent liabilities. For the purpose of this analysis, it is arbitrarily assumed a one-off increase in expenditures of HRK 1 billion in 2009. The effects of such increase show that the increase in total net borrowing is carried over to the entire period under review.

Table 9: Assumptions of the Baseline Scenario and Results of the Sensitivity Analysis

	2007	2008p	2009p	2010p	2011p
Assumptions (baseline scenario)					
Real GDP, growth rate	5.6	2.5	2.0	3.2	4.0
Inflation (GDP deflator)	4.0	6.2	3.7	3.5	3.2
Revenue, growth rate	12.8	8.0	4.8	5.8	6.5
Expenditure, growth rate	9.3	10.1	4.7	4.9	5.2
Net lending/borrowing					
Baseline scenario	-1.6	-1.3	-0.9	-0.6	0.0
Slower economic growth	-1.6	-1.3	-1.5	-1.9	-1.4
Weaker revenue realization	-1.6	-1.3	-1.9	-2.8	-2.2
One-off increase in expenditure	-1.6	-1.3	-1.2	-0.9	-0.3

Source: MF

Figure 7: Results of Sensitivity Analysis



Source: MF

Public Debt Sensitivity Analysis

It is of great importance to continuously conduct public debt sensitivity analysis so as to enable timely and realistic understanding of various implications of alternative scenarios under the macroeconomic and fiscal assumptions. Besides, conducting tests which include a series of alternative scenarios of the basic determinants for public debt movement makes it possible to measure the intensity of public debt reactions to changes in certain determining factors. Finally, public debt sensitivity analyses enable realistic consideration of potential measures, which would mitigate negative developments of the public debt level, which might occur as a result of changes in the main determining factors.

The public debt sensitivity analyses are based on the baseline scenario, which rests on medium-term macroeconomic projections and assumptions. A series of alternative scenarios are then applied with the assumed values being kept at a certain (historical) level or subjected to various shocks.

In view of that, tests have been conducted, which assume the debt movements towards the assumption of historical values of its key determinants, as well as the analysis of a slower economic growth, the analysis of maintaining primary balance at the level of the historical average and the shock of a real interest rate, the analysis of the debt reaction to arbitrary depreciation of the domestic currency and the shock of contingent liabilities.

In conducting the previously described sensitivity analysis, it is apparent that depreciation of the kuna, especially against the euro, would have the strongest impact on public debt movements in the next several years. The reason for that lies primarily in the fact that about 4/5 of total public debt is denominated in foreign currencies, of which 60% in Euros.

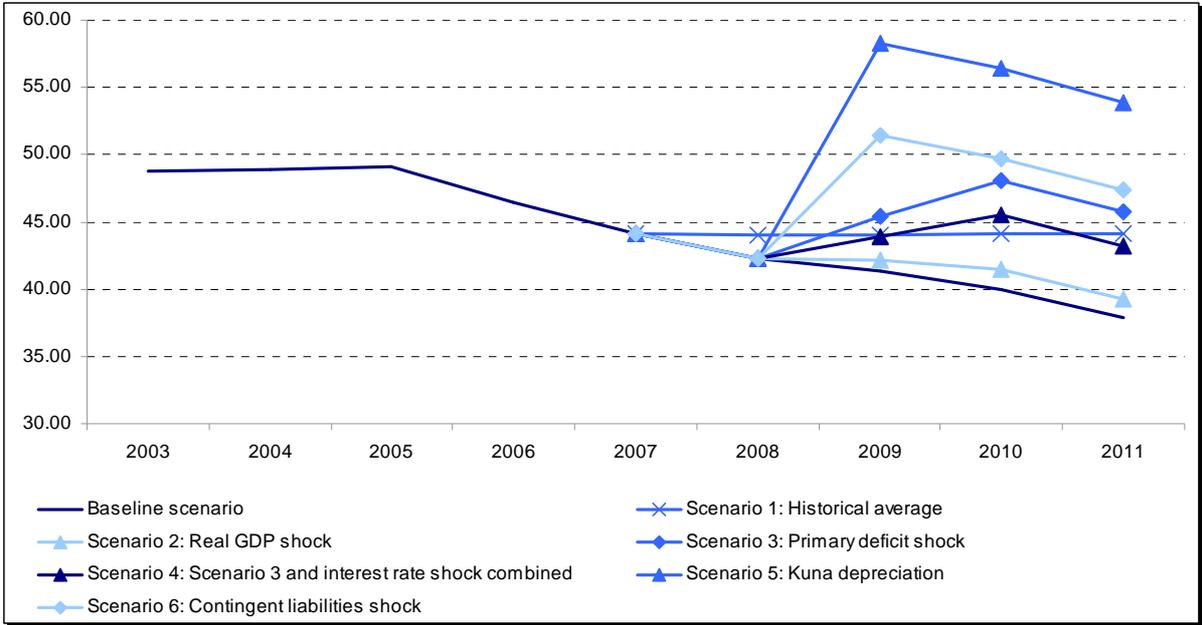
For the purpose of this test, a 30-percent depreciation of the kuna in 2009 is assumed and it is apparent that under such conditions one may expect that the public debt could rise to a significantly high level of GDP, although, even with such arbitrary high level of depreciation of the domestic currency, the proportion of public debt would maintain its proportion under 60% of the estimated GDP. Intensity of the reaction of public debt share in GDP to the assumed depreciation shock points to the fact that continued realisation of low levels of fiscal deficits is necessary, as well as the orientation towards domestic sources of financing.

Besides, the tests conducted have shown a strong reaction of the public debt to changes in contingent liabilities (guarantees), thus suggesting the need to curb their growth, i.e. to restructure certain economic sectors in order to eliminate the need for guarantee issuance.

In addition, public debt demonstrates an unfavourable medium-term trend in case of primary deficit shock. For the purpose of the public debt sensitivity analysis in respect to changes of the primary deficit, it showed for two years in a row to be worsened by two standard deviations in relation to the baseline medium-term projection. A shock of the primary deficit, as the main debt generator, has shown adverse public debt developments over the medium term, especially because of the fact that the effects of the primary deficit shock subside very slowly.

The scenarios in which the assumptions are kept at their historical (average) values have shown a gradual growth of public debt as a share in GDP towards the end of the period observed. It clearly suggests the need to continue with fiscal adjustment.

Figure 8: Public Debt as a Share in GDP under Different Scenarios (in %)



Source: MF

Table 10: Results of Public Debt Sensitivity Analysis

	2007	2008	2009	2010	2011
I. Baseline medium-term projection	44.2	42.3	41.4	40.0	37.9
II. Debt-to-GDP ratio sensitivity analysis					
1. Real GDP growth, real interest rate and primary deficit in 2009-2011 at historical average level	44.2	44.0	44.0	44.1	44.1
2. Real GDP growth in 2009 at the level of 0% and real GDP growth in 2010 at the level of 1/2 of the projected real GDP growth	44.2	42.3	42.2	41.4	39.2
3. Primary deficit in 2009 and 2010 at historical average level minus two standard deviations	44.2	42.3	45.4	48.1	45.7
4. Scenario 3 and interest rate shock using one standard deviation in 2009 and 2010 combined	44.2	42.3	43.8	45.5	43.2
5. One-off depreciation of 30% in 2009	44.2	42.3	58.2	56.4	53.8
6. Increase of other debt-creating flows (guarantees) by 10% of GDP in 2009	44.2	42.3	51.4	49.7	47.3
Historical values of key variables (past six years)					
	Historical average	Standard deviation			
Primary deficit	1.7	1.1			
Real GDP growth (%)	5.0	0.6			
Nominal interest rate (%) /6	5.5	0.1			
Real interest rate (%)	1.9	0.3			
Inflation rate (GDP deflator, %)	3.6	0.3			
Public revenue in GDP	45.2	0.6			

Source: MF

3.2.2 Comparison with Previous Programme

In this chapter, an overview is given of total revenues, expenditures and net lending/borrowing levels presented in the previous year's PEP and this year's PEP, along with an explanation of differences.

A significant part of changes in revenues, expenditures and net lending/borrowing as a share in GDP during the reviewed years is the consequence of differences in the levels of the nominal GDP. The differences in the levels of the nominal GDP in the new programme, in comparison with the previous one, are a result of altered macroeconomic assumptions. In the period 2008-2010 the projected real GDP growth amounted on average 6.5%, which is in accordance with the preceding programme, or 2.6%, which, on the other hand, is in accordance with the new one. In the same period an average growth rate of GDP deflator amounted to 3.4%, which complies with the previous programme, and 4.5%, which complies with the new one. In addition, the level of the nominal GDP in 2007 is higher in the new programme than in the previous one. Lower level of the real GDP growth, higher level of the GDP deflator growth and higher level of the nominal GDP in 2007 in accordance with the new programme and in comparison with the previous one had implications on development of projected levels of the nominal GDP in the period under review, affecting thus developments of the observed values expressed as shares in GDP.

However, the differences between certain fiscal values for the same years in last year's PEP and this year's PEP can also be explained by other reasons, which are all very characteristic of revenues and expenditures.

As regards the revenue side it is important to stress that 2007 was accomplished in accordance with the plan, whereas there were certain changes in the projected revenue levels during other reviewed years. Namely, in 2008 revenue realisation was higher, which can be attributed to revenue movements in the first half of 2008, which turned out to be higher than expected. Therefore, new revenue projections have been incorporated into amendments to the budget for the abovementioned year. One-off revenues, realised on the basis of revenues from profits of public companies, banks and other financial institutions as well as from dividends, had their implications on developments of the share of revenue in GDP as well. The effect of a higher revenue level in 2008 is carried over throughout the period under review through the baseline effect. However, lower expected levels of the overall economic activity in 2009 and 2010 affect the movement of revenues in the opposite direction.

Various factors have had an effect on differences in the levels of expenditures expressed as a share in GDP between the previous and this year's programme. In addition to the effects of

change of the nominal GDP level it is important to emphasise the effect of capital transfers growth, which mostly results from the changes in the general government coverage. The difference in the coverage of the general government is the consequence of defining the new coverage of institutional sectors of national accounts in accordance with ESA 95 methodology, which has been applied since the second half of 2008. The application of the new methodology on determining the coverage of institutional sector has also reflected upon the coverage of general government sector. In other words, certain institutional units, which had until then been a part of the general government sector, were classified, following certain rules, under other sectors, whereas some other institutional units became a part of the general government. One of the most notable changes in this respect was classification of Croatian Motorways (HAC) outside the general government sector, which has had an impact on capital transfer movements in the period under review. It has resulted from the fact that transfers towards this unit are no longer consolidated in the general government budget, but are now pure expenditure. Changes of macroeconomic assumptions have further influenced the movements of this category in the examined period.

Furthermore, differences in the expenditure levels expressed as shares in GDP with regard to two programmes are also caused by expenditures for subsidies. The primary reason for that are the subsidies for agriculture. Namely, last-year's programme projections built on the 2007 projection, whereas they were finally realised at a higher level and the same occurred with medium-term projections. Also, changes have been brought on by differences in the levels of the projected gross fixed capital formation, which mostly results from the changes in the coverage of the general government sector described above. Other changes that need to be mentioned are effects of social transfers, which are influenced by expenditures used for the recovery of health care as a part of amendments to the 2008 budget and effects of the health care reform as of 2009.

Table 11: Comparison of Revenues, Expenditures and Net Lending/Borrowing of the General Government according to 2007 PEP and 2008 PEP

	2007	2008p	2009p	2010p	2011p
2008 PEP (% GDP)					
Total revenue	46.0	45.7	45.2	44.8	44.4
Total expenditure	47.6	46.9	46.1	45.4	44.4
Net lending/borrowing	-1.6	-1.3	-0.9	-0.6	0.0
2007 PEP (% GDP)					
Total revenue	46.2	43.7	42.8	41.8	
Total expenditure	47.8	45.2	43.4	41.6	
Net lending/borrowing	-1.6	-1.5	-0.6	0.2	
Difference: 2008 PEP and 2007 PEP (percentage points)					
Total revenue	-0.2	1.9	2.4	3.0	
Explained by:					
Revision of GDP	-0.2	0.3	2.0	3.5	
Difference due to final outturn of 2007	0.0				
Increase in one-off revenues		0.3	0.2	0.0	
Difference due to projection for 2008		1.3			
Difference due to projection for 2009			0.1		
Difference in projection for 2010				-0.5	
Total expenditure	-0.2	1.7	2.7	3.8	
Explained by:					
Revision of GDP	-0.2	0.3	2.1	3.4	
Subsidies		0.4	0.3	0.3	
Social transfers		0.3	0.9	0.9	
Gross fixed capital formation		-0.4	-0.5	-0.3	
Interest expenditure		-0.2	-0.3	-0.5	
Compensation of employees		0.3	0.3	-0.3	
Kapital transfers		0.7	0.2	0.3	
Other		0.3	-0.3	0.0	
Net lending/borrowing	0.0	0.2	-0.3	-0.8	

Source: MF

3.3 QUALITY OF PUBLIC FINANCES

In the previous period, a number of measures were implemented to improve the quality of public finance. These are: on July 15, 2008 a new Budget Act was adopted (OG 87/08), which entered into force on January 1, 2009 and which introduced quality changes of budget management⁸. The Registry of Non-Tax Revenues has been established as one of the first steps towards facilitating and rationalisation of non-tax revenues, thereby decreasing administrative burden of citizens and legal entities. The Registry of Social Benefits and the Registry of State Aid as pre-requisites for more rational public expenditure are close to finalization as well. The application of the system for monitoring and reporting public finance statistics by using internationally accepted methodologies was improved. As regards the revenue side of the budget, the activities aimed at strengthening controls of budgetary revenue collection continued. In this respect a project was carried out in the frames of the Phare 2005 Programme, which contributed to the promotion of control services of the Croatian Tax Administration in the field of monitoring big taxpayers as well as the analysis of problems with regard to international tax environment, with particular attention paid to combating tax evasion.

Also, on May 9, 2008 the Act on the Personal Identification Number was adopted (OG 60/08), which provides for the methods of introduction, determination, assignment, use and cancellation of the Personal Identification Number. The use of the Personal Identification Number started on January 1, 2009 and is aimed to increase efficiency in the fight against corruption, improving the efficiency of the tax system, a more effective functioning of the social contributions system as well as a more efficient targeting of such contributions. Personal Identification Number has been introduced with the purpose of overall informatization of public administration aimed at efficiency increase of state institutions and decrease of administrative burden of citizens, automatic exchange of information between public administration bodies and other state institutions facilitating thereby exercise of rights for citizens, and better control over property of citizens and legal entities as well as flow of capital, which is the key precondition for transparent economy, systematic fight against corruption and aligning of the Croatian legislation with the *acquis communautaire*.

The focus of the tax policy over the medium-term will be on the alignment of the Croatian tax legislation with the *acquis communautaire*. Furthermore, the efficiency of supervision of budgetary spending and timely execution of budgetary expenditures will be improved, so as to ensure that budgetary resources are channelled into the areas of strategic importance.

The adoption of the Act on Amendments to the Act on Public Procurement, which entered into force on January 1, 2009 (OG 125/08) additionally contributed to the raising of the public finance quality. Quality changes refer to the integration of the new provisions of the European Law in the field of legal protection, rest periods and exemption from the application of the Act. In addition, certain discrepancies have been removed as well as problems concerning the application of certain institutes, particularly those related to the negotiation process without prior notification, deadlines for submission of tenders and participation applications, group cancellation or cancellation of a part of the public procurement procedure, the procurement object and procurement plan. Another important step must be mentioned, namely, the adoption of the Public-Private Partnership Act in October 2008, which is a basis for a systematic development of the application of the model for the public-private partnership in the Republic of Croatia.⁹

⁸ The new Act on Budget and its amendments of the 2003 Act on Budget are described in more detail in the Chapter: Institutional Characteristics of Public Finance in this document.

⁹ Provisions of this Act are described in more detail in Chapter 4.1.7 Public-Private Partnership.

Further rising of public finance quality will be considerably supported by the implementation of structural reforms, among which the health care reform must be emphasised, the main goal of which is to improve health services and stabilise the system as a whole.

In terms of structural reform it is highly important to stress the orientation of the overall economic and thus fiscal policy, to encouraging knowledge and excellence, i.e. the creation of society based upon knowledge as a way of increasing the competitiveness of economy. Accordingly, the preceding period saw a systematic improvement of the quality of education, science and research in accordance with the Lisbon Declaration and the Strategic Development Framework for 2006-2013. Measures implemented were directed towards encouraging the acquisition of higher education levels and equalising the demand and supply on the labour market. They consisted of drawing up the National Curricula for preschool, primary and secondary education, the implementation of external evaluation of achievements with the aim to align education standards of the Republic of Croatia with those of the EU, incentive measures including the provision of free textbooks and transportation to students, the accommodation in student homes, the modernisation and reduction in the number of vocational programmes, the establishment of new educational institutions, drawing up strategic documents in the fields of science and research, support systems for research in development in companies by way of introducing tax relieves, financing of adult education for the purpose of acquiring qualifications or retraining.¹⁰

It is also important to stress the orientation of the fiscal policy towards a more balanced development of Croatia. The Act on Amendments to the Act on Financing Units of Local and Regional Self-government, which provides for more balanced and fairer distribution of tax revenues among all regions of the Republic of Croatia, considerable resources were allocated to many development and infrastructure projects aimed at encouraging stronger economic activity and a higher standard of living. Such an orientation resulted in investments in development projects at the regional level going up more than twice in the last three years. As the consequence of adverse macroeconomic conditions, the next medium-term period will see re-allocation of certain investments into infrastructure projects in terms of time frames.

Further promotion of economic activity largely depends on the creation of an advantageous business environment. When speaking about the creation of an advantageous business climate, the state resources are allocated to the implementation of the key measures in the area of public administration and the judiciary with the aim of lifting all the existing administrative barriers and establishing a modern, efficient and professional system of public administration at service to all entrepreneurs and citizens. Another goal is to set up an efficient judicial system and promote the rule of law through systematic fight against corruption, as manifested in budgetary allocations for that purpose. An active contribution of the state to the promotion of entrepreneurship is reflected in a series of incentive programmes in crafts, small and medium enterprises as well as tourism, agriculture and fisheries.

In terms of public finance, the EU Pre-Accession Programme management must also be mentioned. In 2008, intensive strengthening of capacities for using the EU funds took place. Benchmarks set by the European Commission were met, which resulted in lifting suspension for signing contracts as part of 2006 PHARE programme. In the 2006 Pre-Accession PHARE programme, 84.8% of funds or EUR 44.79 million was allocated, which will be implemented through a total of 119 contracts. 8.8% of 2006 PHARE funds are savings made by contracting prices which were lower than planned. Several contracts were signed in 2008 for large infrastructure projects financed through the ISPA Pre-Accession Programme. These refer to the rehabilitation of the railway Vinkovci-Tovarnik-state border, amounting to EUR 41.76 million and to the contract on installing a signalling system on the same railway, amounting to

¹⁰ Measures directed towards the development of a knowledge-based society are presented in more detail in Chapter 4.6.1 Development of a Knowledge-Based Society

EUR 16.41 million. Construction of water and wastewater purification systems started in the town of Karlovac, based on the contract signed for the amount of EUR 14.5 million. In autumn 2008 the Republic of Croatia was granted accreditation for the first four components of the new IPA Pre-Accession Programme.

3.4 SUSTAINABILITY OF PUBLIC FINANCES

The analysis of long-term sustainability of public finance is based on the long-term projections of the population of the Republic of Croatia applying a scenario with medium fertility and medium migration¹¹ and baseline macroeconomic assumptions of future movements, which, in comparison with the previous PEP, foresee lower real GDP growth rates in the initial period, faster reduction of the unemployment rate and the new fiscal projections for the period until 2011.

Projections have been made under the assumption that in the period under review there would be no significant changes in application of existing legislation which regulate public pension and health expenditures and that the manner of calculating and collecting social security contributions would remain unchanged. However, it should be emphasised that other factors have been considered in the projections, such as expected effects of equalisation of “new” and “old” pensioners, increase in premature old-age and disability pensions, the lowest pension levels as well as new amendments to regulations governing health care insurance, which introduce not only the changes in the methods of financing health services but also changes in financing primary health care, hospital system and sick-leave.¹² All other public revenues, with the exception of social security contributions, as a share of GDP will stay the same, and all other expenditures, except for pension, health and interest expenditures, will retain their current share in GDP. It is furthermore important to emphasise that as of 2009 health insurance contributions will include supplementary 3% from pensions of those pensioners, whose pension is higher than an average salary.

As regards participation rates, it is assumed that behaviour patterns of individual economic agents will stay unchanged, with participation rates according to the characteristic age groups (15-24, 25-49, and 50-64) and gender remaining the same. On such assumption, it can be seen that after the year 2010 the overall participation rate will fall as a result of a growing share of the population in older age groups.

Unemployment rate is expected to fall until 2012 to reach the level of 7%, which is considered to be the structural unemployment rate, and it will remain unchanged until 2050. The growth of productivity per employee is derived from the assumptions on real GDP growth and changes in the number of employed people, which is determined by long-term demographic projections and assumed participation rates.

On the basis of the assumptions described above, a moderate decrease in revenues from pension insurance contributions is estimated: from 6.9% of GDP in 2005 to 6.3% of GDP in 2015, stabilising in subsequent years. Such decline can be explained by a gradual increase in the share of employees claiming their pension insurance under both mandatory pillars of pension insurance, with a proportion of their contributions of 15% of their gross salary paid into the first and 5% into the second pillar of pension insurance. Older employees, on the other hand, are largely covered only by the first pillar of pension insurance, with total amount of their contributions (20% of the calculation basis) being paid into the public fund. As older employees retire, the number of employees who pay only a portion of their total contribution

¹¹ The same long-term projections of population were used in drawing up the preceding two PEPs, which the Central Bureau of Statistics published in 2006.

¹² Described in more detail in Chapter 4.3.2 Social Security System and 4.6.2 Health Care Reform

(15% of the calculation basis) into the public fund will grow. The share of revenues from pension contributions is expected to stabilise at the level of 6.3% of GDP after 2015, as a result of the assumption that real growth of wage per employee is equal to labour productivity and of the contribution rate definition as a constant portion of wages, where higher first-pillar contributions for older employees are taken into account for the purpose of pension insurance contributions.

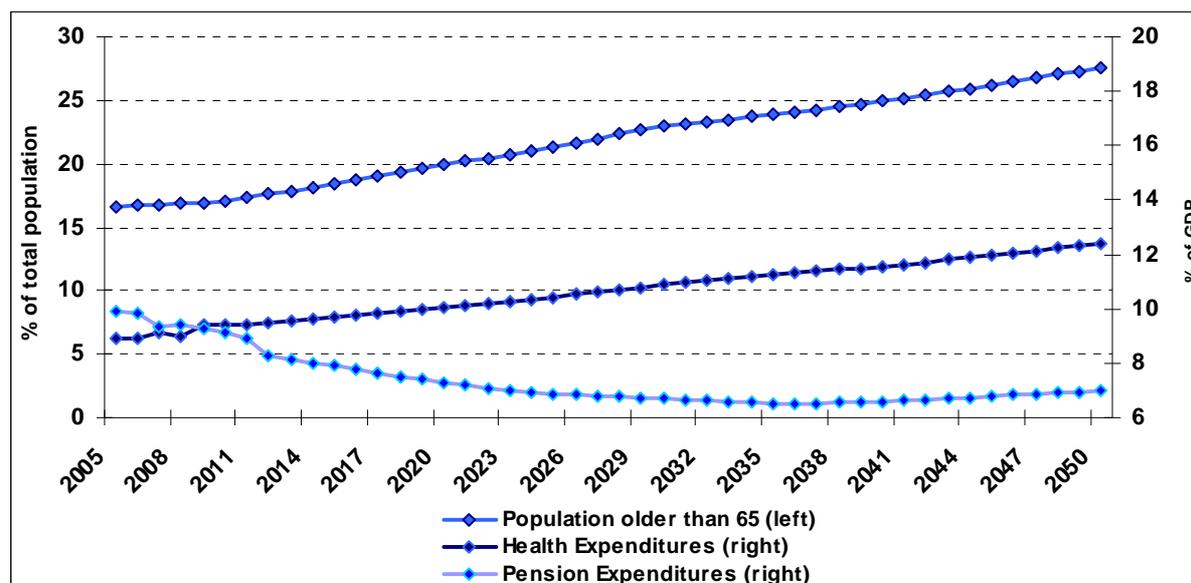
The projection results show a significant decrease in public pension expenditures ¹³ from 9.9% of GDP in 2005 to 7.0% of GDP in 2050, with the pensions and permanent rights of war veterans being excluded from the analysis. The share of pension expenditures in GDP is slightly higher than projected in the previous PEP, which mostly results from lower real GDP growth rates. Although the number of the aging population is increasing, the pension reform and the decrease of relative pensions paid entirely from the first pillar give rise to long-term projections of the decrease of the portion of public pension expenditures in GDP. This result is certain to high extent if the current parameters of pension calculation are maintained, i.e. wage and price indexation of pensions. It should also be noted that the projections take into account a gradual decrease in the share of those pensioners whose pensions are paid entirely from the first pillar, and the growing share of those who are paid the basic part of their pensions from the first pillar and the other part from the second, which is going to be paid from individual capitalised pension funds.

An increase of public expenditures in the health care system is projected from 6.2% of GDP in 2005 to 13.7% of GDP in 2050. Such growth is a result of the estimated pure effect of aging population and rising health expenditures in line with productivity growth as well as on the basis of expected effect of the new health care reform and growing development costs for the health sector, especially with respect to expenditures for medicines and new technologies continually developed in the field of medicine. The expenditure growth arising from the pure aging effect is a result of a growing share of the population in older age groups who absorb relatively large amounts of health expenditures. In addition to the effect of aging population, it is also assumed that health expenditures for each age and gender group will grow in line with GDP per employee, which means that they will only follow the current trends in economy and society as a whole. However, since salaries of medical personnel are one of the major expenditure items of the health care system, it can be assumed that health expenditures will grow at the same rate as compensation of medical personnel, which in turn is expected to grow at the same rate as average wages in the economy in general, which are in this case equal to the labour productivity growth, i.e. GDP per employee.

In terms of health expenditures, interest should also be mentioned, which is expected to fall from the level of 2.2% of GDP in 2005 to 1.2% of GDP in 2050. The described movements of respective revenue and expenditure categories will determine the trends of total revenues and expenditures in the reviewed period to a large extent.

¹³ Public expenditures for pensions comprise only expenditures paid from the state budget, but not expenditures of private, mandatory and voluntary pension funds.

Figure 9: Aging of Population, Health and Pension Expenditures



Source: MF

3.5 INSTITUTIONAL FEATURES OF PUBLIC FINANCES

The legal framework regulating the area of public finance has several levels: the Constitution of the Republic of Croatia, the Budget Act and its implementing regulations, the annual budget of the Republic of Croatia, as well as ordinances and instructions. Strategy for Improvement and Modernisation of the Processes within the State Treasury for 2007-2011 is the basic development document for this area. The principal legal act regulating budgetary processes, relations between institutions within the system and establishing prerequisites for ensuring fiscal discipline and the quality of public finance management is the Budget Act.

In July 2008 the Croatian Parliament adopted the new Budget Act, which entered into force on January 1, 2009 and which specifies the instruments for public expenditure management and regulates the process of planning, preparation, adoption and execution of the budget, asset management and debt management, public debt management, borrowing and issuance of guarantees by the central government and the units of local and regional self-government, budgetary relations in the public sector, accounting, as well as budgetary supervision.

In comparison with the 2003 Budget Act, the new Budget Act provides for the following:

- introducing the practice of preparing a three-year strategy of the Government policies, where the strategy priorities and goals of the Government policies would directly influence the allocation of funds within the budget.
- in addition to the annual budget, the Croatian Parliament, i.e. the representative body (at the local level) also adopts budget projections for the following two years.
- the Croatian Parliament, i.e. the representative body (at the local level) adopts the budget at the higher economic classification level, i.e. at the sub-group level (the third level) in relation to the former fourth level of department. Projections are adopted at the second economic classification level, while retaining the existing detailed levels of reporting in a semi-annual and annual report on budget execution.
- introducing guarantees that local and regional self-government units issue to public service companies and other legal persons owned by such units, and consent that such units give to public service companies and legal persons in their ownership, which recorded a deficit in their operations in the preceding year and/or were established in

the preceding two-year period and institutions established by such a unit, into the scope of possible incurring of debts by that local and regional self-government unit.

- local and regional self-government units are obliged to inform the Ministry of Finance on consent issued to public service companies and other legal persons in their ownership and on concluded loan agreements with those legal persons.

The Act also provides for the implementation of projects financed from the EU funds, among other things, in making it possible to carry uncompleted projects into the next year and to exclude such projects from borrowing limitations by the local and regional self-government units.

In 2009 continued simplification and rationalisation of the non-tax revenue system are foreseen, along with establishing supervision over the introduction of new non-tax revenue by defining criteria and additional limitations, which will be facilitated by the Registry of Non-Tax Revenues, established in 2008.

Also, in the forthcoming three-year period, implementation of the measures aimed at the promotion of budgetary processes, as specified by the Strategy, will continue. These are:

- development of success indicators, which will contribute to the establishment of the system of responsibility for results achieved,
- establishing an automated system of supervision over liabilities incurrence, including multi-year liabilities,
- establishing a comprehensive accounting system, integrating the general ledgers of budgetary users with the general ledger of the State Treasury in order to ensure availability of data on the liabilities incurred and their maturity,
- proceeding with internal audit of the State Treasury system/business processes according to risk assessment, management requirements and results of risk assessments in the Treasury.

4 STRUCTURAL REFORM OBJECTIVES

4.1 ENTERPRISE SECTOR

4.1.1 Competition Policy and State Aid

Competition Policy

The Croatian Competition Agency (Agency), in cooperation with German experts from the PHARE 2005 project, prepared a draft proposal of the new Competition Act with the aim of establishing a more efficient competition system. At the same time, along with the initial interdepartmental cooperation in the Republic of Croatia, a translation of the draft was also submitted to the European Commission (DGCOMP) for opinion. The draft proposal of the Act essentially stipulates the provision of authority to the Agency to impose penalties to entrepreneurs violating competition rules, and establishes judicial protection so that a single court will be competent to control the legality of the Agency's decisions and the severity of the penalties imposed. Moreover, a range of procedural changes have been planned, with the aim of ensuring simplified procedures with the Agency.

As a consequence of multi-year needs for an increase in human resources, in the course of 2008 the Agency has expanded its professional service by recruiting eight new members (economists and jurists), in addition to which the implementation records were strengthened.

Based on the new Competition Act, the adoption of which is planned in the first quarter of 2009, adoption of several implementation regulations will be necessary (Regulation on Block Exemption in the Transport Sector, Regulation on the Procedure and Criteria for Imposing and Calculating Penalties and Regulation on Criteria for Reducing Penalties or Acquittal from Penalties), as well as amendments to the existing Regulation on the Registration Procedure and Criteria for the Assessment of the Concentration of the Entrepreneurs, during the third quarter of 2009.

Education pertaining to the application of new regulations in the competition area will be ensured in the medium-term through the IPA 2007 project, the implementation of which is planned as of the third quarter of 2009.

State Aid

Existing measures and activities in the field of state aid in Croatia have brought about adequate positive results, visible primarily in strengthening the awareness of providers and users of state aid regarding the implementation of the State Aid Act, successful restructuring and privatisation of the steel sector and the final preparation of the shipbuilding restructuring, which is traditionally a significant activity.

In September of 2008 the Agency Council adopted the Annual Report on State Aid for 2007 which was adopted by the Croatian Parliament in December 2008. Based on the data compiled, state aids allocated during 2007 amounted to HRK 8.9 billion, which is an increase of 13% in comparison to 2006. The increase is primarily a result of larger amounts of the aid allocated to the shipbuilding sector for shipyard rehabilitation, the transport sector (Croatian Railways), steel sector, aid for the rehabilitation and restructuring, regional aid and aid for the sectors of fisheries and agriculture.

The total share of state aid in GDP in 2007 retained the level of 3.2% recorded in 2006 as well.

In regards to the types of state aid instruments, the overall amount of state aid in 2007 consisted primarily of subsidies (58%). This is followed by state guarantees (24.8%) and tax exemptions (10%). The remaining part (7.2%) refers to more favourable loans and shares in equity. According to categories of state aid, from the total amount of state aid, those for horizontal purposes amounted to 14% while state aid for special sectors (a significant share of state aid allocated for shipyard rehabilitation and the successful end of privatising two steelworks) amounted to 48%. Another 36% of the total allocated state aid went to the agriculture and fisheries sectors, while state aid on the local level amounted to 2%.

In 2008 the state aid implementation records were strengthened, as a result of an efficient implementation of the State Aid Act and activities regarding the publishing of decisions on the list of rules and state aid rules, as well as fulfilment of benchmarks pertaining to negotiations regarding membership in the European Union. In this context, the continual strengthening of professional resources by recruiting new employees is ongoing.

The efficient implementation of state aid control contributes to the strengthening of vulnerable economic activities for an equitable and sustainable competition in the European Union. In this, the process of restructuring and privatisation is used as an instrument of accessing companies in difficulties, by complying with regulations on state aid, which will in the end result in more rational spending of the government budget resources.

The procedure of granting state aid in the field of shipbuilding for the five Croatian shipyards will continue in accordance with the Agency decision from July 2008, once the Ministry of the Economy, Labour and Entrepreneurship and the Croatian Privatisation Fund have informed the Agency about the completion of the privatisation process and have delivered an investment plan and the investor's business plan to the Agency, along with the other necessary documentation and records, in accordance with regulations pertaining to state aid. According to the Decision of the Government of the Republic of Croatia, the obligation of new investors to be selected in the privatisation process of each shipyard is, in addition to other tasks, to prepare an investment plan and a business plan, based on which the restructuring of a shipyard is to take place, and create their long-term sustainability (profitability) based on market principles, and according to rules and regulations on state aid pertaining to the allocation of aid to entrepreneurs confronted with difficulties.

In regards to the state aid policy, it will focus on the allocation of state aid for achieving horizontal and regional development goals. The intention of further allocation of horizontal subsidies, like in the previous years, is based on the additional increase of their share in the overall amount, and on high quality allocation of resources for the purpose of increasing economic growth and rapprochement to EU trends. Moreover, the education and training of professionals within the Agency and providers of state aid on all levels will continue, with a special emphasis on the regional and local self-governments. All of the above will be implemented with support from the IPA 2007 project.

Furthermore, the readiness of the state aid providers to apply the information system for monitoring and recording state aid (CROSADS) must be achieved in the term planned, the system being established at the Agency for the purpose of comprehensive monitoring and reporting on state aid in the Republic of Croatia.

This should be complemented by the anticipated positive results from the process of aligning the existing state aid, which will contribute to the use of state aid for the goals aligned with state aid regulations and the *acquis communautaire*.

In regards to further regulating the legislative framework, 24 decisions on the publishing of rules pertaining to state aid were adopted in the course of 2007 and 2008. By the end of 2009 another three decisions on the publishing of rules pertaining to state aid will be adopted.

In 2009 and later, through the Committee for the Monitoring and Preparation of the List of Rules Publication and State Aid Rules, the latest developments pertaining to the *acquis communautaire* will be monitored and decisions regarding the list of rules and state aid rules will be adopted.

The publication of the remaining new rules (rules on state aid in the form of guarantees, appendix to the rules on aid for transport and GBER – General Block Exemption Regulation as well as rules which will be adopted in the course of 2009 within the *acquis communautaire*) is planned for the first half of 2009.

4.1.2 Privatisation

Finalising the privatisation of most of the Croatian Privatisation Fund (CPF) portfolio is one of the preconditions for creating an efficient market economy, as well as for establishing conditions which will enable an increase in the private sector share in the Croatian economy, with all positive effects regarding fair competition and an increase in the Croatian economy competitiveness.

By mid September 2008 the Croatian Privatisation Fund encompassed 890 companies (of which 690 were available for sale) with the overall equity of HRK 66.7 billion of which HRK 17.3 billion are state-owned. Although 45 companies were privatised in the course of last year (5 through a public tender sale and 40 erased from the court register following the completion of bankruptcy or liquidation proceedings)¹⁴, the portfolio structure remained practically unchanged in comparison to last year in regards to the number of companies and equity shares. Accordingly, CPF, with a share of 25% in the equity is a minority owner in 80% of the companies (712 companies), in another 87 companies its share ranges between 25% and 50%, while in 96 companies, with a share exceeding 50% the state is still a majority owner.

According to what was emphasised on several occasions, the dynamics of selling companies in the majority ownership of CPF is a result of a demanding structure of the remaining portfolio, particularly from the aspect of finding a strategic partner (24 tenders were published for the sale of 15 companies, of which 9 for companies within the CPF portfolio and 6 for the Croatian Railways subsidiary companies).

Upon completion of the steel sector privatisation with the sale of Željezara Split, Valjaonica cijevi Sisak and the TLM Šibenik aluminium complex, activities on resolving the problems of long-term sustainability in the shipbuilding sector continued, which is, from the aspect of privatisation, the most complex and the most demanding sector remaining in the CPF portfolio. To this end, the most significant activities regarding the preparation of shipyards for privatisation were undertaken in the third quarter, based on the Decision on the Intention to Privatised and the Privatisation Principles for Five Shipyards in the Majority Ownership of the State, adopted by the Government of the Republic of Croatia in May 2008.

In addition to principles on which privatisation models should be based according to this Decision, final deadlines for the privatisation completion have been established (in the course of 2009) for three shipyards (Uljanik d.d. Pula, Brodogradilište Kraljevica d.d. and Brodotrogir d.d. Trogir). The shipyard restructuring must be conducted based on the model used for privatising the steel sector, which assumes that after privatisation the new owner/owners will prepare, in cooperation with the Government, individual restructuring plans and will deliver them for approval to the European Commission and the Croatian Competition Agency.

¹⁴ From a total of 5 privatised companies, one is a Croatian Railways subsidiary - RVR Service Activities d.o.o Zagreb

With the aim of creating conditions for finalizing the privatisation process, the analysis of various modalities of the announced CPF transformation is ongoing, as well as the legislative framework preparation for creating closed-end investment funds. The concept of finalising the privatisation of most of the CPF portfolio, consisting mostly of minority shares (in 712 companies or 80% of the portfolio where the Government is in possession of up to 25% of total shares), is based on the selection of high quality shares, in most cases with market value, which should be transferred to the closed-end investment funds. The management of funds would be entrusted to professional management companies, selected through a public tender. The IPO share of the closed-end investment funds is planned as the out-going strategy in this process. A more detailed privatisation implementation through closed-end investment funds (number of funds, individual value, duration) will be determined following the adoption of the legislative framework which will enable the activities of the funds in question.

The realisation of the concept presented would determine the role of the state mostly to decision-making in regards to privatisation of companies in which it holds the majority package of shares and for which it is determined that a strategic partner is the best form of privatisation (currently a total of 87 companies from the CPF portfolio are available for sale). Companies whose sale can not be achieved through a public tender, or for which an investor has not been found, as companies with no prospects, will be forced to withdraw from the market either through bankruptcy or liquidation.

4.1.3 Railway Restructuring

Achievements in the railway sector in regards to 2007 PEP pertain primarily to the adoption of a legislative framework, to ensure further measures of improving business processes, more efficient business operation and other criteria in accordance with guidelines and the railways development strategy. The legislative framework was adopted with the aim of aligning the "first and second railways package" of the *acquis communautaire* in the railway sector. During the same period the following legal regulations were adopted:

- Act on the Railway Transport Safety Agency (OG 120/08) (Safety Authority);
- preparation of subordinate legislation in regards to the Railway Transport Safety Act (4 ordinances);
- National Railway Infrastructure Programme (OG 31/08);
- creation of the Independent Department for Railway Accident Investigation (Investigation Body);
- Publishing the Network Report 2009;
- contract with the infrastructure manager signed;
- ISPA project "Reconstruction of the Railway Tracks Vinkovci – Tovarnik – State Border";
- proposed projects through the IPA fund.

Liberalisation of the railway sector and establishing the network primarily implies further legislation alignment and the creation of an institutional framework aligned with the existing EU practice.

The "legislation package", regulating the railway sector so far, encompassed the Railway Act, Act on the Division of Croatian Railways, Railway Transport Safety Act and four related ordinances. In the course of 2007 and 2008 the following acts were adopted:

- Act on Amendments to the Railway Act (OG 79/07);
- Act on the Agency for the Railway Services Market Regulation (OG 79/07);
- Act on the Railway Transport Safety Agency (OG 120/08).

In cooperation with the competent directorate, Ministry of the Sea, Transport and Infrastructure (MSTI) founded nine working groups for the preparation of new ordinances resulting from the Railway Transport Safety Act. The existing subordinate legislation has shown to be inadequate and immense, and this complex technical field will be regulated in another manner, where the existing 250 ordinances/regulations are to be reduced to 31 new ordinances/regulations. The anticipated benefits from the adoption of new regulations are expected in regards to the alignment with the EU technical legislation and determining appropriate criteria for a new system of posts (recruitment) within the existing railway companies. The finalisation has been planned by the end of June 2010.

In the forthcoming period, activities of creating new administrative authorities are planned, namely: the Agency for the Railway Services Market Regulation (Regulatory Body) and the Railway Transport Safety Agency (Safety Authority). Since a new Regulation is in force regarding the inner organisation of MSTI, a new Independent Department for Railway Accident Investigation (Investigation Body) was founded. In the same period, recruitment for the available posts in this Department was anticipated.

The Croatian Parliament adopted the "National Railway Infrastructure Programme" (NRIP) in March 2008. NRIP constitutes a strategic document for the development of the railway network in the Republic of Croatia, in the period 2008 - 2012. This Programme lays down the management and modernisation criteria for the existing railway track network, plans the development and construction of new sections of tracks and proposes solutions for the existing problem of local tracks and issues of railway and road crossings. The overall financial resources allocated for the implementation of NRIP are estimated at about HRK 18.1 billion, in the structure of which budget resources amount to 88%, EU funds to 6% and other sources to 6%. Out of the total HRK 18.1 billion planned, about HRK 12 billion is intended for investments into the construction of new sections and modernisation of the existing railway network, while about HRK 6 billion is intended for maintaining the existing network and traffic regulation. Activities pertaining to revising the status of railway infrastructure as a public domain in general usage are ongoing, this being a significant precondition for implementing NRIP, and in this respect regulating ownership issues in regards to certain real estate. Upon completion of these activities, the infrastructure data base will be organised.

In accordance with the Railway Act and the Act on the Division of Croatian Railways, the newly founded company HŽ – Infrastruktura d.o.o. has assumed the role of the Railway Infrastructure Manager. Based on these Acts, the Railway Infrastructure Manager has the obligation of adopting and publishing annually the document entitled "Network Report". The first Network Statement for 2009 is published on the official web site www.hznet.hr and will be in force for the next Timetable 2008/2009. The Network Statement document focuses on the consumer of services and provides all relevant information regarding the description of the railway network, access conditions, procedure for capacity allocation as well as calculation and charging models for the usage of routes.

The baseline for structuring the fee price or the future model of calculation and charging a fee for infrastructure usage will be derived from the amount of the total current (operational) business of the Railway Infrastructure Manager. At present, when only one passenger operator (railway operator) and only one cargo railway operator are available, the total fee amount has been determined as a lump sum, amounting to a total of HRK 80 million in 2008.

In accordance with the legislation in force and the regular EU practice in regards to public financing in the course of 2008, activities pertaining to the introduction of a new public financing model have intensified. In this respect, the Contract on Railway Infrastructure Management has been signed in June 2008 between the Croatian Government (represented by its Transport Minister) and the infrastructure manager (Company HŽ – Infrastruktura d.o.o.). The Contract is concluded on a multi-year basis, while its annexes, constituting its integral

part, are prepared annually and are based on financial resources secured in the current year. In cooperation with foreign consultants, the Proposals of the Contract on Subsidising Transport Services in Railway Transport have been prepared (PSO Contracts). As of 2008 two PSO Contracts will be concluded: PSO for subsidising passenger services and a new PSO for subsidising combined transport. Since there are currently only two operators for each type of transport, these contracts will be concluded between MSTI and HŽ – Passenger Transport d.o.o. and between MSTI and HŽ – Cargo d.o.o.

In order to secure long-term sustainability of the railway sector with a lasting reduction of need for resources from the government budget, and competitiveness with foreign railway operators once the market is fully liberalised, the MSTI has initiated a new round of consultations with all interested parties in order to prepare and apply the new strategic document, with a working title "Sustainability and Competitiveness Programme for the Railway Sector in the Republic of Croatia".

The main goal, like in the previous period, pertains to the organisation of the railway sector of the Republic of Croatia aligned with the existing practice in the EU. In accordance with the relevant EU guidelines transposed into national legislation, this goal primarily refers to the organisation of new and independent institutions, the founding and functioning of which would guarantee compliance with fundamental principles of a liberalised railway sector.

Actual restructuring activities by the end of 2008 were conducted exclusively according to conditions set by the World Bank for the PAL 1 and PAL 2 loan – determined by the matrix of measures. After the World Bank mission in March 2008 and based on the existing annual Business Plans of companies within the HŽ - Holding group, a redefining of former goals was agreed with the World Bank, following which a new targeted working ratio was defined at 187%. On this occasion the Managements of all companies have undertaken all necessary rationalisation measures in their operation and the implementation of adequate measures for achieving the determined success indicator values. The commitment of dependent companies in the further privatisation process was confirmed, as well as a significant decrease in the number of employees. The standstill in the privatisation finalisation is due to the inexistence of sufficient interest in the private sector, so certain tenders were repeated, whereby the privatisation completion of 10 dependent companies is planned by the end of 2009.

When restructuring was initiated in 2004 within the PAL 2 loan, the working ratio value was 243% and the targeted value for 2007 amounted to 170%. The salary policy and non-fulfilment of Business Plans for companies within the HŽ – Holding group resulted in a deterioration of the working ratio to 193% by the end of 2007.

Table 12: Working Ratio

	2004	2005	2006	2007
Working ratio (state budget co-financing excluded)	243%	220%	190%	193%

Source: HŽ - Croatian Railways, Financial Reports 2004 - 2007

Cooperation in the usage of EU funds continued during 2008. Within the PHARE 2006 programme, a project worth EUR 2 million was approved for "Restructuring and Development of the Railway Sector of the Republic of Croatia in line with EU Legislation". Three contracts were signed within the context of realising the ISPA project "Reconstruction of the Railway Tracks Vinkovci – Tovarnik – State Border": the contract on construction works, the contract on the reconstruction of safety signalling devices and the contract on supervision. The value of the entire project is estimated at about EUR 75.7 million, where the ISPA component amounts to EUR 28.8 million, while the rest is the national component (EUR 46.9 million).

In continuation of the cooperation through ISPA projects, the European Commission approved new co-financing through the IPA fund in the forthcoming period from 2009 to 2011. The overall goal to be achieved in the forthcoming period refers to the application and introduction of interoperability criteria on main railway corridors X and V. The MSTI have been formally informed that the European Commission approved the financing for four infrastructure projects. This encompasses the following railway tracks reconstruction and modernisation projects: Okučani – Novska (IPA grant amounting to EUR 30.1 million), Novska – Dugo Selo (IPA grant amounting to EUR 2.3 million) and Savski Marof – Zaprešić tracks (IPA grant amounting to EUR 750,000). The fourth project pertains to the reconstruction of signalling and safety devices and the modernisation of the Main Railway Station in Zagreb (IPA grant amounting to EUR 14 million). The relevant co-financing amounts from the national component are planned and indicated in the budget forecasts 2009-2011.

4.1.4 Restructuring of Shipbuilding Industry

In the course of 2008 the level of employment and productivity of Croatian shipyards remained unchanged from that achieved in 2007. On August 31, 2008 the registry of orders of the Croatian shipyards contained 42 ships, the total value of which is USD 2.8 billion. Despite the fact that shipyards delivered 13 ships in the first 8 months of 2008, the total value of which was USD 487.85 million, business activities in shipyards are still in difficulties.

The main causes of these difficulties primarily pertain to the increase in production costs, due to an increase in the cost of material and an unfavourable USD/EUR exchange rate. Additional aggravating circumstances influencing the operation of shipyards pertain to inner weaknesses of the actual shipyards, among which the most significant ones are the low level of technological equipment and inefficient business operation.

A significant improvement and elimination of deficiencies in the business process management and a reduction of both inner and external weaknesses will be achieved through shipyard privatisation. The completion of privatisation implementation is planned for 2009, according to the strategic commitment of the Croatian Government. The measures of this strategic commitment focused on privatisation of the state portfolio, are conducted particularly with the aim of improving efficiency, sustainability of operation and competitiveness through the rules pertaining to competition, in conditions existing at the time when Croatia joins the European Union, in which case the Government will no longer have to intervene through state aid and other contributions in order to stabilise the shipyard operation.

With the aim of speeding-up the restructuring of shipyards in the majority ownership of the state, the Government reached a Decision on privatisation of shipyards on May 21, 2008. This decision encompasses the privatisation of the following shipyards: 3. Maj, Brodosplit, Brodotrogir, Kraljevica and Uljanik.

In continuation with the process of review and analysis of the approach to find the optimal model and strategy of the future status of shipyards, and in relation to the Decision on Privatisation, the Croatian Government is conducting continual cooperation with representatives of the European Commission within the negotiations on the accession of the Republic of Croatia to the European Union under the chapter Competition Policy.

In this respect the Croatian Government and the European Commission have held technical consultations in 2008, based on which the Croatian Government reached a decision on August 28, 2008 about its intention to simultaneously privatise all six shipyards.

The privatisation encompasses the approach based on two essential models dividing the privatisation procedure of four shipyards currently encountering serious difficulties and the

losses of which exceed the level of equity values (3. Maj, Brodosplit, Brodotrogir, Kraljevica), and a separate privatisation of the Uljanik shipyard. This approach towards the Uljanik shipyard was determined due to a specific status of this shipyard, the losses of which in the previous periods do not exceed equity value.

In regards to the privatisation implementation, basic steps have been determined and principles accepted for this implementation, based on several fundamental factors which will guarantee transparency and efficiency of the process, and alignment with the *acquis communautaire* in the field of market competition. These primarily encompass:

a) alignment with the *acquis communautaire* in the privatisation implementation procedure:

- adoption of the Investment Plan and the Business Plan by the investors, in accordance with conditions prescribed in Article 70 of the Stabilisation and Association Agreement and Community Guidelines on state aid for rehabilitation and restructuring of entrepreneurs in difficulties, which must ensure the long-term company sustainability - the plans in question must be accepted by the Croatian Competition Agency, the European Commission and the Government of the Republic of Croatia.

b) determining the obligations and procedures in the process of competing in international tenders:

- providing the strategic partner with the possibility to assess and propose which part of the company obligations towards creditors the strategic partner will assume;
- maintaining optimum employment and the employment structure necessary for conducting efficient production processes, with the possibility of training and re-training;
- maintaining to the maximum possible extent the main company activity, but by providing the strategic partner with the possibility to change the company activity on the condition that jobs are preserved;
- adjustment of the production programme to market requirements and access to new markets, with the possibility of territorial transfer of production.

The main goal to be achieved through privatisation primarily refers to creating conditions for a long-term sustainable operation by:

- ensuring the influx of fresh capital;
- access to new markets;
- improving the management know-how and business efficiency; and
- stimulating the introduction of new technologies.

Detailed conditions for the privatisation tenders will be determined in cooperation with the European Commission representatives by the end of January 2009, while the publication of tenders itself is planned by the first half of February 2009.

In addition to the offer of a certain price for shares, the bidders at the tender will be obliged to prepare restructuring programmes where state aid proposals included in those programmes will be subject to the approval of the Croatian Competition Agency. If some of the shipyards whose privatisation has been planned are not privatised based on a public tender to be published in February 2009, the second public tender is planned in the third quarter of 2009. Finalization of the privatization process is planned for September 2009.

Concurrently with the activities pertaining to the restructuring and privatisation of shipyards, a certain progress was achieved in the field of transposing European rules for the allocation of state aid to the shipbuilding industry, based on which the Ministry of the Economy, Labour and Entrepreneurship prepared the Program of Aid for Innovations in Shipbuilding. The Croatian Competition Agency approved state aid included in the programme on June 27, 2008, and the significance resulting from this is a long-term positive effect on the

shipbuilding industry in the Republic of Croatia in the following period, regardless of the possible new ownership structure in the shipyards.

4.1.5 Energy

In the course of 2008, significant changes occurred in the field of electricity and natural gas, which has also resulted in the complete liberalisation of the electricity market (July 1, 2008) and the gas market (August 1, 2008). Prices for network activities and public services were established, particularly for the transfer and distribution of electricity, and for the transfer and distribution of gas, in accordance with recommendations of the Croatian Energy Regulatory Agency.

The main goal in the field of energy is to create a system conforming to the existing EU practice, by respecting the economic criteria and adhering to the highest safety standards.

In accordance with the new energy development guidelines, the Republic of Croatia, in cooperation with the United Nations Development Program (UNDP), initiated the preparation of the project "Adjustment and Upgrade of the Energy Development Strategy in the Republic of Croatia" and the "Implementation Programme of the Energy Development Strategy" in 2007. The Adjustment and Upgrade of the Energy Development Strategy of the Republic of Croatia will encompass the period from 2008 to 2020, with a reference to 2030. The programme of implementing the strategy will encompass a four-year period from 2009 to 2012. The adoption of the project "Adjustment and Upgrade of the Energy Development Strategy of the Republic of Croatia" is planned for 2009.

The model of bilateral market was selected for the initial liberalisation of the electricity market, based on electricity trade through bilateral agreements. Contractual parties in a bilateral agreement for the supply of electricity are the purchaser and supplier, while contractual parties to the bilateral agreements on the purchase of electricity are the supplier, trader or producer.

By December 31, 2008, 2,715 purchasers used their status of a preferred buyer, whereby they have taken advantage of the right to contract electricity independently for their market needs. The total contracted annual consumption of electricity by preferred buyers amounts to 6.1 tetrawatthours (TWh), amounting to 40% of the overall annual electricity consumption in Croatia.

In late 2007, HEP – the Transmission System Operator had signed a two-year Multilateral Agreement of Transmission System Operators (MOTS) for the establishment and division of the transit capacities used, from the ITC Clearing and Settlement Agreement 2008 - 2009, applied as of January 1, 2008. In regards to the above it must be emphasised that HEP – the Transmission System Operator no longer charges the electricity transfer fee.

The Croatian electricity transfer system is connected to neighbouring systems well and has enabled the first connection between the CENTREL system and the UCTE system in 1999, once 400 kV between Croatia and Hungary were put into operation. Successful connections are a key condition for the establishment of an electricity market, and the construction of a double 400 kV power-transmission line between Ernestinovo (CRO) and Pech (HU), to be completed in 2010, is currently ongoing with the aim of fulfilling this goal.

The Government of the Republic of Croatia adopted the Plan for Development, Modernisation and Construction of the Gas Transmission System in Croatia 2007 - 2011, anticipating the procurement and installation of equipment which will enable the functioning of a secondary market and the gas network development in southern Croatia, thus enabling

the fulfilment of obligations pertaining to the *acquis communautaire* regarding the transport system.

It is estimated that due to a significant growth of consumption, the existing supply capacities will not be sufficient in the period after 2009. This is why a plan is in place for a further development of supply capacities for natural gas, through the capacity increase in the supply pipeline system from the Russian Federation through Slovenia for 500 million cubic meters (by 2010), the construction of the supply pipeline system through Hungary (by 2012), the construction of the terminal for liquefied natural gas (LNG) in northern Adriatic (by 2012) with the final capacity of 14 billion cubic meters per year, and the construction of the additional natural gas storage for Croatian needs (by 2010). The other project is the Ionic-Adriatic Pipeline as a branch of the Trans Adriatic Pipeline, connecting Albania, Montenegro and Croatia.

In the field of petroleum products, it is stated that petroleum product prices have followed those on the Mediterranean market, which has consequently influenced the final price forming on the end-customer market.

In regards to the supply safety issues, the Croatian Compulsory Oil Stocks Agency has achieved a level of oil and petroleum products reserves of 60 days.

The Regulation on biofuel quality prescribes an indicated goal of 5.75% of the biofuel share in the overall annual consumption of petroleum and diesel fuel, to be achieved by December 31, 2010. The Biofuels Act and related subordinate legislation will be adopted by the end of 2009, and will entirely regulate that field.

For the purpose of implementing this goal, budgetary resources will not be used. Business entities will use the resources available based on market principles according to their abilities.

4.1.6 Small and Medium-Size Enterprises

The Programme of Incentives to Small and Medium-Size Enterprises 2008 – 2012 of the Government of the Republic of Croatia as of April 18, 2008 establishes key development goals for small businesses as follows: (1) strengthening competitiveness, (2) uniform regional development, (3) raising the quality of entrepreneurial infrastructure, (4) decrease of administrative obstacles, (5) strengthening the entrepreneurial climate in the society and (6) internetisation and electronic business operation.

Significant progress was achieved in the process of improving small and medium-size enterprises, which further stimulates the entrepreneurial environment development, and which is primarily based on the successful allocation of resources through different types of incentives in transparent procedures and harmonisation with all principles of the economic policy and competition principles.

Additional evidence to this are the latest published results of the "Global Competitiveness Yearbook 2008"¹⁵ where Croatia holds the first place among the 16 non-member countries of

¹⁵ Report from the World Economic Forum (WEF) regarding the analysis of the Lisbon Strategy which has shown that in most fields of applying the Lisbon Strategy, Croatia shows better results than some EU member states. In the course of the last two years Croatia has shown significant improvements in the field of education reform and an increase in social inclusion, as well as in the stimulation of entrepreneurship through a reduction of administrative obstacles, whereby it is ranking higher. In the analysis based on all criteria, Croatia assumed the 49th position from a total of 55 countries encompassed by the research. This means that its position moved up four places and is now ranking among the 50 most competitive countries in the world. Additionally, in competition by areas it holds the first place for competitiveness in tourism. The World Economic Forum publishes the Report on the Application of the Lisbon Strategy every two years since 2002. Source: National Competitiveness Council, Institute for Management Development (IMD) from Lausanne.

the European Union, while ranking next to EU members – between Greece and Italy in its overall grade and ahead of Romania, Poland and Bulgaria. The biggest contribution to this position comes from an increase of foreign investments in general and the results achieved in the development and expansion of the capital market, as well as those accomplished in scientific infrastructure, educational factors and technological infrastructure.

Programme guidelines of stimulating small and medium-size enterprises in the medium-term period 2008 - 2012 rely on the results achieved so far, and on further qualitative improvement of the development model in this sector.

In order to achieve further improvement in this sector, the elimination of all administrative obstacles is expected, which is one of the Croatian Government priorities for the next four-year period. In this respect, and within the HITRO.HR service, the pilot project "on-line company registration in a day" began, where the company founding procedure is entirely conducted electronically.

In the HITROREZ project completed by the end of 2007, out of 1,451 regulations, 425 were proposed for deletion and 374 for simplification. The Croatian Government founded OREA - Office for the Regulations Effect Assessment. The Department for the Economic Effects Assessment of Regulations and the Macroeconomic Analysis was founded within the Ministry of the Economy, Labour and Entrepreneurship.¹⁶

In regards to the mentioned positive results, the achieved development degree of small and medium-size enterprises in the sector structure and business category as well as in the sources enabling sustainable growth of this sector, is estimated as a necessary introduction of economic measures and instruments, primarily referring to:

- the creation of conditions which will to a larger extent enable an easier access to financing sources in the conditions of relatively good development of the banking sector which is sound and solvent;
- inclusion of SME into other forms of the financial market, based on the level of internet usage for e-trade and e-business and in sectors with significant growth possibilities, including entrepreneurship in the field of new technologies and connections with the research and development entrepreneurship and the academic community.

Instruments and measures of stimulating small and medium-size entrepreneurship have been encompassed by incentive projects from the Operational Plan for the fiscal year, where competition strengthening measures, financial instruments for competition stimulation through the application of new technologies, financial instruments of regional development and aid for innovations, new products and the introduction of EU standards, are available.

In the medium-term period 2008 - 2012, based on the Government Programme, actual activities will encompass measures of stimulating entrepreneurship among women and target groups, co-operative entrepreneurship as well as trades and crafts. In the process of creating

¹⁶ Regulation on Inner Organisation of the Ministry of the Economy, Labour and Entrepreneurship (OG 41/08), Article 138: "The Department for the Assessment of Economic Effects of Regulations and the Macroeconomic Analysis shall coordinate and communicate with the Office for the Regulations Effect Assessment (OREA) in order to ensure full compliance with the Regulation on OREA, shall coordinate the system for the assessment of effects on the economy in cooperation with other state administration bodies (SAB), the private sector and the public, shall provide instructions and opinions in regards to the preparation of the assessment of the economic effect of regulations, shall provide professional support to parties proposing regulations, shall advise SAB and bodies of the Government of the Republic of Croatia in regards to the analysis and analysis preparation as well as review final reports prepared by SAB in the capacity of parties proposing regulations, shall actively participate in the strategy development in regards to the economic effects assessment on the national level, shall conduct the macroeconomic analysis, shall propose draft measures for further development and improvement of the system of assessment effects regulations have on the economy, and shall harmonise forms and methodologies in cooperation with other SAB and interested parties."

entrepreneurial infrastructure, the most significant investments encompass the construction of entrepreneurial zones, support institutions for entrepreneurship and clusters. In implementation activities for the strengthening of entrepreneurial culture, projects of marketing activities and entrepreneurship advertising will continue, as well as the development of e-projects ensuring overall elimination of administrative obstacles and a decrease in entrepreneurial costs.

4.1.7 Public-Private Partnership

The Government of the Republic of Croatia stimulates public-private partnership (PPP) with the intention to influence, through its application, a strong, long-term, sustainable economic development, which will, in addition to the higher level of public services for the population, enable the Croatian economy to accomplish a higher level of competitiveness.

In accordance with measures and plans stated in the last year's PEP, in the course of 2008 the Government of the Republic of Croatia prepared the Public-Private Partnership Act as the legislative framework basis of the PPP system in the Republic of Croatia

The Public-Private Partnership Act (PPPA) was adopted by the Croatian Parliament on October 24, 2008, entering into force eight days following its publication in the Official Gazette(OG 129/08, as of November 8, 2008), i.e. on November 15, 2008. The purpose of adopting PPPA is stimulation and a systematic development of PPP in the Republic of Croatia.¹⁷

The Act regulates the entire PPP area, primarily:

- the procedure of preparation, proposing and approving PPP projects;
- rights and obligations of public and private partners in the application of contractual and status PPP models;
- establishment and administering the Registry of PPP Contracts;
- monitoring the implementation of PPP projects;
- authority of the Agency for PPP.¹⁸

Further upgrade of PPP legislative framework will be implemented through the preparation of implementation acts based on the Act indicated, by the end of the first quarter of 2009.

The Government of the Republic of Croatia adopted also the Strategic Framework for Public-Private Partnership Development, containing the basic presumptions for a future successful development of PPP in the Republic of Croatia.

¹⁷ The existing framework for the PPP implementation consists of Guidelines for the application of contractual models of the public-private partnership of the Government of the Republic of Croatia, published by the end of 2006 and the Regulation on providing prior approval for the conclusion of public-private partnerships based on the private financial initiative model (OG 73/08). With the adoption of PPPA and the adoption of adequate subordinate legislation, the existing legislation is being replaced, and a comprehensive legal framework is established, regulating the field of PPP in the Republic of Croatia. In this respect, on December 12, 2008 the Government of the Republic of Croatia adopted Conclusion 146/08 whereby Guidelines for the implementation of contractual forms of public-private partnership (PPP) were put out of force and which points to the implementation of the Public-Private Partnership Act.

¹⁸ PPPA contains only the essential provisions, while their details are stipulated in the related subordinate legislation (regulations, ordinances) and implementation documents (guides, manuals, instructions). Although PPPA is an integral part of the public procurement legal framework, the central part of PPPA does not refer to or relate exclusively to provisions on public procurement procedures, but also includes provisions on the preparation, proposal and selection of PPP projects, the rights and obligations of public and private partners in implementing the contracts concluded, as well as on the organisation and tasks of the Agency for PPP as the central body competent for PPP. In the section referring to the procedure of private partner selection, PPPA directly refers to the application of provisions from two other acts; the Public Procurement Act and the Concessions Act.

The central institution competent for the application of the PPP model in the Republic of Croatia is the Agency for PPP, and within the scope of their competence, the Ministry of the Economy, Labour and Entrepreneurship (development policies) and the Ministry of Finance (concessions policies, budgetary plans and the fiscal effects and risks assessment) also play a significant role.

The main competence and task of the PPP Agency is the assessment and approval of PPP projects, administering the Registry of PPP Contracts, monitoring implementation of PPP projects and improvement of the theoretic and practical framework related to PPP.

The status of a PPP project may only be given to project proposals approved by the Agency for PPP. For the purpose of assessing the project proposal, the Agency for PPP also compiles opinions of competent ministries, or regional and/or local self-governments, where the precondition for accepting the project proposal is approval from the Ministry of Finance which analyses the project proposal from the aspect of fiscal effects and risks, as well as financial sustainability.

In order to strengthen administrative capacities of the Agency for PPP, a training programme and different types of education and training are planned for Agency employees. The Ordinance on the training of participants in procedures of preparing and implementing PPP projects is planned for adoption by the end of 2009, which will determine the system in detail, with actual education and training modules for all representatives in the public sector competent for PPP projects. The implementation of training and education of the public sector representatives would follow mainly during the year 2010.

4.2 FINANCIAL SECTOR

The financial system in the Republic of Croatia is concentrated around banks, and in late June 2008, total assets of all banks amounted to 75.5% of the overall assets of all financial agents. Among other credit institutions, according to the share in the overall assets of all financial agents, housing savings banks participated with 1.4% and savings and loan co-operatives with 0.4%.

Although in the period till the end of 2007 the banks have decreased their share in the overall assets of all financial agents, with the growth of investment funds and pension funds share, in 2008 their share in the assets of all financial agents increased due to a fall in the value of investment fund assets. The reason for the fall in the value of investment fund assets is an increase in the withdrawal of investors due to less interest for such investments.

Table 13: Financial sector structure (% of total assets at the end of a period)

	2005	2006	2007	June 2008
Banks	78.9	76.7	73.9	75.5
Open-end investment funds, net assets	2.7	4	6.4	4.1
Closed-end investment funds, net assets	1.1	1.4	1.7	1.4
Insurance companies	5.0	4.9	5.0	5.3
Housing savings banks	1.9	1.6	1.4	1.4
Compulsory pension funds, net assets	3.6	4	4.5	4.8
Voluntary pension funds, net assets	0.1	0.1	0.2	0.2
Savings and loan co-operatives	0.5	0.5	0.4	0.4
Leasing companies	6.2	6.8	6.5	6.9
Total	100.0	100.0	100.0	100.0

Source: CNB, MF, CFSSA

4.2.1 Banking Sector

In mid 2008, 33 banks and 5 housing savings banks operated in Croatia. Their share in the overall assets of all financial agents was about 75%. At the same time, the banking system was highly concentrated, where 10 largest banks represented about 92% of the overall assets of all banks. Foreign-owned banks dominate the ownership structure, representing 90.7% of the overall assets of all banks. Banks owned by national entities amount to 4.5% of the overall assets of banks, while 4.8% of the overall assets of all banks is privately owned on the national level.

In order to influence the reduction of loan growth, which is for the most part based on foreign borrowing of banks from their parent institutions, the Croatian National Bank introduced a credit control measure in late 2006, which obligates banks with the annual placement growth in 2007 exceeding 12% to purchase bills in the amount of 50% of the excess amount. The same measure was made more stringent in July 2007 (OG 132/07) and in March 2008 (OG 29/08). In continuation with the provisions stated, the placement growth of banks was also limited by achieving the appropriate capital adequacy of banks as a precondition of growth, and in this respect the Croatian National Bank also adopted two Decisions on Amendments to the Decision on the Capital Adequacy of Banks (OG 130/07 and 31/08).

In regards to credit risk, it must be emphasised that for the purpose of better currency induced credit risk management, due to a significant euroisation of bank assets, the regulation adopted by the Croatian National Bank in 2006¹⁹ is still in force, according to which higher weights are applied to credit risk when calculating the capital adequacy of banks for exposures to those customers whose foreign exchange position is not matched, in the currency in which they earn their income as opposed to the currency in which placement was granted to them. Moreover, since May 2007, a better insight into credit risk when banks grant their new placements was made available to banks which are founders of the Croatian Registry of Credit Obligations, providing them with reports on credit obligations of their customers.

In the process of aligning the existing savings and loan co-operatives with the *acquis communautaire* relating to the operation of credit institutions, in December 2006 the Act on Amendments to the Banking Act (OG 141/06) was adopted, introducing the possibility of transforming savings and loan co-operatives into savings banks, as well as the possibility of founding savings banks, and the Credit Unions Act (OG 141/06) introducing the possibility of aligning the savings and loan co-operatives with the Act in question, i.e. the possibility of founding credit unions. According to preliminary data, 43 savings and loan co-operatives have decided to transform its business into savings banks, 37 to conform with the Act and operate as credit unions, whereas 24 of them have opted to terminate their operation by implementing the voluntary liquidation procedure. However, in the licensing process until September 2008, 37 savings and loan co-operatives decided to change their initial decision and adopted a decision on voluntary operation liquidation, while 4 savings and loan co-operatives merged with the largest savings and loan co-operative.

In accordance with all of the above, the Croatian National Bank received 21 requests for transforming savings and loan co-operatives into savings banks and one request for founding a savings bank, 18 requests for continued operation of the savings and loan co-operatives as credit unions and 2 requests for the founding of a credit union, notices on the merger of 4 savings and loan co-operatives and decisions of 61 savings and loan co-operatives regarding the initiated procedure of voluntary liquidation. In the process of resolving requests of the savings and loan co-operatives for transformation into savings banks, for continued operation

¹⁹ Decision on amendments to the Decision on the capital adequacy of banks (OG 149/05) and Decision on amendments to the Instruction on a single application of the Decision on the capital adequacy of banks (OG 41/06)

as credit unions or for the founding of credit unions, the Croatian National Bank has reached the following decisions by September 2008:

- 1 savings and loan co-operative was transformed into a savings bank, while one savings bank was founded;
- 20 savings and loan co-operatives did not fulfil the conditions for transforming into a savings bank, and their request was denied;
- 18 requests of savings and loan co-operatives for operation as credit unions were positively resolved as well as 3 requests for the founding of a credit union.

The Credit Institutions Act (OG 117/08), implementing provisions of the Capital Requirement Directive²⁰ in the part relating to credit institutions, was adopted in September 2008, while the Croatian National Bank adopted subordinate legislation regulating in detail the calculation of the capital adequacy of credit institutions, as well as a range of other subordinate regulations based on the new Credit Institutions Act, which are published in the Official Gazette 1/09²¹. The Act prescribes that credit institutions must have a minimum capital adequacy of 12%.

In addition to the Credit Institutions Act, the Croatian Parliament also adopted the Act on Electronic Money Institutions (OG 117/08)²² as well as the Act on Settlement Finality in Payment and Securities Settlement Systems (OG 117/08)²³, the Act on Amendments to the Deposit Insurance Act (OG 119/08)²⁴ and the Financial Conglomerates Act (OG 147/08)²⁵.

At the last session of the National Payment System Committee (the Committee) in November 2008, draft Act on the Payment System Services, into which the EC Directive on Payment Services in the Internal Market (2007/64) would be transposed, was presented to the Committee members. The adoption of the Act is planned for the second quarter of 2009. As well, the Committee members got acquainted with the Framework for the Detection of Counterfeits and Fitness Sorting by Credit Institutions and Other Professional Cash Handlers. The application of Guidelines is planned for January 1, 2010.

With regard to the payment system of the Republic of Croatia, there is still room for further improvement in the area of providing payment services by non-banking institutions and their licensing and supervision, in the transparency of conditions for providing payment services, the rights and obligations of payment service providers and users, the out-of-court settlement of disputes and other issues, all of which is also necessary for the functioning of the single EU market. This area will be regulated through the new Act on the Payment System Services.

With the aim to protect consumers, the creation and adoption of the Consumer Loan Act is planned for 2009, which will regulate contractual relations of customers as service users and service providers who do not necessarily have to be credit institutions.

²⁰ The Capital Requirement Directive encompasses Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions.

²¹ In addition to the Capital Requirement Directive it also encompasses transposed provisions of Directive 2001/24/EC on the reorganisation and liquidation of credit institutions, Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and Council Directive 89/117/EEC on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents.

²² Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions

²³ Directive 1998/26/EC on settlement finality in payment and securities settlement systems

²⁴ Directive 94/19/EC on deposit-guarantee schemes

²⁵ Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate

4.2.2 Non-Banking Sector

On October 1, 2008 the permit for conducting insurance activities was issued to 25 insurance companies and 2 reinsurance companies in the Republic of Croatia. In addition, 24 companies for mediation in insurance were in operation, while 196 agents conducted mediating activities in insurance as physical persons. The activities of representation in insurance were conducted by 152 trades and crafts for representation in insurance and 154 companies for representation in insurance, while 5,458 insurance representatives conducted activities in insurance as physical persons (including also insurance representatives in the banking sector). At the 30 technical inspection stations it is possible to contract the compulsory insurance policy for the motor vehicle owner or user, from liability for damages to third parties and additional accident insurance in motor vehicles. All of the legal and physical persons listed above operate on the basis of a decision of the Croatian Financial Services Supervisory Agency (the Agency), while 24 banks obtained a permit of the Croatian National Bank for conducting the tasks of representation in insurance, upon a prior approval of the Agency.

As of October 1, 2008, 4 compulsory pension funds operated in Croatia, the overall net assets of which amounted to HRK 22.5 billion by late September 2008. Due to unfavourable trends on the global financial market, the Agency in the capacity of the capital market regulator, reacted to proposals of compulsory pension funds and their management companies, whereby a decision on the founding of an "intervention fund" was adopted in the form of an open-end investment fund with a private offer into which compulsory pension funds and their management companies make contributions based on their market shares. The initial contributions in the amount of HRK 150 million will be paid once the fund is founded, and will increase if needed, while payments would be made in the course of five years. A compulsory pension fund which would use the intervention fund resources may only use these assets for payments to stakeholders.

As of October 1, 2008, 6 open-end voluntary pension funds were active, with the overall assets of HRK 742.4 million, and 14 closed-end voluntary pension funds with the overall assets of HRK 133.4 million.

On the capital market, in addition to pension funds, as of October 1, 2008, 122 open-end investment funds were active with the overall net assets of HRK 14.9 billion, 4 closed-end investment funds with HRK 1.8 billion in assets and 7 closed-end investment funds for investments into real estate with overall assets of HRK 607.6 million total.

Based on a special law, 2 funds were founded and registered – the Fund of Croatian Homeland War Veterans and Members of Their Families with HRK 2.9 billion in assets, and the Pensioners' Fund with assets of HRK 4.4 billion total.

In the course of 2008, Croatian legislation was aligned in the non-banking sector and the Act on Amendments to the Insurance Act (OG 87/08) and the Capital Market Act (OG 88/08) were adopted, regulating the conditions for the founding, operation, supervision and termination of an investment company, market operator and the operator in the offsetting and settlement system in the Republic of Croatia, conditions for providing investment services and conducting investment activities and other related activities, rules for conducting business in a regulated market, conditions for the offer of securities to the public and listing securities on a regulated market, obligations in regards to publishing information pertaining to securities listed on a regulated market, abuse of the market, deposits of financial instruments as well as offsetting and settlement of transactions involving financial instruments, and the authorities and actions of the Agency in implementing this Act.

In 2009 the preparation and adoption of the Act on Amendments to the Act on Compulsory Insurances within the Transport Sector is planned, with the aim of aligning the provisions with the *acquis communautaire*, in the part pertaining to air transport.

The Capital Market Act stipulates the adoption of a significant amount of subordinate legislation, while drafts of the subordinate legislation prepared by the Agency have been submitted for a public debate. With the aim of a better and more comprehensive coordination and market preparation for the forthcoming changes, a series of meetings was held with representatives of the industry, the Zagreb Stock Exchange and the Central Depository Agency.

Concurrently with the preparation of subordinate legislation, the Agency as a supervisory body regarding the operation of actors in the capital market, revises and improves its approach to supervision, which will be based on risk management control and internal controls of the entities supervised in the forthcoming period. In regards to this, the methodology of direct supervision of investment funds is ongoing, to be based on the risk assessment of certain companies.

In the second half of 2008, special attention was given to technical meetings with the industry representatives, referring to the implementation of the Capital Requirement Directive, and drafts of subordinate legislation have been prepared which regulate in detail the calculation of capital adequacy, while the adoption of all subordinate legislation is planned for the first quarter of 2009, which will, in addition to full alignment with the *acquis communautaire*, also enable full implementation of the Capital Market Act. The end of June 2009 has been set as the term for the alignment of all entities on the market with legal provisions and subordinate legislation. In the aforementioned period, the Agency intends to continue working on the supervision methodology, to continue consulting the industry and educate participants in the capital market, with the aim of adjusting to European standards and to continually monitor the adoption of regulations on the EU level, interpretations of the European Commission and Committee of European Securities Regulators (CESR) and to update and adjust its activities accordingly. By the alignment deadline, the adoption of subordinate legislation is planned which will regulate in detail the implementation of the Investor Protection System and the functioning of the Investor Protection Fund.

Moreover, in this period the Agency plans to intensify its cooperation with other regulators in the EU, and to continually implement activities pertaining to monitoring the dynamics of adopting regulations in the EU and their timely implementation into the legislation of the Republic of Croatia.

With the aim of stimulating confidence in the financial market and contributing to the financial market functioning without obstacles, the project for educating a wider public and investors was initiated, encompassing the entire spectrum of the Agency activities. In June 2008 an educational seminar was organised for stock exchange and economic experts, where the first steps were made in the education of police, the State Prosecutor's Office and journalists.

4.3 LABOUR MARKET

All of labour market indicators in the Republic of Croatia continue to indicate to further continuous increase in employment and decrease in unemployment. According to temporary data of the Central Bureau of Statistics, the total number of registered employed persons increased from 1,526,105 in November 2007 to 1,530,428 in November 2008, i.e. by 0.3%. In the same period, the number of unemployed persons registered by the Croatian Employment Service decreased from 253,183 to 233,661, i.e. by 7.7%. According to the labour force survey, the employment rate of persons aged 15 to 64 increased from 56.7% in the second quarter of 2007 to 57.6% in the second quarter of 2008, while the unemployment rate of population aged 15 and more in the same period decreased from 9.1% to 7.9%.

4.3.1 Stimulating Employment

The new cycle of active employment measures, which began in 2006 indicates positive high quality results since most of the newly employed persons are young, without work experience, and those unemployed over the long term. Moreover, we have assessed as positive the fact that users of active employment measures are primarily small and medium-size enterprises, which leads to the conclusion that precisely these employers are generating economic development and growth, by providing new jobs. In the course of 2006, from among all the persons encompassed (4,869), 2,479 people were employed, and 873 persons joined education programmes. In 2007, measures encompassed 8,494 persons, of whom 4,346 (or 51.1%) were women. From the total number of persons encompassed (8,494), through employment aid 4,296 persons were employed, 707 persons were included in the education for a specific employer (training aid), 2,960 persons were included in the education for a non-specified employer and 531 persons were employed through the programme Public Work.

By December 31, 2008, measures encompassed 7,531 persons, of whom 3,641 were women. From the total number of persons encompassed (7,531), through employment aid 3,350 persons were employed, 1,105 persons were included in the education for a specific employer (training aid), 2,361 persons were included in the education for a non-specified employer and 715 persons were employed through the programme Public Work. It needs to be mentioned that for the Annual Employment Stimulation Plan measures, a total of HRK 370 million was secured in the state budget for 2006, and the amount for this purpose was increased to HRK 530 million in 2007 and to HRK 480 million in 2008.

Since the Republic of Croatia wants to base its development on knowledge and investments into people, according to the Lisbon process goals, positive changes in the educational process are also significant and positive, particularly bearing in mind their influence on decreasing the gap between the work force supply and demand, and a rise in the work force employment. The total number of students enrolled in high schools fell by 5.1% between school years 1997/98 and 2007/08 due to demographic trends. However, within this general trend, there are various sub-trends. While the number of students enrolled in gymnasiums increased by 4.3% and the number of students enrolled in four-year technical programmes increased by 7.2%, the number of those enrolled in three-year vocational programmes for the industry as well as for trades and crafts decreased by 27.6%. Among all students at the beginning of the school year 2007/08, 44.5% attended four-year technical programmes, 25% three-year vocational programmes, 2.5% art schools, 27% gymnasiums and 0.9% special schools.

At the beginning of the school year 2006/07, 136,129 students were enrolled in higher education (ISCED level 5), among them 2/3 were enrolled in university studies (ISCED 5A) and 1/3 in vocational studies (ISCED 5B). In addition to universities, higher education, especially vocational studies are offered by polytechnic schools and community colleges. The number of students in higher education increased by 51% in the period between the school year 1997/98 and the school year 2007/08. This is a significant increase in the relative participation in higher education, which has probably brought Croatia closer to the European Union average.

In regards to the taxation system, which is linked to the employment policies, contributions for social security and taxation in relation to the overall work force cost, serve as indicators of the tax wedge level. The tax wedge in Croatia amounts to 37.3% for those employed on a low salary. The tax wedge in the EU amounted to 39.4% in 2005, according to EUROSTAT. This shows a slightly lower tax wedge in Croatia than in the EU. Despite this, with the aim of stimulating employment of the younger population with no work experience, the new Contributions Act enabled the employment of first-time employees or those with a volunteer work contract according to labour regulations, without the obligation of contributions

calculated and paid according to "the base", which represent the employer's cost (health insurance 15%, occupational health insurance 1% and 1.7% for employment) for the duration up to one year from the first date of employment, or the first date according to the volunteer contract. Furthermore, with the aim of promoting active ageing, income of those pension insurance beneficiaries which is based on their occasional employment in handicrafts, is exempt from the obligation to pay contributions.

The Minimum Salary Act was adopted in 2008, bearing in mind the circumstances that 115,000 workers in the Republic of Croatia receive a salary up to HRK 2,500.00 per month. The social work conditions have improved with this Act for workers with the lowest salaries, who represent 7.6% in the overall employment. Upon the adoption of this Act as of July 1, 2008, the minimum salary amounts to 39% of the average salary for 2007, whereby the minimum salary grew from the existing minimum of HRK 2,441 gross to about HRK 2,747, i.e. for the amount of HRK 300.00. The gradual share of the minimum salary in the average salary for the previous year will be calculated for each following calculation period, once the Central Bureau of Statistics has published data on the real GDP growth for the previous year, in the manner that the minimum salary share in the average salary for the previous year increases for the real GDP growth coefficient in the previous year (formula for the share calculation is $39\% + 39 \times \text{real GDP growth}/100 \times \text{average salary for the previous year}$).

In May 2008, the Memorandum on Joint Assessment of Employment Policy Priorities – JAP was signed by the highest officials of the Republic of Croatia and the European Commission, based on which a new cycle of active employment measures will begin, with the preparation and implementation of the National Employment Implementation Plan 2009–2010. Recommendations for the improvement of existing measures and the preparation of new ones were presented to working groups drawing-up the National Implementation Plan, which are a result of the 2-PHARE 2005, and in the preparation of which, along with state administration bodies, social partners on the national level and in four counties (City of Zagreb, Šibenik-Knin, Međimurje and Osijek-Baranja) also participated. The European terminology and qualification of employment policy measures were also presented, according to the EUROSTAT data base methodology.

4.3.2 Social Security System

Material and Legal Protection of Unemployed Persons

By taking into consideration the active involvement on the labour market, it is necessary to also know all circumstances of the long-term processes influencing the labour market in the Republic of Croatia determining our future competitive advantage or limits in our development. These processes are primarily connected to the population ageing, caused by a negative population growth, the result of which is the ageing of the working population and the work force, as well as a decrease in the absolute number of the working age population. Since the younger generations can not replace the more numerous older generations in size, the latter group becoming older than the working age population, the need will arise for the education of increasingly older workers, which is impossible without the life-long learning orientation. Additionally, a bigger fluctuation on the labour market demands relatively frequent changes in the status of an individual: periods of employment will alternate with periods of learning, unemployment and inactivity. Several career changes in the course of a working life will provide an absolute advantage to those investing into their abilities to learn, and maintain their entrepreneurial spirit.

Although significant positive changes on the Croatian labour market have occurred in the last few years, as the registered employment increased significantly, and the registered

unemployment was reduced to a large extent, the situation on the labour market is still not satisfactory, with the most concerning element being the relative scope of long-term unemployment. The share of persons unemployed for more than a year amounted to 58.6% in the overall number of those registered as unemployed by end-2007. Data indicate that long-term unemployment is connected to a lower degree of education and older age, as 38% of the unemployed only have primary school qualifications. Since the relative scope of long-term unemployment may be reduced by educational measures of an active employment policy for the purpose of refreshing, supplementing or changing work-related knowledge and skills of the unemployed persons with the aim of increasing their employability, the new Act on Employment Mediation and Unemployment Rights was adopted, where the issue of financial compensation for unemployment has been modified. The solutions adopted refer to the possibility of a more significant financial incentive for the unemployed to participate in educational measures, when the financial compensation is determined in the amount of a scholarship, which constitutes a 50% increase in regards to the existing compensation.

On the other hand, the unemployment benefits increased significantly in the first three months following the loss of employment, as well as its gradual decrease in order to discourage long-term unemployment, particularly among the older population who has acquired the right to continual financial compensation. This measure is a response to the fact that according to the existing data 54.4% of those using financial unemployment benefits are 54 and younger, which is why it is necessary to stimulate employment and work activation with a smaller compensation following a year of unemployment. Along with the described increase in the fees, the obligations and responsibilities of the unemployed have increased, in regards to joining educational activities with the aim of finding employment, as well as refusing employment, which is a change from the existing system depending exclusively on qualifications and experience, as the established professional plan as well as psychological and physical abilities of the unemployed person will now be taken into consideration.

Due to the above, the restructuring of material and legal protection for the unemployed persons was conducted with the aim of protecting the unemployed in the first year of unemployment from poverty with higher compensations, and providing the unemployed with a longer period of employability through educational activities and active work seeking, as well as stimulating employment and work activation of the unemployed with a lower unemployment benefits obtained until they have found employment.

The amount of approximately HRK 853 million is secured in 2009 for material and legal protection of the unemployed, which is HRK 53 million more in comparison to 2008, for the financial compensation restructuring and financial aid during education, based on the labour market trends, the continuous employment growth trend and unemployment reduction, and by taking into consideration the average salary unemployed persons received prior to becoming unemployed. It is important to emphasise that the increase in question does not imply an increase of the contribution rate for employment, only a redistribution of the existing resources accumulated in the course of a fiscal year.

Pension Insurance

Within the pension insurance system, constituting one of the components of the entire social security system in the Republic of Croatia, certain modification occurred in the legislation during 2007 and 2008, regulated both as a generational solidarity system and a capitalised pension insurance system.

Amendments to the Pension Insurance Act were introduced on two occasions in regards to compulsory pension insurance based on generational solidarity. The Act on Amendments to the Pension Insurance Act (OG 79/2007) which entered into force on January 1, 2008,

enabled the raise of early retirement pensions through a change in the baseline factor for determining early retirement pensions amounting to 0.15% now as opposed to the previous baseline factor of 0.34%, reducing the overall maximum pension decrease (for the insured opting for the early retirement pension five years prior to fulfilling conditions for regular retirement pension) to only 9%, as opposed to the previous maximum decrease of 20.4%. The level of disability pensions due to professional inability to work has also been raised, paid during employment, as well as disability pensions caused by injuries at work or professional diseases, by changing the pension factors and the level of minimum pensions so that it is determined in the same manner for all the years accumulated, as determined by the Pension Insurance Act (OG 102/98). In the meantime, amendments to the same Act from 2002 regulated the calculation of minimum pensions by applying the factor of 0.825% of the average gross salary of all employed persons in Croatia in 1998 until 30 years of work towards pension have been accumulated, and by applying the factor of 0.4125% of the average gross salary of all employed persons in Croatia in 1998 for each accumulated year exceeding 30 years. The aim of all these changes was to improve the material status of pension beneficiaries and raise the level of average pension share in the average salary. With the Act on Amendments to the Pension Insurance Act (OG 35/2008) which entered into force on March 28, 2008, the pension insurance beneficiaries working part-time have obtained equal rights to pension insurance, as well as the marital and extramarital union in regards to the right to family pension. The Allowance on Pensions Earned Act according to the Pension Insurance Act (OG 79/2007) is being applied since 2008, significantly improving the material status of "new pensioners" and harmonising the amount of pension obtained for the same number of accumulated years for beneficiaries who have obtained pensions based on regulations in force prior to the pension reform and following its initial period. The Act determines an allowance on pension in the range between 4% and 27% of the pension, depending on the year the right was exercised. Through special regulations, the Act on Amendments to the Trades and Crafts Act (OG 68/2007) and the Contributions Act (OG 84/2008), certain preconditions were created for a more significant inclusion of younger pensioners into paid work, thus marking the implementation of the measure stipulated by the Joint Memorandum on Social Inclusion.

In the field of a capitalised system, certain amendments in legislation were also conducted, with the aim of transposing the *acquis communautaire* in regards to the operation of pension funds (possibility of increased investments outside of the Republic of Croatia), and in relation to more precise regulation of additional pension systems (voluntary closed-end pension funds).

In regards to the significant role of the minimum pension representing the basic instrument of achieving the principle of solidarity and redistribution in the generational solidarity system, the procedure of minimum pension sustainable financing will be analysed in the medium-term period (2009 - 2011), as well as the possibility of its achievement with a review of the income and property status. In this regard, criteria for determining the minimum pension will be defined and incorporated into the legislative framework. Further reform of the pension reform will encompass certain measures to be undertaken with the aim of further average pension increase, in accordance with economic abilities of the country, and in this respect with special monitoring of early retirements, in regards to amendments of the Pension Insurance Act. For now the new anticipated more beneficial option of early retirement, despite the previous PEP Assessment and the assessment indicated in the 2007 Progress Report in Chapter 3 – Economic Criteria Subchapter 3.1 - Existence of an Efficient Market Economy, did not significantly influence the increase of pension insurance costs, due to a relatively short time that the regulation stipulating this option has been in force. Thus particularly the fiscal effect of the amended regulation will be monitored and timely intervention is planned if a disturbance is noticed in relation to the existing condition and an increase of pension

insurance costs which would exceed the framework planned (overall fiscal cost of 0.35 – 0.4 GDP per year for the amended Pension Insurance Act and the Allowance on Pensions Earned Act). Achieving the pension system fiscal consolidation in the medium-term remains one of the priority tasks. Since the medium-term period begins in 2009, the first year in which pensions will be calculated based on salaries from the entire working life, a longer working life is expected as well as exercising pension rights at a later time. In accordance with demographic trends, possible increases of the age limit for acquiring the right to regular retirement pension will be analysed.

In regards to the capitalised system, trends in the system and the application of acts regulating this field will continue to be monitored for possible upgrades and adjustment to new conditions of the social and economic development of the country. By now the pension reform has achieved results in stabilising the pension system deficit. The same deficit decrease trend is also expected in the medium-term period, and with the aim of securing adequate pensions for future generations of pensioners, the possibility is planned to increase the contribution rate for the second pillar in the period until 2013 (Strategic Development Framework 2006 - 2013), and further liberalisation of pension fund investment policies, in regards to investments into first-class equity securities. This is why an analysis of potentially raising the contributions for the second pillar in the medium-term will be conducted, and concurrently the analysis of the effects the modified formula has on basic pension (available to the persons insured in both mandatory insurance pillars, for the period following the introduction of the capitalised system), in order to reach a decision on the choice between two ways of improving the capitalised pension savings system.

Within the open coordination model (in which Croatia intends to actively participate upon accession to the EU) and in accordance with the Lisbon Strategy, preparations for future reporting on the condition and trends within the entire pension system will be conducted according to the established methodology, with the aim of modernising the pension system and achieving an adequate, available, financially sustainable, adjustable and efficient pension insurance system.

In regards to key priorities according to the amended Decision on Accession Partnership as of February 5, 2008, also including the re-introduction of the possibility for submitting the convalidation request, this priority measure was fulfilled. According to the Convalidation Act (OG 104/97), all individual acts and decisions reached or adopted by different bodies or legal entities with public authority, adopted or issued in regards to judicial or administrative cases in the territory of the Republic of Croatia, which were or still are under the protection or administration of the United Nations, may have been convalidated in accordance with the Constitution of the Republic of Croatia, the Constitutional Act on Human Rights and Freedoms and on Rights of Ethnic and National Communities or Minorities in the Republic of Croatia, and the laws of the Republic of Croatia. Based on this Act a Regulation was adopted prescribing the convalidation process, where a tentative one-year term was prescribed for submitting requests from the date the Regulation entered into force. With the aim of renewing the term for submitting requests, an Ordinance was adopted on the procedure of convalidating decision and individual acts from the field of pension insurance, which entered into force on May 17, 2008, enabling all interested parties fulfilling the conditions, to submit requests for convalidating decisions and individual acts in this term. The Croatian Pension Insurance Institute is in charge of the Ordinance application, which is monitored and supervised by the Ministry of the Economy, Labour and Entrepreneurship. With the abovementioned, the requirement from the EC 2007 Progress Report, Chapter 2 – Political Criteria, Subchapter 2.2 – Human Rights and Protection of Minorities, for enabling access to pension insurance rights to persons residing in the Croatian territory under UN protection in the nineties has been fulfilled as well.

Social Welfare

Social welfare in Croatia focuses on the prevention of poverty, social vulnerability and exclusion. This constitutes a social protection network with the aim of care for and inclusion of the socially most endangered or socially vulnerable population, and plays a significant role in the prevention of poverty and the mitigation of its effects.

According to measures of the Social Benefits Reform Strategy 2007 - 2008 amendments to the existing Social Welfare Act²⁶ were adopted in July 2007, simplifying the procedure of fulfilling rights, while a new regulation is planned in 2009 with the aim of raising the quality of the entire system. In order to increase the share of social benefits in GDP, the Government of the Republic of Croatia reached a Decision on the base rate for achieving the right pertaining to social welfare in March 2008, whereby this baseline was increased by 25%, i.e. from HRK 400 to HRK 500. The application of the decision in question begins on November 1, 2008.

The Registry of Social Benefits is being prepared as one of the measures of this Strategy, for which resources have been secured in the state budget, including all contributions relating to employment, health care, social welfare, family exemptions etc.

In regards to the Registry of Social Benefits, the introduction of a Personal Identification Number according to the Act on the Personal Identification Number²⁷, will enable simple, accurate and fast records regarding the beneficiary of the social welfare rights, facilitate the availability of necessary data for persons for whom prescribed conditions for achieving these rights are established, determine income and property (income and property census), facilitate monitoring and verification in case of modified circumstances, a better control of payments in this respect will be enabled, while the overlapping of rights will not be possible – like obtaining rights based on eligibility in two categories from different social benefit systems.

Along with the introduction of a Personal Identification Number, further development of the integrated information system is anticipated, encompassing the identification of all state and local social benefits and electronic data exchange with a high quality control and verification system, as well as authorisation for the data exchange and usage.

With the aim of improving the social services organisation, further activities are planned in regards to decentralisation, deinstitutionalisation, computerisation and improving the social services quality, which is continually conducted through reforms established by the Social SWDP²⁸ in cooperation with the World Bank.

Within the IPA component IV - Operational Programme for the Human Resources Development, last year's project proposal "Creation of a Support Network in the Social Integration and Employment of Vulnerable and Marginalised Groups" was expanded and amended in the project proposal "Establishing Support in Social Integration and Employment of Disadvantaged and Marginalised Groups". The goal of the project is support for long-term unemployed recipients of permanent help when accessing the labour market, based on their specific needs. The expected results encompass a strengthened inter-departmental and inter-institutional partnership and an improved quality of service in social welfare centres, to be achieved through two components. Within the first component the analysis of existing practices and services in the field of social inclusion and employment with recommendations for improvement will be conducted, along with forming working groups (consisting of all relevant stakeholders) and implementing consultations in order to improve cooperation, finding new ways of communication and work, which would result in the Procedure Protocol. Within the second component, education of experts from the social welfare centres will take

²⁶ Act on Amendments to the Social Welfare Act (OG 44/07)

²⁷ Act on the Personal Identification Number (OG, No. 60/08)

²⁸ SWDP - Social Welfare Development Project

place, in order to provide a better quality of service described in Article 77.i of the Social Welfare Act "Advising and assistance in surmounting special difficulties", including assistance in looking for employment. Following their education these experts would become "mentors for social inclusion" which would, in addition to assistance in looking for employment, continue to provide psycho-social support even after the persons in question find work.

Within the EU Accession Partnership for the Republic of Croatia, one of the two significant cooperation activities in the field of employment and social inclusion is also the preparation of a Joint Memorandum on Social Inclusion (JIM)²⁹. In accordance with the identified main problems in JIM, the National Implementation Plan for Social Inclusion was prepared (2007 – 2008) with the aim of expanding the social services network, developing the extra-institutional services system and improving the social services access to children, the elderly and persons with disability. Based on JIM documents and the National Implementation Plan, the Report on the Implementation of the Joint Memorandum on Social Inclusion of the Republic of Croatia 2007-2008 was prepared, adopted by the Government of the Republic of Croatia and submitted to the European Commission in July 2008. All parties implementing or co-implementing the measures stipulated by the National Implementation Plan have the obligation to undertake further activities for the implementation of measures and its monitoring.

The implementation of systematic protection of rights and interests of children and vulnerable groups is ongoing, through the application of the national plans, programmes, strategies and policies adopted. In the course of 2009 the preparation and adoption of the following documents is planned: the National Strategy for the Protection of Children from Abuse and Neglect, Protocol on the Procedure Regarding Serious Neglect of a Parent, Adoptive Parent, Guardian or Another Person pertaining to the responsibility to provide for or care for a child and the National Plan Against the Sexual Abuse of Children. The Convention on Child Protection and Cooperation Regarding International Adoption (Hague Convention from 1993) is also in the preparatory stage.

Protection of Motherhood and Family Allowance

The protection of motherhood and a system of family aid plays primarily a procreation role, as well as an increase in the quality of life for families with children. This system, as part of the general social policy represents a component of public policy focused on children, young people and families.

In the motherhood protection system, based on amendments to the Mandatory Health Insurance Act dated January 1, 2008, all employed mothers have the right to salary compensation in the full amount until the child is six months old when using their right to compulsory maternity leave. Moreover, the Act on the Execution of the State Budget of the Republic of Croatia for 2008 prescribes the right to the minimum financial compensation during maternity leave in the amount of HRK 1,663, while one-off financial aid for the birth of a child, established at HRK 2,328 in 2007, was re-established in 2008 in the same amount. During 2008 the Act on Maternity and Parental Benefits was adopted, entering into force on January 1, 2009. This Act has been harmonised with the National Population Policy³⁰ from 2006, as well as with adequate EU regulations and directives.³¹ With the adoption of this Act,

²⁹ JIM – Joint Memorandum on Social Inclusion of the Republic of Croatia – (signed on 5 March 2007) between the Government of the Republic of Croatia and the European Union

³⁰ Official Gazette 132/06

³¹ Regulation (EEC) No 1408/71 of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community, Regulation (EEC) No 574/72 of the Council of 21 March 1972 fixing the procedure for implementing Regulation (EEC) No 1408/71 on the application of

a more balanced presence of both parents (gender equality) on the labour market has been achieved, the procreation policy is stimulated, whereby the woman and man in the role of a mother and father, are stimulated to procreate with the adequate adjustment to requirements of family life and work, particularly pregnant women and new mothers, in order to facilitate their continual presence in the labour market, the involvement of fathers in family life, responsible parenthood and welfare of children as well as the economic independence of women. Once this Act enters into force, it will open possibilities for full equality of women and men in the care and provision for their children, maternity leave and parental leave will be flexible and it will enable the usage of parental leave until the child has turned 8 years old.

Starting with January 1, 2007, according to the National Population Policy, amended provisions of the Act on Child Support³² are applied, based on which the amount of the average monthly income by family member has increased in regards to obtaining the right to support, from HRK 1,330 to HRK 1,663, another income level was introduced for determining the amount of support for children and the minimum amount of child support was increased from HRK 166 to HRK 199. Moreover, the right to procreation allowance was also introduced for the 3rd and 4th child, for all child support users, if receiving support for three or more children. Based on these legal provisions, in addition to the procreation goal, a better social goal of the child support would be achieved, and the child support would encompass a larger group of children exposed to unfavourable social conditions.

During 2007 and 2008, 17 county family centres were founded. The purpose of founding new family centres is the raising of family services, particularly those services focused on preventing the development of unwanted relations within families, and for providing advisory support when planning a family, care and provision for children and in work with young people. These activities of family centres take place in close cooperation with the competent authorities of the local and regional self-governments.

In the field of protecting the rights and interests of a child, provisions of the Family Act³³ were amended, based on which the legal and institutional protection of children without parental care has been strengthened as of January 1, 2008. Authorities of the social welfare centres were expanded in procedures involving the protection of child rights, with the obligation of initiating legal proceedings against irresponsible parents, and temporary financial support was introduced.

Student Status Improvement

With the aim of improving student status and the availability of higher education to a larger group of students, the Ministry of Science, Education and Sports (MSES) will undertake certain measures and will allocate the following subsidies to full-time students at higher education institutions in the Republic of Croatia:

1. Scholarships for full-time students of the higher education institutions in the Republic of Croatia (universities, vocational studies and post-graduate studies). Based on a public tender for allocating state scholarships, 2,500 new scholarships are approved each year, granted in

social security schemes to employed persons and their families moving within the Community, Council Directive 96/34/EC of 3 June 1996 on the framework agreement on parental leave concluded by UNICEF, CEEP and the ETUC, Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding (tenth individual Directive within the meaning of Article 16 (1) of Directive 89/391/EEC) and Council Directive 86/613/EEC of 11 December 1986 on the application of the principle of equal treatment between men and women engaged in an activity, including agriculture, in a self-employed capacity, and on the protection of self-employed women during pregnancy and motherhood

³² Official Gazette 138/06

³³ Official Gazette 116/03, 17/04, 136/04 and 107/07

several categories (for particularly talented students, for students enrolled in unpopular studies, for students with insufficient financial resources, for students with disability, for students residing in social welfare facilities or in foster families...). Currently some 9,000 full-time students are encompassed by the state scholarship system receiving the amount of HRK 500 (for students studying in the place of residence and living with their parents), HRK 700 (for students studying outside of their place of residence who live in student dorms) and HRK 800 (for students studying outside of their place of residence and are subtenants). In 2009 the Ministry intends to grant 2,500 new scholarships.

2. Transport for full-time students. MSES had co-financed the transport of full-time students in the cities of Osijek, Rijeka and Split during 2008. Students with disabilities have the right to subsidised transport in the amount of HRK 500 a month. In 2009 MSES intends to continue co-financing transport costs for full-time students and students with disabilities.

3. Subsidies for lodging and food. MSES is subsidising the costs of lodging in dorms for university and high school students for about 12,000 full-time students in the Republic of Croatia, and allocates monthly subsidies for about 8,000 students residing in private premises. Students obtain the right for a subsidy for lodging by participating in a public tender for obtaining student lodging in student dorms, and by participating in the public tender for obtaining a private lodging subsidy. Both tenders are organised by the competent student centre. The monthly amount of subsidy for lodging in a university or high school dorm amounts to HRK 105 for an individual student, while the monthly subsidy for private lodging amounts to HRK 147. The right to meals is provided to all full-time students in Croatia, and may be used by obtaining the student identification card X, which indicates the monthly financial balance for meals for each student. The amount of the monthly financial balance for meals of an individual student depends on the student's residence and the number of days per month. If the student resides in a county in which the higher education institution attended is located (in-county students), the monthly financial balance for meals is about HRK 300; if the student resides outside of the county in which the higher education institution attended is located (out-of-county students), the amount of financial balance for meals is about HRK 700; if the student resides in a student dorm, the amount of financial balance for meals is about HRK 930. Students who obtain the right to subsidised student meals may use it in student centre restaurants and in a significant number of private restaurants encompassed by the subsidised student meal system. In 2009, MSES will continue allocating subsidies for lodging and meals to full-time students in the Republic of Croatia.

4.4 AGRICULTURAL SECTOR

The primary objectives of the agricultural policy are focused on the improvement of competitiveness of the sector and adjustment to the future EU membership. Therefore, the Government of the Republic of Croatia has continued with the implementation of agricultural policy measures aimed at changing the structure of agricultural farms, ensuring a smooth operation of the market and effective public services.

Land Market

Management of the state-owned agricultural land has continued to be performed in accordance with the Agricultural Land Act and a subordinate application of general bylaws regulating real-estate transactions. The types of management through public tender include: lease, sale and concession. The state-owned land management programmes envisage a total sale of 224,054 ha of agricultural land, of which 43,342 ha or 19% of the total plan under the programmes has been sold so far. In 2008, 4,839 ha of state-owned land were sold, or 11% of

the total land sold through public tenders. From the beginning of the implementation of state-owned agricultural land management programmes to the end of 2008, 63,509 ha were sold.

The programmes envisage 123,568 ha for lease, out of which 63,798 ha or 52% of the total plan under the programmes has been leased. In 2008, a total of 5,450 ha of state-owned land were leased or 9% of the total land leased through public tenders.

The programmes envisage 125,144 ha of state-owned agricultural land to be granted for concession. So far, a total of 54,356 ha, or 43% of the plan under the management programmes has been granted for concession. In 2008 7,670 ha of state-owned agricultural land were given for concession through public tenders which accounts for 14% of the total land given for concession through public tenders. Since the beginning of the implementation of state-owned agricultural land management programmes 58,831 ha have been granted for concession.

In 2008 revenues from sale and lease (state, county and local budgets) totalled HRK 142.7 million (52.5 million from sale and 90.2 million from lease), while data on concession revenue obtained so far suggest that concession revenue totalled HRK 18.7 million.

One of important priorities in changing the structure of agricultural farms is the consolidation of agricultural land areas. In this respect, the implementation of the project “Consolidation of Agricultural Land in Croatia” continues.

In 2008 the new Agricultural Land Act was adopted. It regulates consolidation of agricultural land for the purpose of improving the structure of agricultural farms and enables continuation of eliminating the remaining obstacles to the efficient agricultural land market.

Privatisation of State-Owned Companies

The privatisation of remaining companies engaged in agricultural and food-processing industry continued in 2008. The privatisation of the company KIM d.d., Karlovac was successfully completed by the sale of an additional package of shares (67%) to a dairy DUKAT d.d., Zagreb. Following a public tender for the sale of shares of Sladorana d.d., Županja, in September 2008, the Management Board of the Croatian Privatisation Fund decided to sell 38.1% of Sladorana shares to the sugar company, Viro d.d, Virovitica. The privatisation of a large agricultural and food-processing company in majority state ownership, VUPIK d.d., Vukovar, has not yet been completed and is planned to be finalised in 2009.

Regulation of the Agricultural and Food Products Market

Activities on the harmonisation of market mechanisms for particular agricultural products with the market organisation in the EU have continued. The most sensitive product in this segment is wheat and the application of the EU model elements continued in 2008, paired with the introduction of the mechanism of import-export permits. The state guarantees an intervention price of 101.3 euro/ton, which is the European intervention price for all cereals. In 2008, the state did not participate in the purchase so trading was completely determined by the market.

For the purpose of regulating the fruit and vegetable market, in 2008 a public tender was launched for construction and equipping of warehouse capacities, aiming at improving insufficient capacity for fruit and vegetable storage. The adoption of regulations is underway, which will transpose all EU quality standards for fruit and vegetable into the Croatian legislation, with their application starting in 2009. The Fruit Quality Ordinance (OG 114/08 and 137/08) and the Vegetable Quality Ordinance (OG 114/08 and 137/08) were published in

mid-October and entered into force on the eight day of their publication in the Official Gazette.

Work is ongoing on the creation of market order for fruit and vegetable which would regulate trading in fruit and vegetable and establishing companies for their production. Activities concerning the creation of the vineyard cadastre, development of the digital database and gradual performance of field activities aimed at verification and collection of other vineyard data will continue in 2009.

In the cattle production area, activities aimed at harmonising market mechanisms and establishing market orders have continued, with an aim of combating grey market and increasing food safety. Except for bovine animals, a single system of compulsory animal identification was established for swine and in 2009 work will start on the system of compulsory identification of sheep and goats. The classification mechanism for bovine and swine carcasses on the slaughter-line has been completely established. In 2009 it is planned to create a legal framework for classification of sheep and goat carcasses on the slaughter-line as well as for establishment of standards regarding the slaughter and poultry meat cutting. The implementation of a beef tracking system is planned, which would enable us to monitor products from farms to tables. A regulation on the introduction of bee grazing cadastre was adopted.

State Aid in Agriculture

The bulk of the state aid to agriculture is administered pursuant to the Act on State Aid to Agriculture and Fisheries. In 2008, about HRK 2.5 billion from the state budget was earmarked for aid covered by this Act, which is an increase of around 8% compared to 2007. The largest portion of the funds (74%) is still intended for direct support to manufacturing, but that share has been gradually decreasing in favour of rural development measures (26%). The share of investment aids and aids to rural development increased to some 21%, while the share of income support to non-commercial farmers accounted for some 5%. The adoption of a new Act on State Aid to Agriculture is planned, which would, among other things, implement gradual adjustments in the aid allocation system directed at aggregating and levelling aids for individual groups of agricultural products, aiming at gradual transfer to a system of single payment for each farm.

The objective of agricultural policy continues to be the improvement of the level of competitiveness and adjustment to the developed EU market of agricultural products and foodstuffs. This is to be achieved by increasing the overall amount of funds earmarked for aid to the sector, especially by increasing funds for structural aids. The total budget for market-pricing policy measures under the first pillar is to be increased moderately, while aids relating to measures for rural development under the second pillar are expected to increase by a more sizeable amount.

Rural Development

The national measures for rural development have so far been primarily aimed at education of the rural population, support to agricultural schools, establishment and development of agricultural co-operatives and vocational associations, improvement of trading in agricultural products, development of rural tourism and co-financing of infrastructure connections for agricultural farms. In 2008, HRK 724.75 million from the state budget were earmarked for the implementation of these measures.

The national measures for rural development in 2009 will be directed to the greatest extent at supporting investments in agricultural farms, Operational Programmes of the Government of

the Republic of Croatia, development of the rural area, education of rural population, support to agricultural schools, establishment and development of agricultural co-operatives and vocational associations, promotion and marketing of agricultural products and development of rural tourism. In 2009, HRK 856.1 million from the state budget will be earmarked for the implementation of these measures.

Within the framework of EU pre-accession assistance for development of rural areas, activities relating to the implementation of the SAPRAD programme have continued. Three tenders have been invited so far and 120 applications received, of which 29 have been approved and contracted in the two rounds of tenders, with a total of HRK 87 million of approved aid, which accounts for 35.76%.

In the third round of tenders, 23 applications were received, of which 6 were rejected due to incomplete documentation/untimely arrival, 10 applications were denied or the applicants withdrew, while the remaining 7 applications were contracted with the amount of aid totalling HRK 24.4 million. The overall amount was financed entirely by the Republic of Croatia and the EU in the 25% (CRO) to 75% (EU) ratio. Following three rounds of tenders, of the HRK 243.3 million available, HRK 111.4 million or 45.79% were allocated, while HRK 131.9 million remain available.

The IPARD plan, prepared under the Instrument of Pre-Accession Assistance and containing the proposed measures, was adopted on February 25, 2008, while the accreditation of structures for the preparation and implementation of the IPARD is underway. After having received a positive opinion by the European Commission the next step is to transfer responsibilities and invite tenders for measures which will be accredited.

Phytosanitary Area

The general objective is to continue improving the quality of monitoring organisms harmful to plants and complete the implementation of the plant passport system and the implementation of the new system of registration of plant protection products, as well as to attain the quality comparable to the quality level in EU Member States. For these objectives to be achieved, an increase in the number of employees in the plant protection office is planned and their professional training.

Significant progress has been achieved in the alignment of regulations and their implementation. All regulations governing the area of plant protection products and monitoring pesticide residues in food have been aligned with the *acquis communautaire*, and the registration of plant protection products is carried out in accordance with EU standards. The registration of plant producers, importers and distributors in the phytosanitary registry continues, and competent authorities began issuing plant passports in the second half of 2008.

In the area of quality of seed and propagating material, the Act on Seeds, Planting Material and Registration of Varieties of Agricultural Plants has been in force since 1 January 2008 together with 16 ordinances regulating trading in seeds and propagating material, which makes this area fully aligned with EU legislation.

Furthermore, the Plant Variety Protection Act was amended in 2008, thus making the legislation of the Republic of Croatia fully aligned with the International Convention for the Protection of New Varieties of Plants (UPOV) and EU regulations which regulate the area of plant variety protection and enrichment rights.

Food Safety and Quality

Further to the adoption of the Food Act (OG 46/07) by which the Republic of Croatia transposed all the principles contained in the Regulation (EC) No. 178/2002, the Ministry of Agriculture, Fisheries and Rural Development (the Ministry) was designated the competent authority for safety and hygiene of foodstuffs and feed and for organisation of official controls and it represents the contact point with the European Commission.

Pursuant to provisions of the Food Act the Ministry started activities on the creation of a national plan of official controls, procedures for official controls, the guide for microbiological criteria and the legislation for authorisation of laboratories, legislation related to authorisation of laboratories for foodstuffs, feed and animal health, and legislation related to providing information within the Rapid Alert System for Food and Feed. Activities on co-financing of accreditation of laboratories will continue as well. Further obligations within their competence envisage the establishment of the Rapid Alert System for Food and Feed (RASFF) and the creation of a communications strategy.

The harmonisation with the relevant vertical EU regulations which lay down quality requirements, facilitate market liberalisation and ensure free movement of goods continued in 2008. Amendments were made to regulations governing the system of agricultural product and foodstuff identification system with geographical indications, designations of origin and traditional speciality logos, aiming at their alignment with new EU regulations of 2006.

The Act on Designations of Origin, Geographical Indications and the Traditional Speciality Logo for Agricultural Products and Foodstuffs (OG 84/08) was adopted and harmonisation of subordinate legislation is underway. The said Act lays down the responsibilities of the existing agricultural inspection and quality inspection in the segment of implementing laws and subordinate legislation which regulate the area of registration and protection of agricultural products and foodstuffs with one of the labels.

In the period 2008-2013, for the purpose of structural reforms in the food-processing industry, aid to the sector is planned under the pre-accession programmes SAPARD and IPARD. In 2009, a Strategy for Development of the Food-Processing Industry is to be created as well as the National Operative Programme which would contain horizontal measures of support to food-processing industry aimed at improving competitiveness of the food-processing industry and creating sustainable jobs.

Veterinary Area

During 2008, the process of legislative alignment in the veterinary area continued in accordance with the "Strategy for Transfer, Adoption and Implementation of the *Acquis Communautaire* for Chapter 12: Food Safety, Veterinary and Phytosanitary Policy". The said Strategy was created for the purpose of fulfilling the second benchmark for opening of negotiations on Chapter 12. The "Action Plan for Control and Eradication of Classical Swine Fever in Domestic and Wild Pigs" was also created to meet the same benchmark.

In order for the animal database to become fully operational, a system for identification and registration of pigs has been created. All the necessary measures were undertaken for the bovine database to become fully operational (Single Bovine Registry).

The classification of facilities having to do with food production, based on the *acquis communautaire*, was completed in April 2008. Teams of county and state veterinary inspectors of the Ministry completed the classification of 960 facilities having to do with food production of animal origin as well as the classification of 40 facilities dealing with animal by-products. The said classification will serve as the basis for the future National Programme for Improvement of Facilities.

Pursuant to Article 145 of the Veterinary Act, the Veterinary Directorate is obligated to establish the Central Veterinary Information System. Staff recruitment process is underway. The information system would encompass the system of registries and computer programmes, aimed at animal health and welfare protection and implementation of measures of veterinary public health.

Fisheries

Since March 2008, the new organisational scheme of the Fisheries Directorate includes three divisions: Division for Fisheries Resources and Fleet Management, Division for Structural and Market Measures and Fisheries Inspection Division. The administrative strengthening of the Fisheries Directorate is to be continued by increasing the number of employees pursuant to the adopted recruitment plan for the period until 2010. An important role in the strengthening of the institutional capacity of the administrative unit for support to the fisheries sector has been given to the project within the PHARE 2005 programme, which is in the implementation phase.

In accordance with the provisions of the Commission Regulation 2244/2003, the Fisheries Monitoring Centre (FMC) was established in 2008 as the central unit for monitoring fishing vessels. It will monitor fishing vessels and collect information on the fishing fleet, fishing efforts and catch, as well as data on fish prices and other economic indicators. Further repurchasing of fishing licenses is underway.

Aiming at ensuring better operation and efficiency of the fisheries inspection, the funds under the pre-accession programme PHARE 2005 were used for the procurement of adequate IT equipment (laptops and palmtops), while the project of procurement of three patrol vessels for the fisheries inspection is underway. The vessels are to be delivered in late 2008.

A new Act on State Aid in Fisheries is underway. Its draft proposal will be completed by the end of the third quarter 2009. Substantial funds from the state budget have also been allocated for incentives to fishermen to form associations. They are awarded through public tenders. For further development of fisheries infrastructure, the Republic of Croatia also draws on EU pre-accession assistance funds. Thus, a contract was signed within the framework of the PHARE 2005 programme on the establishment of a fishing pier in Umag, where construction works are expected to be completed in January 2009. The overall budget of the PHARE 2005 programme is EUR 5.1 million. The project under the name "Strengthening Market Infrastructure in the Fisheries Sector of the Republic of Croatia" was proposed within the scope of the first component of the IPA in the fiscal period covering year 2008. Structural support to the fisheries sector was introduced as a separate item in the state budget. Croatia plans to adopt a Strategic Plan envisaged by the Council Regulation 1198/2006 on the European Fisheries Fund by the end of the current year. Croatia also intends to create its Operational Programme in 2009 in order for it to be fully prepared for channelling funds from the EFF.

In the period 2009 - 2011, started activities are to be continued, primarily in the area of institutional strengthening, by increasing the number of employees pursuant to the adopted recruitment plan for the period until 2010, and in the area of introducing appropriate mechanisms of structural and market measures in the fisheries sector. The necessary laws and subordinate legislation will be integrated in the national legislation by the end of 2009. The review of fishing licenses and a fleet census are also to be completed by the end of 2009, as well as the equipping of vessels in the 15-18 m category with VMS technology electronic devices for transmitting data on the position of the vessel and electronic logs.

4.5 ADMINISTRATIVE REFORM

In 2008, the Government of the Republic of Croatia adopted a State Administration Reform Strategy 2008-2011, thus establishing an integral strategic framework for public administration reform. A draft proposal of the Act on the Salaries of Civil Servants was drawn up and analysed by SIGMA. At its session on December 19, 2008, the Government of the Republic of Croatia adopted the final proposal of the Act on the Salaries of Civil Servants, which was sent for adoption to the Croatian Parliament. Aiming at improving supervision over the state administration a new Administrative Inspection Act was adopted, ensuring a higher degree of independence and responsibility of the Administrative Inspector in carrying out the supervision and providing the mechanisms for imposition of measures ordered by the Administrative Inspector.

Aiming at simplifying administrative procedures and making it easier for Croatian citizens to exercise their rights, the Draft Proposal of the Act on General Administrative Procedure was sent to the Croatian Parliament for adoption. The proposal was adopted at the first reading in the Parliament, at its session held on October 24, 2008, and the creation of the final proposal is underway. With the aim of modernisation of office transactions at state administration bodies as well as strengthening of electronic administration to support the overall development of the economy, in January 2009 the Government of the Republic of Croatia adopted the new Regulation on Office Transactions.

The project of functional analysis and support in the reconstruction of state administration bodies and their subordinate agencies in the Republic of Croatia is completed. The project, launched on December 1, 2007, was based on the Agreement that was concluded by the Republic of Croatia and the International Bank for Reconstruction and Development on the Swedish International Development Cooperation Agency's Grant and was carried out by the Institute for International Relations, selected through an international public tender. The project encompassed ten central state administration bodies and five state administration offices in counties. The restructuring of state administration bodies in accordance with the functional analysis results is planned for 2009.

The National Strategy for Training of Civil Servants and Officials at Local and Regional Self-Government Units 2009-2013 was adopted. This Strategy, together with the Decentralisation Strategy, was created within the framework of the CARDS 2003 programme "Capacity Strengthening for Administrative Decentralisation" and was presented at the closing conference on performance under the CARDS 2003 project, held in May 2008.

The project "Assessment of the System of Salaries and Remuneration in Local and Regional Self-Government Units and Recommendations for Reform of the System" was completed in 2008. The results of the project will serve as the starting point for the regulation of the system of salaries of local civil servants and civil service employees.

The Act on Civil Servants and Civil Service Employees in Local and Regional Self-Government, which regulates the rights, obligations and responsibilities of employees in administrative bodies of local and regional self-government, was adopted as well.

Continued professional improvement and training of civil servants was provided by the Civil Servants Training Centre, with a total of 680 training activities being provided in 2008 that were attended by some 7,200 civil servants. In addition, on-going training of local and regional government servants was provided by the Local Democracy Academy.

In the process of further reform of state administration, special attention will be given to creation of more efficient development of human resources in state administration, to ensuring consistency in remuneration and promotion, improving supervision of the performance of state administration bodies and further training of civil servants, aiming at

raising the quality of public services. Special attention will also be given to the use of the modern information and communication technology.

In 2008, the Central Government Office for e-Croatia created and submitted to the Government of the Republic of Croatia for adoption a proposal for e-Government Development Strategy 2009-2012 with the associated plan of activities in 2009. The foundations for e-Government of the Republic of Croatia were set in the programme e-Croatia, created in 2003 with the aim of establishing a system which would enable Croatian citizens to communicate with public administration bodies and use their services via Internet. The implementation of the e-Government Strategy will additionally strengthen the use of information and communication technology in the operation of state administration and its communication with Croatian citizens and the economy. This will also set the framework and objectives for new and existing activities of e-Government, laying stress on the satisfaction of its users, rationalisation of administrative procedures and provision of modern electronic services.

In addition to all this, within the framework of further implementation of the programme e-Croatia, activities will continue on the strengthening of information technology capacities in other areas as well. Full support will thus be provided to the implementation of already adopted strategic documents of the Government of the Republic of Croatia (the Strategy for Development of Electronic Business in the Republic of Croatia 2007-2010, the Broadband Development Strategy in the Republic of Croatia by the year 2008 and the Strategy on Transition from Analogue to Digital Television Broadcasting in the Republic of Croatia and the National Anti-Corruption Strategy).

For the purpose of meeting the above stated objectives, the following measures are to be taken:

- implementation of the Administrative Inspection Act and performance of thorough inspection of all state administration bodies;
- adopting a Strategy for Development of Human Resources in State Administration;
- providing training in relation to the new General Administrative Procedure Act;
- providing training for the implementation of regulations on civil service relations in state administration;
- adopting a Regulation on Job Classification and Salaries of Civil Service Employees;
- implementing activities envisaged in the Implementation Plan of the e-Government Development Strategy for 2009;
- creation of a semi-annual and annual report on the implementation of the e-Government Development Strategy in 2009.

Simplification of administrative procedures, modernisation of office transactions, strengthening of the role of e-Government, restructuring of state administration bodies based on the results of the functional analysis and strengthening of competencies, knowledge and motivation of civil servants in providing administrative services through ongoing training and establishment of an efficient human resources development system, paired with improved supervision of the performance of state administration bodies and improved quality of administrative services will directly contribute to a rise in the efficiency of the public sector, to the reduction of operating costs and to the stability of the business environment, as well as to the increase in the efficiency and further development of the private sector and economy as a whole.

4.6 ADDITIONAL REFORM AREAS

4.6.1 Development of a Knowledge-Based Society

During the past period, the implementation of the Education System Development Plan 2005-2010 and Scientific and Technological Policy of the Republic of Croatia 2006-2010 continued and systematic efforts were invested in the improvement of the quality of education, science and research based on the principles of comparability with the objectives of the Lisbon Declaration and in accordance with the objectives set under the Strategic Development Framework 2006-2013.

The adoption of pedagogical standards of preschool, primary and secondary education and the adoption of the Primary and Secondary Education Act laid down the foundations for improvement of the quality of education and for harmonising activities at kindergartens and schools. The creation of the National Curriculum for Preschool Education, General Compulsory and Secondary School Education is underway.

In the school year 2007/2008, 51 new kindergartens were opened and 55% of children in Croatia received preschool education. Primary school education in the school year 2007/2008 was provided at 872 primary schools, which were attended by 380.942 students. Plans for the upcoming period include pre-testing of fourth and eight grade students, as well as national exams. In addition, the instruments for PIRLS (*Progress in International Reading Literacy Study*) testing are planned to be developed in the school year 2008/2009, aiming at making the results of Croatian students comparable with those of their European peers.

Continued implementation of the National Programme of Measures for the Introduction of Compulsory Secondary Education resulted in the 2.5% rise in the number of enrolled students compared with previous period, primarily due to provided incentives such as free textbooks, free transportation and free accommodation in student homes. Preparations for the state school-leaving exams were intensified but its implementation was postponed to the school year 2009/2010. Students will continue to sit for national exams. In 2009, Croatia will participate in the PISA examination of knowledge and skills of its students. Systematic efforts are invested in the modernisation of programmes of vocational schools and implementation of other activities under the adopted Development Strategy of Vocational Secondary Education. Preparations for the creation of the Croatian Qualification Framework are underway in line with the adopted Action Plan 2008-2012. The integrated system for standardised data set management (e-Matica) and the system of data collection, monitoring and analysis (VETIS) have been additionally improved and will continue to be systematically improved.

The Bologna process has been systematically implemented. Two public and four private higher education institutions were established. The University Campus Borongaj opened its doors to 6,000 students from three faculties of the University of Zagreb, with more than 20 faculties, institutes and agencies planned to be relocated to Borongaj in the next few years. The new Act on Universities will clearly regulate the obligations of higher education institutions relating to organisation and implementation of study programmes. The new Act envisages better cooperation between higher education institutions and the labour market. Integration of the university will continue, study programmes will be re-evaluated and external evaluation of higher education institutions will be organised, and student and teacher mobility will be improved.

The Action Plan for Promoting Investments in Science and Research that was adopted by the Government of the Republic of Croatia in April 2008 envisages defined measures for development and reform of the science system. A system of state aid to research and development at companies was launched and the procedure for inclusion of foreign citizens in scientific projects was made less complicated. Centres for technology transfer were

established at several universities and establishment of new centres is planned in 2009. A system of incentives for applications and projects within the EU Seventh Framework Programme was established. Establishment of biotechnology incubators (BioCenter) and the launching of the Science and Innovation Investment Fund, which will finance technology transfers, are being prepared under the IPA programme. A reform of the entire system for financing scientific projects is being prepared through the National Foundation for Science, Higher Education and Technological Development of the Republic of Croatia. In 2009, improvements are planned in the system relating to research assistants and scientific infrastructure.

In relation to adult education, a Week of Life-Long Learning was organised in October 2008, aiming at raising public awareness as regards the need for life-long learning and education. Financing of adult education for different jobs continued, aiming at promoting employment and self-employment. Activities of institutions that provide adult education are planned to be aligned with the obligations arising under the Adult Education Act in the course of 2009. A database on adult education in the Republic of Croatia is also planned to become fully operational by the end of 2009.

4.6.2 Health Care Reform

The package of reform measures for the health care system builds on the direction of the reform of the preceding years. According to the Health Care Development Strategy, the following reform measures are aimed at:

- continued financial stabilisation of the system,
- introducing new sources of financing,
- strengthening of the system of supervision of health care system expenditures.

One of the first measures of the financial system stabilisation began with the stabilisation of financing of hospitals. Hospital system accounts for approximately 50% of the budget of the Croatian Health Insurance Institute. On March 31, 2008 hospital arrears due to its suppliers amounted to HRK 2.26 billion and on November 30 they amounted to HRK 1.76 billion, which shows a decrease by HRK 500 million. An annual increase of the hospital budget did not only influence the balancing of operation but it also lead to the decrease of arrears and the same trend is expected to continue in 2009.

On January 1, 2009 the system of financing primary health care saw an introduction of the fixed and variable capitation system. The fixed part of the capitation covers the costs of regular operation, whereas the variable part introduces a possibility to cover costs for services performed on the primary level, instead of referring patients to other health institutions at the secondary level. In addition, execution of contracts with the Croatian Health Insurance Institute has been stimulated, as well as the implementation of prevention programmes through contracts concluded with the community health centres and the additional means collected on the basis of a group practice. These measures do not only represent measures of supervision over finances. In fact, they can be seen as incentive measures aiming at keeping patients at the primary level in accordance with medical indications and reducing unnecessary utilisation of hospital facilities, the result of which is a decrease in prices within the system by the difference amount between the prices of hospital services and the prices of services provided at the primary health care level.

In addition, for the insured person who is beneficiary of the pension the amount of which does not exceed the amount of an average monthly net salary, health insurance contribution is calculated at the rate of 1%, whereas contributions are provided from the state budget.

For the insured person whose pension exceeds the amount of an average monthly net salary, health insurance contribution is calculated at the rate of 3%, whereas the party liable to pay the contribution is the insured, and the Croatian Health Insurance Institute is the party responsible for calculation and pension contribution payment.

For persons insured on the basis of unemployment, health insurance contribution is calculated at the rate of 5% and these contributions are provided by the state budget.

A new source of financing in 2009 is the revenue obtained from the premiums of the civil liability in respect of the use of motor vehicles.

An additional source of financing in 2009 is the collection of co-payments in the primary health care as well as while obtaining prescription drugs at the pharmacies, which is in accordance with the provisions of the new Health Insurance Act, which stipulates the mandatory participation of the persons insured with the Croatian Health Insurance Institute in primary health care costs.

A growing number of insured persons who will sign a supplemental health insurance policy is expected, since the new Health Insurance Act stipulates mandatory participation of the persons insured with the Croatian Health Insurance Institute in health care costs, whereas a part of the insured persons will be able to exercise their right to supplemental health insurance from the state budget funds.

4.6.3 Judicial Reform

The revised Action Plan associated with the Judicial System Reform Strategy, which was adopted by the Government of the Republic of Croatia at its session on June 25, 2008, is an instrument that provides additional momentum to the process of judicial system reform and resolution of the main issues burdening the judicial system of the Republic of Croatia.

Land Registry Reform

Land registry reform, which is carried out within the Project of Establishing Order in the Land Registry and Cadastre, is in its final phase, with the deadline for its completion being extended to December 15, 2009. The average time needed for entry of ownership rights in the land registry reached 73 days, or 6 days for mortgages, which made real estate transactions in the Republic of Croatia easier. It is possible to access land registry and cadastral data over the Internet, which makes it easier for citizens and entrepreneurs to access information. The Act on Amendments to the Act on the Land Registry was adopted on October 3, 2007.

Modernisation and More Efficient Operation of Courts

Aiming at reducing the duration of court proceedings, the Republic of Croatia set out to amend a number of its procedural laws. The Act on Amendments to the Execution Act (OG 67/08) was adopted in May 2008, while the Act on Amendments to the Enforcement Act (OG 84/08) was adopted in July 2008. In May 2008, the Municipal Court in Karlovac and Commercial Courts in Varaždin, Osijek, Bjelovar, Rijeka and Pazin started practicing mediation proceedings.

Informatisation of the Judiciary

By the end of 2008 the Integrated Court Case Management System (ICMS) was introduced at 9 courts. The State Attorney's Office of the Republic of Croatia launched the project of the Case Tracking System (CTS) which represents the first phase and lays down the foundations for the ICMS of the State Attorney's Office. The system will be built on the same foundations, information platforms and tools as the ICMS and will later be functionally integrated with the ICMS. It is expected to be tested at the beginning of 2009. The court registry is prepared for on-line registration of companies. In addition to the commercial court, the registration process can now be carried out at HITRO.HR offices at FINA or at offices of public notaries. At this moment, the registration process also lies within the competence of the Commercial Court in Varaždin, Osijek, Zadar and Split, and by the end of 2009, the same service will be possible at all commercial courts.

Rationalisation of the Courts Network

The Act on Jurisdiction and Seats of Courts, which was adopted in July 2008, reduced the number of municipal courts from the previous 108 to 67 municipal courts. The rationalisation of the courts network will proceed in several phases. The rationalisation of the network of misdemeanour courts will be carried out in the second phase. The network of municipal State Attorney's Offices will also be rationalised pursuant to the key used in the rationalisation of the network of municipal courts. The Act on Jurisdiction and Seats of State Attorney's Offices was adopted to that effect in December 2008. A Department for Rationalisation of Court Network and State Attorney's Offices was established within the Division for Justice Administration (which is part of the Directorate for Organisation and Human Resources of the Ministry of Justice). Its responsibility will include all tasks relating to the rationalisation of the network of courts and the network of State Attorney's Offices.

Penal Legislation Reform and Implementation of the Anti-Corruption Strategy

The new Anti-Corruption Strategy was adopted by the Croatian Parliament on June 19, 2008. Aiming at ensuring its effective implementation, the Government of the Republic of Croatia adopted the Action Plan of the Anti-Corruption Strategy on June 25, 2008, which lays down in detail all anti-corruption measures, competent authorities, and objectives, as well as deadlines and resources necessary for their implementation. The new Criminal Procedure Act which significantly changes the criminal procedure in terms of efficiency and effectiveness was adopted on December 15, 2008.

Structural Measures in the Medium-Term (2009-2011)

The judicial reform aims at creating an independent, unbiased, expert and efficient judiciary. The creation of such a system will restore the confidence of Croatian citizens in the rule of law which is one of the preconditions for faster economic development of the country. The implementation of 165 measures under the Action Plan of the Judicial Reform Strategy is aimed at reducing the duration of court proceedings, ensuring the conduction of proceedings within a reasonable period, reducing the cost of the judiciary, raising the level of quality and expertise, raising the level of confidence of Croatia's citizens in its judiciary, facilitating the use of alternative methods of dispute resolution, etc. Some of the measures are long-term, while the majority is expected to be completed in 2008, 2009, 2010 and 2011. Considering their large number, it will not be able to mention all of them. The legal framework for free legal aid has been set up, thus aiming to ensure access to courts for all Croatian citizens. In

addition, substantial funds have been invested in the informatisation and capital investments were made to ensure improved conditions for smooth functioning of the judiciary.

The final deadline for the implementation of the Common Information System (CIS) for the land registry and the cadastre is set for the end of 2009, when the system is expected to become fully operational. In that sense, the extension of the deadline until December 15, 2005 was approved.

By the end of 2010, the ICMS will be introduced at 60 more courts: 30 municipal courts, 19 county courts and 11 commercial courts. In 2013, the introduction of the ICMS is planned at the remaining 34 municipal courts. In the period 2012 – 2015, the ICMS is to be introduced at around 70 misdemeanour courts depending on the rationalisation of misdemeanour courts.

The time limit set for the completion of the rationalisation of the municipal court network, which means the time limit within the scope of which the operations of merged courts at their new seats will be ensured is December 31, 2019. For the implementation of this Act, sufficient funds are earmarked in the state budget so as to ensure the financial basis for the commencement of operation of a certain number of merged courts at their new seats as at January 1, 2009. The following is planned in the period 2009 – 2011: 21 municipal courts are expected to merge into 9 municipal courts in 2009, 9 municipal courts are expected to merge into 4 municipal courts in 2010 and 4 municipal courts are expected to merge into 2 municipal courts in 2011.

On January 1, 2009 the provisions of the new Criminal Procedure Act, adopted on December 15, 2008, entered into force. Those provisions are aimed at improving the speed and efficiency of procedures but they do not require major adjustments. The entry into force of provisions requiring major changes and substantial technical and organisational adjustments are planned for September 1, 2011.

The new Anti-Corruption Strategy and the Action Plan of the Anti-Corruption Strategy are aimed at combating corruption and imposing zero tolerance of corruption, as well as at eradicating and preventing cases of corruption in Croatian society.

The implementation of measures under the Action Plan of the Anti-Corruption Strategy is also planned in this period (a total of 195 measures) which is aimed at achieving the objectives set in the Strategy. Some of the measures are long-term, while the majority is expected to be completed in 2008, 2009, 2010 and 2011.

4.6.4 Environmental Protection

As regards the area of horizontal legislation, implementing regulations on the strategic environmental assessment (SEA)³⁴ and environmental impact assessment (EIA)³⁵ which are aligned with respective EU directives were adopted pursuant to the Environmental Protection Act (OG 110/07). What follows is the creation of guidelines for the implementation of the SEA and EIA and training of employees at competent county authorities. Within the scope of activities of the Croatian Environment Agency (CEA), work on the development of existing and new databases will be continued in 2009, as well as work on the implementation and co-ordination of the Environmental Protection Information System (EPIS). Activities will also continue as regards the identification of national reference centres for all thematic areas. Activities will continue on creation of selected indicators for reporting on the state of the environment and on the revision and amendment of the National List of Indicators for all thematic areas, as well as on the implementation of the Geographic Information System (GIS)

³⁴ Regulation on strategic environmental assessment of plans and programmes (OG 64/08)

³⁵ Regulation on environmental impact assessment (OG 64/08)

search engine for several databases relating to different thematic areas. In 2009, preparations for the Report on the State of the Environment in the Republic of Croatia covering the period 2006-2010 will continue.

Activities were continued on the fulfilment of obligations assumed under the Kyoto Protocol, aiming at reducing greenhouse gas emission. The registry of greenhouse gas emissions was established at CEA and it was connected with the International Transaction Log. The registry will become fully operational by the end of 2009. By adopting subordinate legislation at the end of 2008, legal prerequisites for establishment of the scheme for greenhouse gas emission allowance trading in the Republic of Croatia stemming from Directive 2003/87/EC were met. In the first half of 2009, the National Plan for the Emission Quota Allocation in the Republic of Croatia for the period 2010-2012 will also be adopted. All preconditions for the functioning of the scheme for greenhouse gas emission allowance trading will be met in 2010. All participants in the scheme will receive training in 2009. As regards substances that deplete the ozone layer, the consumption of chlorofluorocarbons (CFCs) that were used in cooling and air-conditioning systems in the Republic of Croatia is phased out. The establishment of a centre for collection and recycling of freons is underway. A halon bank has been established. It will collect and recycle halons which are primarily used in fire extinguishers and fire installations.

The objectives and measures for on-going improvement of air quality in the territory of the Republic of Croatia were laid down in the Plan³⁶, which was adopted by the Government of the Republic of Croatia in May 2008. The overall annual cost of the Plan implementation is estimated at some HRK 4.1 billion (EUR 571 million), of which some HRK 7 - 10 million will be financed from the state budget. Other costs will be borne by legal and natural persons, through direct investment or via different fees as well as by local and regional self-government units. In the area of air quality Croatian legislation is fully aligned with Directive 96/62/EC and its "daughter" directives. The monitoring of the implementation measures under the Plan will continue in 2009, aiming at reducing air pollution. The Programme for Emission Reduction of Specific Pollutants Causing Acidification, Eutrofication and Ground Ozone in the Republic of Croatia for the period until 2010 with projections for the period 2010-2020 will be created, as well as the Action Plan for Reduction of Air Pollution by Suspended Particles and Ground Ozone in Areas and Settled Areas of the Republic of Croatia in which limit and target values are exceeded.

In the field of waste management, activities were continued on the rehabilitation and closing of waste disposal sites, so rehabilitation of 57 waste disposal sites has been completed so far. When the rehabilitation is completed, the majority of waste disposal sites will be turned to reloading sites and recycling yards connected with future county/regional waste management centres (WMCs) which will include new waste disposal sites. The construction of the WMC Bikarac in the Šibenik-Knin County is co-financed under the ISPA programme. The tender notice for construction works was published in 2008. The co-financing of the construction of three more WMCs is planned under the IPA Operative Programme 2007-2009. Activities on the rehabilitation of pollution "hotspots" are continued, and at the end of 2008 the project under PHARE 2006 programme aimed at improving hazardous waste management was contracted.

In the field of water management, activities aimed at establishing and strengthening the integrated water management system continued through intensive investments in water management infrastructure. In July 2008, the Croatian Parliament adopted the Water Management Strategy (OG 91/08). The adoption of the new Water Act, Water Management Financing Act and the associated subordinate legislation is planned in the first quarter 2009,

³⁶ Air Quality Protection and Improvement Plan in the Republic of Croatia for the period 2008 - 2011 (OG 61/08).

which will complete the process of alignment with the *acquis communautaire*. Allocation of funds from the state budget, grants, loans and EU assistance funds in the period 2009-2011 is envisaged for the following projects: capacity strengthening and development of guidelines for the implementation of the EU Water Framework Directive; realisation of capital water supply projects, capital projects relating to protection of water and sea against pollution, capital irrigation projects, regional project for management of rivers Neretva and Trebišnjica, which is implemented in cooperation with Bosnia and Herzegovina (World Bank Grant worth HRK 9 million); the ISPA project Programme for Water and Waste Water Karlovac and the ISPA technical assistance for the preparation of projects under the IPA programme; Internal Waters Project; IPA projects Slavonski Brod and Knin – Drniš.

As regards sea, water and marine environment quality, in 2008 the Government of the Republic of Croatia adopted the Intervention Plan in Case of Sudden Sea Pollution (OG 92/08) and the Regulation on Beach Water Quality Standards (OG 73/08). Beach water quality is monitored on an ongoing basis and annual reports, maps and leaflets are published on bathing water quality. Activities on the implementation of the Project against the Pollution of Water in the Coastal Area (IBRD loan) continue.

In the field of nature protection, in the course of 2008 measures envisaged under the 2007 PEP were implemented, while other measures are carried over to the upcoming period. Priorities in the period 2009-2011 are further alignment of legislation with the *acquis communautaire*, establishment of necessary implementing mechanisms and strengthening of administrative capacity at all levels by employing new experts and providing training to existing and new employees. Special attention will be given to the creation of proposal of the EU ecological network NATURA 2000 and creation of management plans for this area, as well as to establishment of monitoring systems. Work will continue on the establishment of the Environmental Protection Information System and the protection of new areas pursuant to the Environmental Protection Act.

As regards the control of industrial contamination, implementing regulations for the implementation of IPPC³⁷ and Seveso II³⁸ Directives were adopted in September 2008. Activities on the strengthening of capacity for the implementation of the IPPC Directive have also been carried out within the framework of the CARDS 2004 project. The total amount of investment required for alignment of existing plants under the IPPC Directive by applying best available techniques are estimated at around EUR 2 billion. The Regulation on the EMAS³⁹ System (which will enter into force on the date of accession of the Republic of Croatia to the European Union) was adopted in September 2008. Promotional activities aimed at the introduction of EMAS to companies and organisations were also continued. On December 19, 2008, the Government of the Republic of Croatia adopted the Emission Reduction Plan for SO₂, NO_x and Solid Particles for Existing Large Combustion Plants and Gas Turbines, which lays down measures and the time frame for alignment of existing objects with the *acquis communautaire* and determines funds necessary for alignment.

In the field of chemicals safety, the Government of the Republic of Croatia adopted the National Chemicals Safety Strategy in June 2008 and submitted it to the Croatian Parliament for approval which was provided on November 28, 2008. Aiming at establishing the system of surveillance of alignment with good laboratory practices, the Ministry of Health and Social Welfare (MHSW) will adopt the National Good Laboratory Practice Surveillance Programme. As of January 1, 2009, sanitary inspectors who were employed with the state administration office became part of the unified inspection service within the MHSW. As regards genetically modified organisms (GMOs), it is planned that in 2009, the Council for Genetically Modified

³⁷ Council Directive 96/61/EC concerning integrated pollution prevention and control.

³⁸ Council Directive 96/82/EC on the control of major-accident hazards involving dangerous substances.

³⁹ Regulation on the inclusion of organisations in the eco management and audit scheme

Organisms will establish the Committee for the Contained Use of GMOs and the Committee for Release of GMOs into the environment. In accordance with the Ordinance on official control, in the course of 2009 the Laboratory for detecting GMOs in food and feed at the Croatian National Institute of Public Health and the Laboratory for detecting GMOs in seeds at the Institute for Seed and Seedlings in Osijek are to be accredited under ISO 17025. The implementation of the UNEP-GEF project “Building Capacity for Effective Participation in the Biosafety Clearing - House of the Cartagena Protocol on Biosafety“ was launched in June 2008. Amendments to the Act on GMOs are planned in 2009 in the part relating to cross-border movement of GMOs.

In the field related to protection against noise, the adoption of the new Noise Protection Act is planned in 2009, as well as amendments to the Ordinance on the Method of Preparation and Content of Noise Maps and Action Plans, aiming at their alignment with the *acquis*.

In the field of forestry, the implementation of the “Conceptual and Operational Plan of National Forest Resources Inventory of the Republic of Croatia” is underway. Field work has been completed and data processing is expected to be continued by the end of 2009. The process of creation of the registry of forest fires entered its final phase, while the establishment of the registry on the level of damage to forests is underway. The project for improving the implementation of fire-prevention measures is expected to be launched in 2009, aiming at reducing the number of forest fires. The existing National Forest Policy and Strategy will be revised in the period 2009-2010, and the National Forest Programme will be created.

With the aim of protection of agricultural land against pollution, the project “Development of the Croatian Soil Monitoring Programme with a Pilot Project LIFE05TCY/CRO/000105” is being implemented. The project is co-financed by the European Commission (Life Third Countries), the competent authority for the project implementation is the Croatian Environment Agency, while implementation partners are Faculty of Agriculture and the Institute for Soil. The “Soil Monitoring Manual - first edition / working version” has been drawn up on the basis of which pilot projects on the agricultural, forest and contaminated soil were implemented in 2006 and 2007. On the basis of pilot projects, the Soil Monitoring Programme has been drawn up and will be presented to the Government of the Republic of Croatia and line ministries at the beginning of 2009. Soil monitoring is one of the basic tasks of the Institute for Soil pursuant to the Agricultural Land Act (OG 152/08) and the Regulation on the Establishment of the Institute for Soil (OG 100/01). In addition, new Agricultural Land Act (OG 152/08) was adopted while the new Ordinance on Agricultural Land Protection against Pollution (OG No. 15/92) is under adoption procedure.

5. ECONOMIC POLICY MATRIX

5.1. ENTERPRISE SECTOR		
5.1.1. Competition Policy and State Aid		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Alignment of Croatian legislation with the competition acquis based on the new Competition Protection Act	<ul style="list-style-type: none"> Adoption of the Regulation on block exemption in the transport sector Adoption of the Regulation on the method and criteria for imposition and calculation of penalties Adoption of the Regulation on the criteria for reduction in or exemption from penalties Adoption of the Regulation on the method of reporting and criteria for assessment of concentration of entrepreneurs 	IV quarter 2009
Efficient implementation of competition-related legislation	<ul style="list-style-type: none"> Training for application of new legislation for employees of the Croatian Competition Agency, other regulatory authorities and the judiciary (through IPA 2007 project) 	2009-2011
Alignment of Croatian legislation with acquis communautaire in the field of state aid	<ul style="list-style-type: none"> Issuance of state aid rules in accordance with the procedure prescribed by the Regulation on State Aid 	continuously
Efficient implementation of state aid-related legislation	<ul style="list-style-type: none"> Completion of the state aid granting procedure for five Croatian shipyards Professional training of Croatian Competition Agency employees and state aid providers (at central and local level) through IPA 2007 project 	2009 2009-2011
5.1.2. Privatisation		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Privatisation of the largest proportion of the remaining CPF portfolio	<ul style="list-style-type: none"> Transformation of CPF, introduction of new privatisation models and preparation of the companies in majority ownership for sale 	2009-2010
Privatisation and restructuring of five shipyards and one subsidiary	<ul style="list-style-type: none"> Announcement of tenders verified by the EC, sale to the strategic partner and establishment of appropriate restructuring programmes 	2009
Professionalized management of a proportion of the portfolio (mainly minority shares)	<ul style="list-style-type: none"> Development and adoption of regulatory framework for establishment of special closed-end investment funds 	2009-2010
Continuation of privatisation of majority shares	<ul style="list-style-type: none"> Intensification of activities related to announcement of public tender procedures 	2009-2010
Continuation of privatisation of Croatian Railways	<ul style="list-style-type: none"> Sale of Croatian Railways' subsidiary companies 	2009-2010
5.1.3. Railway Restructuring		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Harmonisation of legislation	<ul style="list-style-type: none"> Creation of subordinate legislation 	2010
Liberalisation of railway transport market	<ul style="list-style-type: none"> Preparation of network reports Allocation of routes to operators Establishment and full operability of the Security Agency 	2009 2009 2009-2011
Restructuring and modernisation of railway company	<ul style="list-style-type: none"> Fulfilment of conditions under PAL 2 loan 	continuously
Adoption of the National Railway Infrastructure Programme	<ul style="list-style-type: none"> Creation of annual maintenance and modernisation plans 	2009
5.1.4. Restructuring of Shipbuilding Industry		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Restructuring aimed at achieving self-sustained profitable operation of individual shipyards	<ul style="list-style-type: none"> Implementation of the restructuring programme 	continuously
Privatisation with a view to ensuring the preconditions for further successful operation of shipyards through the implementation of current economic policy measures compatible with the economic policy of the EU	<ul style="list-style-type: none"> Choice of the privatisation model will depend on the Privatisation Act and Employee Stock Ownership Act (ESOP), and will be carried out via public tenders and defined ToR 	31 December 2009
Increase of product sophistication in the shipbuilding industry in order to increase value added	<ul style="list-style-type: none"> Selection of market niche, domestic and international integration and production specialisation, implementation of IMO regulations etc. 	continuously
Creation of a new shipbuilding market on a commercially sustainable basis	<ul style="list-style-type: none"> Offering ships designed pursuant to the Leadership 2015 project 	continuously
Transfer to designing and constructing more complex vessels in order to increase value added	<ul style="list-style-type: none"> Entering into agreements on the construction of more complex vessels 	continuously
Increase of efficiency and cost competitiveness	<ul style="list-style-type: none"> Implementation of the Restructuring and rationalisation programme, cost control etc. 	continuously
Exploitation of synergy effects in order to reduce costs and achieve a more efficient access to the shipbuilding market	<ul style="list-style-type: none"> Centralisation of procurement, design, marketing and production specialisation 	continuously
5.1.5. Energy		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Establishment of a system that has been brought into line with the EU practice	<ul style="list-style-type: none"> Adjustment of internal market to the conditions in Europe Adjustment of infrastructure to the market needs Petroleum products - increase in petroleum reserves and petroleum products to the EU level and extraction of fuel according to EU standards 	continuously continuously continuously
5.1.6. Small and Medium-Size Enterprises		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Lifelong entrepreneurial education	<ul style="list-style-type: none"> Project of the national programme for entrepreneurial education in formal and informal education Training in relation to e-business Monitoring 	continuously
Competitiveness and innovations	<ul style="list-style-type: none"> Education of exporters Application of new technologies and technological processes Environmental protection of products Innovations and new products Introduction of EU standards Association of economic entities (clusters) Croatian export offensive, CEO project Integration of SMEs and R&D institutions Incentives to energy enterprises Financial instruments for development of entrepreneurial competitiveness Marketing and promotion Coordination of activities related to expansion of e-commerce and e-business Establishment of scientific-technological parks 	continuously

Improvement of entrepreneurship financing	<ul style="list-style-type: none"> • Credit financing • Risk fund • Business angels • Guarantees 	continuously
Quality improvement and development of business infrastructure	<ul style="list-style-type: none"> • Incentives for development of the Croatian Agency for Small Business • Support to setting up regional development agencies • Training and development of consultants' network • Support to developing entrepreneurial centres, technological parks and incubators 	continuously
Stimulating regional competitiveness	<ul style="list-style-type: none"> • Financial instruments for regional development of entrepreneurship • Incentives to crafts and cooperatives • Social cohesion projects • Promotion of entrepreneurship among target groups 	continuously
5.1.7. Public-Private Partnership		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increased quality level of public services	<ul style="list-style-type: none"> • Upgrading of legislative framework through creation of implementing legislation • Institutional strengthening of the PPP area • Continued scientific analysis of practical experiences 	I quarter 2009 continuously continuously
Efficient use of budgetary funds and better supervision of fiscal risks	<ul style="list-style-type: none"> • Coordination of the PPP Agency and the Ministry of Finance in approval and implementation of PPP projects 	continuously
5.2. FINANCIAL SECTOR		
5.2.1. Banking Sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further development and improvement of prudential regulations and the banking system	<ul style="list-style-type: none"> • Adoption and implementation of subordinate legislation on the basis of the Credit Institutions Act (OG 117/08) 	2009
	<ul style="list-style-type: none"> • Adoption and implementation of subordinate legislation on the basis of the Electronic Money Institutions Act • Adoption of the Payment System Services Act • Adoption and implementation of subordinate legislation on the basis of the Financial Conglomerates Act • Compliance with EU legislation • Adoption of the Consumer Credit Act 	2009 2009 2009 continuously 2009
Establishment of supervisory body, human resource development	<ul style="list-style-type: none"> • Presentation for banks, credit unions and savings banks on new regulations to be adopted in 2008 and implemented from 2009 onwards • Training of supervisors in relation to new regulations and banking risks • Improvement of the banks' prudential reporting system 	continuously continuously continuously
5.2.2. Non-Banking Sector		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further development and improvement of the non-banking sector	<ul style="list-style-type: none"> • Adoption of the Act on Amendments to the Act on Compulsory Insurance within the Transport Sector 	2009
	<ul style="list-style-type: none"> • Adoption of subordinate legislation on the basis of the Capital Market Act • Adoption of subordinate legislation on the basis of the Act on Amendments to the Insurance Act 	2009 2009
Further development of human resources	<ul style="list-style-type: none"> • Education of employees of the Croatian Financial Services Supervisory Agency (HANFA), education for brokers, investment advisors and pension fund managers 	continuously
5.3. LABOUR MARKET		
5.3.1. Stimulating Employment		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Increase of employment and employability by aligning labour market supply with demand	<ul style="list-style-type: none"> • Analysis and independent evaluation of annual employment incentive plans • Development of national implementing plan for the Joint Memorandum on the employment policy priorities 	continuously 2009 and 2010
5.3.2. Social Security System		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Act on Employment Mediation and Rights During Unemployment Period (entered into force on 1 January 2009)	<ul style="list-style-type: none"> • By restructuring unemployment benefits in the first year of unemployment, stimulate educational activities and active looking for job, and stimulate work activation by reducing the benefits in further period 	2009-2011
Ordinance on Convalidation of Decisions and Individual Acts in the Field of Pension Insurance (entered into force on 17 May 2008)	<ul style="list-style-type: none"> • The possibility of applying for convalidation without time restriction enables the persons who have worked in the territories of the Republic of Croatia administered by the UN to exercise rights under pension insurance 	2009-2011
Create a beneficiary-oriented social welfare system by improving service quality through decentralisation and deinstitutionalisation, as well as improvement of work of social services	<ul style="list-style-type: none"> • Introduction of personal identification number • Informatisation of the social welfare system • Implementation and financing of approved innovative projects regarding the rendering of social services at local community level aimed at deinstitutionalisation and reintegration of beneficiaries into the society • Service quality improvement in social welfare facilities (reconstruction and adaptation of social welfare centres, construction of new centres and improvement of sanitary and hygienic conditions in social welfare homes) • Adoption of a new act in the field of social welfare • Development of the "One-Stop-Office" concept 	2009 2009-2011 2009-2010 2009-2011 2009-2010 2009-2010
	Systematic protection of rights and interests of children and vulnerable groups, and harmonisation with international standards	<ul style="list-style-type: none"> • Development and adoption of the National Strategy for the Protection of Children Against Abuse and Neglecting
<ul style="list-style-type: none"> • Development and adoption of the Protocol on the procedure in the case of serious neglect of duty on the part of parents, adoptive parents, foster parents or other persons to care properly for or educate a child • Development of the National Plan Against Sexual Abuse of Children • Initiating the procedure for signing and ratification of the Convention on Protection of Children and Co-operation in Respect of Intercountry Adoption (The Haag Convention as of 1993) • Implementation of the measures imposed by the Joint Inclusion Memorandum (JIM) 		2009 2009 continuously continuously

Strengthening of capacities of social welfare centres for the purpose of providing support to groups that are in unfavourable position with regard to access to employment - IPA IV Operational programme for human resources development	<ul style="list-style-type: none"> Strengthening of partnership between various departments and institutions for dealing with the problem of social exclusion and unemployment of vulnerable and marginalised groups (forming and training of working groups, preparation of the Action Protocol, which will define mutual roles and processes, and preparation of action plan for implementation of defined processes and measures). Strengthening of professional capacities of social welfare centres, where specialists will be educated for social integration mentor positions (education of 24 specialists from social welfare centres for the position of trainers who will educate 60 more specialists for mentor positions) 	2009 - 2011 2009 - 2011
Strengthening of professional capacities of family centres for the purpose of strengthening institutional protection of rights and interests of children, in particular children exposed to adverse risks of growing up, and development of services intended for families, with particular focus on working parents	<ul style="list-style-type: none"> Adoption of new legal provisions regulating the area of family advising Adoption of educational plans and programmes for specialists authorised for providing family advising services Amendments to family-related regulations contributing to strengthening of institutional protection of children 	2010-2011
Development of the system of advisory and preventive services intended for families, children and youth in local community and stimulating parenthood	<ul style="list-style-type: none"> Establishment of family centres and branches of family centres 	2009-2011
Development of the system of family grants	<ul style="list-style-type: none"> Preparation and application of implementing regulations under the National Population Policy Awarding scholarships to regular students (state scholarships) 	2009-2011 continuously
Improve students' standard of living and access to higher education for a larger number of students in the Republic of Croatia	<ul style="list-style-type: none"> Subsidizing transportation costs of regular students and students with disabilities, subsidizing costs of meals and accommodations of students in student hostels 	continuously
5.4. AGRICULTURAL SECTOR		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Enhance the competitiveness and adjustment to EU market standards	<ul style="list-style-type: none"> Increasing total budgetary funds for grants in the sector 	continuously
Alignment and adjustment of the aid system with that in the EU	<ul style="list-style-type: none"> Adoption of new Act on State Aid to Agriculture 	2009
Rural development	<ul style="list-style-type: none"> Financing rural development measures from funds obtained under the pre-accession assistance programme - SAPARD Financing rural development measures from funds obtained under the Instrument for pre-accession assistance - IPA component V - IPARD 2009-2011 Financing rural development measures from the state budget funds 	2009 2009-2011 2009
Structural reforms in the food industry sector	<ul style="list-style-type: none"> Development of the Strategy for development of the food processing industry Adoption of the National operational programme of incentives to the food processing sector 	2009 2009
Introduction of the Central Veterinary Information System	<ul style="list-style-type: none"> Analysis of the existing database and creation of a comprehensive database 	2009-2010
Uniform animal marking system	<ul style="list-style-type: none"> Implementation of animal marking process 	continuously
Defining structural and market mechanisms, as well as state aid in line with the EU; legal definition, identification and recognition of the Producers' Organisation	<ul style="list-style-type: none"> Act on State Aid in Fisheries Sector 	by end-III quarter 2009
Alignment with the EU legislation, describing and defining all fisheries aspects (priorities, goals, necessary financial resources, implementation deadlines)	<ul style="list-style-type: none"> National strategic plan 	by end-2009
Alignment with EU legislation, stimulating development of fisheries	<ul style="list-style-type: none"> Operational fisheries programme 	2010
5.5. PUBLIC ADMINISTRATION REFORM		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Ensuring consistency in remuneration of state administration employees, transparency of the wage bill and remuneration and introduction of more elements based on achievement and work	<ul style="list-style-type: none"> Adoption of the Regulation on classification of jobs and salaries of employees 	2009
Building a more efficient system of development of human resources in the state administration	<ul style="list-style-type: none"> Adoption of the Strategy for development of human resources in the state administration 	2009
Improvement of the supervision of the work of government administration bodies	<ul style="list-style-type: none"> Implementing the Administrative Inspection Act and conducting thorough inspection supervision in all government administration bodies 	2009-2011
Improvement of the quality of public services	<ul style="list-style-type: none"> Training related to the new General Administrative Procedure Act 	2009-2011
Training of civil servants for a more efficient application of legal provisions regulating rights, duties and responsibilities of civil servants and employees in government administration.	<ul style="list-style-type: none"> Training of government employees for application of the regulations on relations among civil servants in the government administration 	2009-2011
Strengthening the role of information and communication technologies in the operations of the government administration and its communication with citizens and the economy, and define the framework and objectives of new and existing activities of electronic administration, with emphasis on user satisfaction, rationalisation of administrative procedures and modern electronic services	<ul style="list-style-type: none"> Carrying out the activities envisaged by the Implementing plan of the Strategy for electronic administration development for 2009 	2009
	<ul style="list-style-type: none"> Preparation of semi-annual report on the implementation of the Strategy for electronic administration development in the Republic of Croatia 2009-2012 	2009
	<ul style="list-style-type: none"> Preparation of annual report on the implementation of the Strategy for electronic administration development in the Republic of Croatia 2009-2012 	2009
5.6. OTHER REFORMS		
5.6.1. Development of Knowledge-Based Society		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Improvement of the quality of primary and secondary education system	<ul style="list-style-type: none"> Encouraging the establishment of kindergartens and increase in the number of pre-school programmes, with particular emphasis on involving rising numbers of children in pre-school programmes 	continuously
	<ul style="list-style-type: none"> Carrying out pre-testing of fourth and eighth grade students 	2009
	<ul style="list-style-type: none"> Conducting national exams - external evaluation of educational programmes and student achievements 	2009
	<ul style="list-style-type: none"> Realisation of the national pedagogical standards in accordance with the feasibility coefficient 	continuously
	<ul style="list-style-type: none"> Development of the National curriculum for pre-school, primary school and secondary school education 	2009-2011
	<ul style="list-style-type: none"> Development of the Croatian Qualification Framework 	2009-2011

	<ul style="list-style-type: none"> Continuation of the project of introducing the state school leaving exam Development of the quality assurance system Carrying out recertification of adult education programmes and creation of databases 	<p>school year 2009/2010 continuously</p> <p>2009-2011</p>
Continued implementation of the Bologna Process	<ul style="list-style-type: none"> Development of and providing support to vocational university programmes in small urban areas Continuation of improvements aimed at achieving better quality of the higher education system Improvement of the inflow of information about the labour market needs into the higher education system and strengthening of co-operation between the higher-education system and the private sector Strengthening of the university integration processes Carrying out external evaluation of the quality of higher-education institutions 	<p>2009-2011</p> <p>continuously</p> <p>continuously</p> <p>2009-2011</p> <p>2009-2011</p>
Strengthen the science and research and co-operation with the economy	<ul style="list-style-type: none"> Strengthening of the National foundation for science, higher education and technological development, and carrying out a scientific project financing reform Starting up scientific centres of excellence through competitive financial instruments Harmonisation of the areas of research aimed at greater degree of transfer of knowledge and technologies in the development of the economy and entrepreneurial endeavours. 	<p>2009-2011</p> <p>2009-2010</p> <p>2009-2011</p>
5.6.2. Health Care Reform		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Further financial stabilisation of the health care system	<ul style="list-style-type: none"> Stabilisation of financing of hospital institutions Introduction of the system of fixed and variable head tax instead of fixed head tax into the primary health care system. 	<p>2009-2011</p> <p>2009-2011</p>
Introducing new sources of financing	<ul style="list-style-type: none"> Securing financing from other sources (supplementary health insurance in the free market), and, one of the measures aimed at preventive health protection in the area of risky behaviour and risky influences is introduction of special contributions with regard to known and acknowledged risks for all members of the society (it has been planned that a substantial proportion of costs of medical treatment of direct and indirect consequences of risk exposure be financed by the risk source). 	2009-2011
Strengthening of the system of control of the health system expenditures	<ul style="list-style-type: none"> Regulation of a part of the control system, both professional and financial. 	2009-2011
5.6.3. Reform of the Judiciary		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Reform of the judiciary	<ul style="list-style-type: none"> Implementation of the Action plan forming an integral part of the Judiciary Reform Strategy 	continuously
Prevention of corruption and organised crime	<ul style="list-style-type: none"> Implementation of the Strategy and Action Plan forming an integral part of the Corruption Prevention Strategy 	continuously
Introducing free legal assistance system	<ul style="list-style-type: none"> Creating structural and all other prerequisites for full implementation of the Act on Free Legal Assistance 	beginning of 2009
Rationalisation of the court network	<p>Rationalisation of the court network - the following has been planned:</p> <ul style="list-style-type: none"> - merger of 21 municipal courts into 9 municipal courts - merger of 9 municipal courts into 4 municipal courts - merger of 4 municipal courts into 2 municipal courts 	<p>continuously</p> <p>2009</p> <p>2010</p> <p>2011</p>
Informatisation of the judiciary	<p>Introduction of ICMS</p> <ul style="list-style-type: none"> - it has been planned to introduce ICMS into 60 courts (30 municipal, 19 county and 11 commercial courts) 	continuously end-2010
Reform of the land registry system	<ul style="list-style-type: none"> Implementation of the Common Information System (CIS) for the land registry and the cadastre 	2009
5.6.4. Environment Protection		
POLICY GOAL	IMPLEMENTING MEASURES	PERIOD
Integration of environmental protection goals into planning and implementation of other sector policies, aiming at promoting sustainable development	<ul style="list-style-type: none"> Creation of guidelines and training for the implementation of the PUO, assessment of impact on the environment, and SPUO, strategic assessment of impact on the environment, procedures International reporting in accordance with assumed obligations and reporting to the Republic of Croatia Establishment and management of the Environment Protection Information System 	<p>2009</p> <p>continuously</p> <p>continuously</p>
Improvement of the comprehensive system of air quality management and creation of conditions for systematic resolution of problems related to climate changes	<ul style="list-style-type: none"> Annual assessment of air quality at designated areas and in populated areas, and the review of air quality categories Construction of the remaining 12 centres for continuous air quality monitoring Establishment of the Air Quality Information System Adoption of the Action Plan for reduction of air pollution from ground-level ozone and particles floating in the air Adoption of the Programme of reduction of emissions of polluting substances which cause acidification, eutrophication and ground-level ozone Making the Greenhouse Gas Register operational Implementation of the Plan for allocation of greenhouse gas emission quotas to legal entities Establishment of the greenhouse gas emission trading system Establishment of the implementation system of flexible mechanisms from the Kyoto protocol 	<p>2009 - continuously</p> <p>2009-2010</p> <p>continuously</p> <p>2009</p> <p>2009</p> <p>2009</p> <p>2010-2012</p> <p>2009-2010</p> <p>2009</p>
Establishment of the comprehensive waste management system	<ul style="list-style-type: none"> Construction of county/regional waste management centres Restructuring of the waste dumping sites by changing their purpose, continued use or by closing them Further development of the system for the management of special waste categories. Implementation of restructuring programmes for former industrial locations polluted by dangerous substances and wild dumping sites of hazardous waste "Development of the dangerous waste management system including the identification and management of the "hot spots" in Croatia"- PHARE 2006 	<p>continuously</p> <p>continuously</p> <p>continuously</p> <p>continuously</p> <p>2009-2010</p>

	<ul style="list-style-type: none"> Further development of the Waste Management Information System by the Environment Protection Agency (as part of Environment Protection Information System) 	2009-2010
Strengthening and establishment of the system of integrated water management with more intensive investments in the water management infrastructure	<ul style="list-style-type: none"> Strengthening/reform of the existing system of financing water management and ensuring more funds per year (amendments to/adoption of new subordinate legislation arising from the Act on Water Management Financing) Strengthening of water management planning - continuation of work on adoption of water management plans in four areas 	continuously continuously
	<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 public drainage systems 	continuously
	<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. 	continuously
	<ul style="list-style-type: none"> Continuation of activities on the establishment of zones of sanitary protection of drinking water at source Improvement of the existing and development of new irrigation systems. Greater investments in the system of protection against damage caused by water 	continuously continuously continuously
Sea and marine environment protection	<ul style="list-style-type: none"> Preparation of the annual National Adriatic Sea Monitoring Report Preparation of annual reports, leaflets and maps of sea water quality on beaches Setting up and further development of IT system "More" for the monitoring of the Adriatic Sea Strengthening of supervision of the sea quality in the coastal area (Project on the protection against pollution in the coastal area). 	continuously continuously continuously 2009
Improvement of the nature protection system	<ul style="list-style-type: none"> Administrative strengthening of nature protection institutions at state and regional level, including an inspection office. Development of a system of protected areas, review and digitalisation of the borders of protected areas and development of the monitoring system Preparation and adoption of implementing regulations based on the Nature Protection Act Revision of sector legislation and development of mechanisms to incorporate nature protection guidelines through co-operation between various sectors 	continuously continuously 2008-2009 continuously
	<ul style="list-style-type: none"> Management of the National Eco-Network and implementation of protection measures Protection of new areas, review of the existing ones. Establishment of the "NATURA 2000" network Implementation of wolf and lynx management plans (revision after 2007) Activities relating to the implementation of the CITES International co-operation in the field of nature protection (implementation of projects): NATURA 2000 – PHARE Construction of the system of management of protected areas and eco-network area, establishment of information system for nature protection in Croatia (PAMS III) 	continuously continuously 2008-2009 continuously continuously 2009 2009
Establishment of industrial pollution control system	<ul style="list-style-type: none"> Education of government bodies and economic entities as regards the implementation of the IPPC Directive Promotional activities as regards the introduction of EMAS into companies and organisations in the Republic of Croatia 	2009 - continuously 2009 - continuously
	<ul style="list-style-type: none"> Establishment of the system and education of government bodies and economic entities as regards the prevention of major accidents involving hazardous substances 	2009 - continuously
	<ul style="list-style-type: none"> Further development of the registry of dangerous and hazardous installations into the Registry of installations with hazardous substances 	2009-2010
Efficient and harmonised implementation of the national policy in the field of chemical safety	<ul style="list-style-type: none"> Implementation of the National programme of chemical safety 	continuously
Improvement of the comprehensive forestry system	<ul style="list-style-type: none"> Development and implementation of the project "National Inventory of Forestry Resources of the Republic of Croatia" The Programme of Fire Prevention Measures Revision of the National Forestry Policy and Strategy National Forestry Programme 	2009 2009-2011 2009-2010 2009-2010
	<ul style="list-style-type: none"> Adoption of a programme of measures for data collection and establishment of a register on the level of damage to forests 	continuously
	<ul style="list-style-type: none"> Establishment and running of a comprehensive information system and register on forest fires 	continuously

Annex I Matrix of Policy Commitments

	2008	2009	2010	2011
OVERALL ASSESSMENT OF FISCAL IMPACTS OF MAJOR IMPLEMENTING MEASURES				
A. Implementation				
B. Net direct impact on the budget	-3.507.878.300	-2.231.661.237	-3.151.958.480	-1.901.107.365
B1. Direct impact on revenues	289.039.515	1.250.514.041	445.008.536	30.747.240
B2. Direct impact on expenditures	3.796.917.816	3.482.175.278	3.596.967.016	1.931.854.605
I. ENTERPRISE SECTOR				
Total (1+2+3+4+5)				
A. Implementation				
B. Net direct impact on the budget	-1.090.945.533	-103.910.209	-940.631.106	-846.281.477
B1. Direct impact on revenues	121.660.264	-271.626.264	117.017.500	-28.649.250
B2. Direct impact on expenditures	1.212.605.797	-167.716.055	1.057.648.606	817.632.227
1. Competition and State Aid				
A. Implementation				
B. Net direct impact on the budget	-7.251.000	-1.760.741	-118.718	5.689.589
B1. Direct impact on revenues	2.940.464	2.076.536	-3.537.000	
B2. Direct impact on expenditures	10.191.464	3.837.277	-3.418.282	-5.689.589
Note: Impact on revenues shown in row B1 relates to EU funds				
2. Railway Restructuring				
A. Implementation	X			
B. Net direct impact on the budget	-249.843.494	164.316.176	-119.212.750	-61.223.775
B1. Direct impact on revenues	59.359.900	-136.851.400	60.277.250	-14.324.625
B2. Direct impact on expenditures	309.203.394	-301.167.576	179.490.000	46.899.150
Subsidies				
A. Implementation				
B. Net direct impact on the budget	-57.169.038	97.969.038	-10.000.000	-20.000.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	57.169.038	-97.969.038	10.000.000	20.000.000
Investments in Modernisation				
A. Implementation				
B. Net direct impact on the budget	-187.833.656	82.047.138	-122.542.750	-45.473.775
B1. Direct impact on revenues	59.359.900	-148.681.400	56.027.250	-14.324.625
B2. Direct impact on expenditures	247.193.556	-230.728.538	178.570.000	31.149.150
Note: Impact on revenues in 2008 relates to loan funds provided by EIB and KFW and funds from ISPA grant; impact on revenues in 2009 and 2010 relates to the planned amounts of ISPA, IPA and Phare grant funds; impact on revenues in 2011 relates to the planned amounts of the IPA funds				
MSTI, Reforms, Development Studies, Alignment of Legislation				
A. Implementation	X			
B. Net direct impact on the budget	-4.840.800	-15.700.000	13.330.000	4.250.000
B1. Direct impact on revenues		11.830.000	4.250.000	
B2. Direct impact on expenditures	4.840.800	27.530.000	-9.080.000	-4.250.000
3. Restructuring of Shipbuilding Industry				
Total				
A. Implementation				
B. Net direct impact on the budget	10.000.000	93.000.000	-20.000.000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-10.000.000	-93.000.000	20.000.000	
Subsidies				
A. Implementation				
B. Net direct impact on the budget	10.000.000	133.000.000		
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-10.000.000	-133.000.000		

	2008	2009	2010	2011
Research, Development and Innovations				
A. Implementation				
B. Net direct impact on the budget		-40.000.000	-20.000.000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures		40.000.000	20.000.000	
4. Small and Medium-Size Enterprises				
A. Implementation	X			
B. Net direct impact on the budget	-302.027.897	-304.953.510	-330.218.629	-364.409.973
B1. Direct impact on revenues				
B2. Direct impact on expenditures	302.027.897	304.953.510	330.218.629	364.409.973
Entrepreneurial Education				
A. Implementation	X			
B. Net direct impact on the budget	-14.489.230	-14.489.230	-17.070.400	-20.520.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	14.489.230	14.489.230	17.070.400	20.520.000
Competitiveness and Innovations				
A. Implementation	X			
B. Net direct impact on the budget	-98.203.990	-97.995.190	-110.236.000	-120.324.500
B1. Direct impact on revenues				
B2. Direct impact on expenditures	98.203.990	97.995.190	110.236.000	120.324.500
Favourable Financing				
A. Implementation	X			
B. Net direct impact on the budget	-59.251.677	-62.386.090	-56.032.229	-65.785.473
B1. Direct impact on revenues				
B2. Direct impact on expenditures	59.251.677	62.386.090	56.032.229	65.785.473
Quality of Consultants				
A. Implementation	X			
B. Net direct impact on the budget	-8.373.000	-8.373.000	-10.360.000	-11.080.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	8.373.000	8.373.000	10.360.000	11.080.000
Regional Competitiveness				
A. Implementation	X			
B. Net direct impact on the budget	-121.710.000	-121.710.000	-136.520.000	-146.700.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	121.710.000	121.710.000	136.520.000	146.700.000
5. Public-Private Partnership				
A. Implementation				
B. Net direct impact on the budget	48.249	-6.874.800	-1.649.630	-703.570
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-48.249	6.874.800	1.649.630	703.570

II. LABOUR MARKET

Total (1+2+3+4+5+6+7+8)

A. Implementation				
B. Net direct impact on the budget	-427.698.800	-675.652.462	-184.622.786	-168.385.178
B1. Direct impact on revenues	100.000.000	0	20.000.000	20.000.000
B2. Direct impact on expenditures	527.698.800	675.652.462	204.622.786	188.385.178

1. Stimulating Employment

A. Implementation				
B. Net direct impact on the budget	50.000.000	-80.000.000	10.000.000	10.000.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-50.000.000	80.000.000	-10.000.000	-10.000.000

Note: Compared to 2007, the employment incentives have been reduced by HRK 50 000 000

2. Financial and Legal Protection of Unemployed Persons

A. Implementation		X		
B. Net direct impact on the budget	100.000.000	-53.000.000	0	0
B1. Direct impact on revenues	100.000.000		20.000.000	20.000.000
B2. Direct impact on expenditures		53.000.000	20.000.000	20.000.000

Note: In 2009 new legislation on financial and legal protection of unemployed persons came into force. Thereby, expenditures are to be increased by HRK 53 million

	2008	2009	2010	2011
3. Implementation of New Regulation within the Pension Insurance System				
A. Implementation	X			
B. Net direct impact on the budget	-56.698.800	-3.995.000	-8.015.000	-14.004.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	56.698.800	3.995.000	8.015.000	14.004.000
4. Increase in Social Welfare Benefit Base from HRK 400.00 to HRK 500.00				
A. Implementation	X			
B. Net direct impact on the budget	-141.000.000	-430.000.000	-75.000.000	-86.000.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	141.000.000	430.000.000	75.000.000	86.000.000
5. Implementation of New Regulation within the Scope of Services and Benefits Provided to Families				
A. Implementation		X		
B. Net direct impact on the budget		-100.000.000	-80.000.000	-40.000.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		100.000.000	80.000.000	40.000.000
6. Subsidizing Students' Accommodation and Meals				
A. Implementation	X			
B. Net direct impact on the budget	-290.000.000	-6.731.700	-26.705.853	-33.314.068
B1. Direct impact on revenues				
B2. Direct impact on expenditures	290.000.000	6.731.700	26.705.853	33.314.068
7. Transportation of Students and Students with Disabilities				
A. Implementation	X			
B. Net direct impact on the budget	-5.000.000	-480.000	-493.200	-615.240
B1. Direct impact on revenues				
B2. Direct impact on expenditures	5.000.000	480.000	493.200	615.240
8. Scholarships for Full-Time Students				
A. Implementation	X			
B. Net direct impact on the budget	-85.000.000	-1.445.762	-4.408.733	-4.451.870
B1. Direct impact on revenues				
B2. Direct impact on expenditures	85.000.000	1.445.762	4.408.733	4.451.870

III. AGRICULTURAL SECTOR

Total (1+2+3+4)

A. Implementation				
B. Net direct impact on the budget	-994.543.049	-20.423.591	208.115.448	159.513.505
B1. Direct impact on revenues	32.364.290	40.549.387	162.767.423	2.512.240
B2. Direct impact on expenditures	1.026.907.340	60.972.978	-45.348.025	-157.001.265
1. State Aid in Agriculture				
A. Implementation				
B. Net direct impact on the budget	-976.175.857	15.580.002	225.927.510	160.386.321
B1. Direct impact on revenues				
B2. Direct impact on expenditures	976.175.857	-15.580.002	-225.927.510	-160.386.321
2. SAPARD Implementation				
A. Implementation	X			
B. Net direct impact on the budget	-9.569.910	4.569.910	-15.333.350	-872.816
B1. Direct impact on revenues	28.703.732	16.296.268	37.015.000	2.512.240
B2. Direct impact on expenditures	38.273.642	11.726.358	52.348.350	3.385.056
3. IPARD Implementation				
A. Implementation		X		
B. Net direct impact on the budget		-2.500.000	-47.500.000	
B1. Direct impact on revenues		10.000.000	140.000.000	
B2. Direct impact on expenditures		12.500.000	187.500.000	
4. Implementation of the World Bank Project for the Adjustment of Agricultural Legislation with Acquis Communautaire				
A. Implementation			X	
B. Net direct impact on the budget	-8.797.282	-38.073.503	45.021.288	
B1. Direct impact on revenues	3.660.558	14.253.119	-14.247.577	
B2. Direct impact on expenditures	12.457.841	52.326.622	-59.268.865	

	2008	2009	2010	2011
IV. ADMINISTRATIVE REFORM (1+2)				
Total (1+2)				
A. Implementation				
B. Net direct impact on the budget		-10.300.258	-8.976.442	-10.168.558
B1. Direct impact on revenues		964.742	0	0
B2. Direct impact on expenditures		11.265.000	8.976.442	10.168.558
1. Implementation of Activities Related to IT-Supported Administration				
A. Implementation				
B. Net direct impact on the budget		-11.200.000	-8.911.442	-10.088.558
B1. Direct impact on revenues				
B2. Direct impact on expenditures		11.200.000	8.911.442	10.088.558
2. Adoption of the Strategy for Development of Human Resources in the State Administration				
A. Implementation		x		
B. Net direct impact on the budget		899.742	-65.000	-80.000
B1. Direct impact on revenues		964.742		
B2. Direct impact on expenditures		65.000	65.000	80.000
V. KNOWLEDGE-BASED SOCIETY				
Total (1+2+3+4+5+6+7+8+9+10)				
A. Implementation				
B. Net direct impact on the budget	-640.252.000	241.846.828	41.734.263	31.597.271
B1. Direct impact on revenues	0	0	0	0
B2. Direct impact on expenditures	640.252.000	-241.846.828	-41.734.263	-31.597.271
1. Development of Pre-School Education				
A. Implementation				
B. Net direct impact on the budget	-9.360.000	8.000.000	5.360.000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	9.360.000	-8.000.000	-5.360.000	
Note: In 2009, partial funding has been secured from the World Bank loan (80%), and the remaining amount will be covered by the state budget (20%)				
2. Development of National Curriculum for Pre-School, Primary-School and Secondary-School Education				
A. Implementation				
B. Net direct impact on the budget	-1.500.000	-3.069.788	-411.222	-154.413
B1. Direct impact on revenues				
B2. Direct impact on expenditures	1.500.000	3.069.788	411.222	154.413
3. National Exams and State School-Leaving Exam				
A. Implementation				
B. Net direct impact on the budget	-23.000.000	-9.820.000	-2.953.800	-1.073.214
B1. Direct impact on revenues				
B2. Direct impact on expenditures	23.000.000	9.820.000	2.953.800	1.073.214
Note: In 2009, partial funding has been secured from the World Bank loan (80%), and the remaining amount will be covered by the state budget (20%)				
4. Application of National Pedagogical Standards in Accordance with Feasibility Coefficient				
A. Implementation				
B. Net direct impact on the budget	-604.200.000	339.249.200	48.072.173	30.832.657
B1. Direct impact on revenues				
B2. Direct impact on expenditures	604.200.000	-339.249.200	-48.072.173	-30.832.657
Note: the calculation has been done according to the allowed growth (9% for 2010 and 3.1% for 2011).				
Note: In 2009, partial funding has been secured from the World Bank loan (80%), and the remaining amount will be covered by the state budget (20%).				
5. Development of Croatian Qualification Framework				
A. Implementation				
B. Net direct impact on the budget	-4.992.000	-1.490.000	-134.100	-50.344
B1. Direct impact on revenues				
B2. Direct impact on expenditures	4.992.000	1.490.000	134.100	50.344
6. Strengthening of Quality of Adult Education				
A. Implementation				
B. Net direct impact on the budget	-200.000	-200.000	-18.000	-6.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	200.000	200.000	18.000	6.000

	2008	2009	2010	2011
7. Development of Quality Assurance System				
A. Implementation		X		
B. Net direct impact on the budget		-6.456.000	-587.496	-218.348
B1. Direct impact on revenues				
B2. Direct impact on expenditures		6.456.000	587.496	218.348
8. Continued Implementation of the Bologna Process				
A. Implementation				
B. Net direct impact on the budget	3.000.000	-77.066.584	-6.935.992	2.604.079
B1. Direct impact on revenues				
B2. Direct impact on expenditures	-3.000.000	77.066.584	6.935.992	-2.604.079
9. Strengthening of National Foundation for Science, Higher Education and Technological Development of the Republic of Croatia				
A. Implementation		X		
B. Net direct impact on the budget		-5.000.000	-450.000	-327.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures		5.000.000	450.000	327.000
10. Start-up and Operation of Centres of Excellence				
A. Implementation		X		
B. Net direct impact on the budget		-2.300.000	-207.300	-10.146
B1. Direct impact on revenues				
B2. Direct impact on expenditures		2.300.000	207.300	10.146
VI. HEALTH CARE REFORM				
Total (1+2+3+4)				
A. Implementation				
B. Net direct impact on the budget		-1.758.198.049	-2.053.159.773	-128.914.995
B1. Direct impact on revenues		1.353.293.000	58.000.000	30.000.000
B2. Direct impact on expenditures		3.111.491.049	2.111.159.773	158.914.995
1. Stabilisation of the financing of hospital institutions				
A. Implementation				
B. Net direct impact on the budget		-956.632.369	-637.201.517	-42.000.000
B1. Direct impact on revenues		696.365.743	1.966.000	10.000.000
B2. Direct impact on expenditures		1.652.998.112	639.167.517	52.000.000
2. Introduction of the system of fixed and variable head tax instead of fixed head tax into the primary health care				
A. Implementation				
B. Net direct impact on the budget		-390.966.831	-202.893.866	-15.100.000
B1. Direct impact on revenues		30.000.000	3.538.000	10.100.000
B2. Direct impact on expenditures		420.966.831	206.431.866	25.200.000
3. Stabilisation of the financing of prescription drugs				
A. Implementation				
B. Net direct impact on the budget		-184.900.449	-1.163.564.390	-37.714.995
B1. Direct impact on revenues		592.625.657	52.391.000	4.000.000
B2. Direct impact on expenditures		777.526.106	1.215.955.390	41.714.995
4. Especially expensive drugs				
A. Implementation				
B. Net direct impact on the budget		-225.698.400	-49.500.000	-34.100.000
B1. Direct impact on revenues		34.301.600	105.000	5.900.000
B2. Direct impact on expenditures		260.000.000	49.605.000	40.000.000
VII. JUDICIAL REFORM				
Total (1+2)				
A. Implementation				
B. Net direct impact on the budget	-122.585.185	-14.551.676	-76.404.950	-874.167.611
B1. Direct impact on revenues	14.736.761	22.530.283	-10.671.644	-12.355.400
B2. Direct impact on expenditures	137.321.946	37.081.959	65.733.306	861.812.211
1. Reform of the Judiciary				
A. Implementation		X		
B. Net direct impact on the budget	-97.844.213	-21.882.748	-87.030.850	-883.769.411
B1. Direct impact on revenues	10.936.761	9.129.683	-9.346.444	-8.500.000
B2. Direct impact on expenditures	108.780.974	31.012.431	77.684.406	875.269.411

Note: The reform of the judiciary is partially financed by EU assistance funds and donations of international organisations, whose impact on revenues is shown in row B1.

	2008	2009	2010	2011
2. Prevention of Corruption				
A. Implementation	X			
B. Net direct impact on the budget	-24.740.972	7.331.072	10.625.900	9.601.800
B1. Direct impact on revenues	3.800.000	13.400.600	-1.325.200	-3.855.400
B2. Direct impact on expenditures	28.540.972	6.069.528	-11.951.100	-13.457.200

Note: Prevention of corruption is partially financed by EU assistance funds and donations of international organisations, whose impact on revenues is shown in row B1. Partial funding of the amount shown under B2 has been secured from the World Bank loan.

VIII. ENVIRONMENTAL PROTECTION

Total (1+2+3+4+5+6+7+8+9)

A. Implementation				
B. Net direct impact on the budget	-231.853.733	109.528.180	-138.013.134	-64.300.322
B1. Direct impact on revenues	20.278.200	104.802.893	97.895.257	19.239.650
B2. Direct impact on expenditures	252.131.933	-4.725.287	235.908.391	83.539.972

1. Integrating Environmental Protection Goals in Planning and Implementation of Other Sector Policies Aiming at Promoting Sustainable Development (MEPPPC, CEA)

A. Implementation			X	
B. Net direct impact on the budget	-250.000	-5.707.500	-2.084.970	2.218.567
B1. Direct impact on revenues				
B2. Direct impact on expenditures	250.000	5.707.500	2.084.970	-2.218.567

2. Air Quality and Climate Protection (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	-4.850.000	-1.080.000	4.360.000	-700.000
B1. Direct impact on revenues	3.644.000	7.355.000	-1.944.000	-9.055.000
B2. Direct impact on expenditures	8.494.000	8.435.000	-6.304.000	-8.355.000

Note: The measure "Establishment of National Air Quality Monitoring Network" is partially financed by the EU Pre-Accession Aid: Phare 2006 "Air Quality Monitoring and Management System", which is disclosed in the state budget under the years 2008, 2009 and 2010.

Support to the activities concerning development of the system of trading in greenhouse gas emissions, including the Greenhouse Gas Register, is provided by one of the components of the CARDS 2004 project "Support for the Further Approximation of Croatian Legislation with the Environmental Acquis".

3. Waste Management (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	4.065.000	-1.096.800	-1.982.400	1.449.700
B1. Direct impact on revenues		29.162.093	78.359.257	22.044.650
B2. Direct impact on expenditures	-4.065.000	30.258.893	80.341.657	20.594.950

Note: Setting-up of waste management centres (WMC) will be co-financed by the ISPA 2005/06 programme (WMC "Bikarac") and by IPA component III on the basis of the Operational Environment Protection Programme 2007-2009 (three more WMCs). Preparation of project documentation for the setting-up of WMCs and remediation of "hot spots" will also be co-financed by ISPA 2005/06 programme and IPA programme on the basis of the Operational Environment Protection Programme 2007-2009. The measure "Development of Hazardous Waste Management System" is partly financed by the EU Pre-Accession Aid: Phare 2006 "Development of Hazardous Waste Management System, Including the Identification and Management of "Hot Spots" in Croatia"

4. Water Management (MAFWM)

A. Implementation				
B. Net direct impact on the budget	-155.575.098	128.205.598	-148.740.000	-72.908.982
B1. Direct impact on revenues	4.400.000	79.720.000	22.280.000	6.250.000
B2. Direct impact on expenditures	159.975.098	-48.485.598	171.020.000	79.158.982

Note: the project Slavonski Brod and Knin – Drniš is co-financed by IPA programme (EU aid amounts to HRK 140 million), the project Water and Waste Water Management Programme Karlovac and the technical assistance project for preparation of projects for IPA are co-financed by ISPA programme (EU aid amounts to HRK 145 million)

The project "Inland waters" is co-financed by a loan (the loan amounts to HRK 665 million)

The regional project on the management of Trebišnjica and Neretva rivers, which is implemented in co-operation with Bosnia and Herzegovina - World Bank donations of HRK 18 million have been approved for co-financing of the project completion (foreign donation amounts to HRK 9 million).

5. Sea and Marine Environment Protection (MEPPPC)

A. Implementation				
B. Net direct impact on the budget	-7.750.000	2.233.000	5.277.000	1.880.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	7.750.000	-2.233.000	-5.277.000	-1.880.000

Note: Partial funding of the amount shown under B2 has been secured by IBRD loan (50%) and the residual will be covered by the state budget funds

	2008	2009	2010	2011
6. Nature Protection (MC)				
A. Implementation				
B. Net direct impact on the budget	-63.816.335	-10.634.601	-702.064	-433.600
B1. Direct impact on revenues	12.234.200	-11.434.200	-800.000	0
B2. Direct impact on expenditures	76.050.535	-799.599	-97.936	433.600
Note: Disclosed funds include donations under the EU project Phare 2005 "Building-up of NATURA 20000 Network".				
7. Establishing Industrial Pollution Control System (MEPPPC)				
A. Implementation				
B. Net direct impact on the budget	-2.792.000	-650.000	2.392.000	
B1. Direct impact on revenues				
B2. Direct impact on expenditures	2.792.000	650.000	-2.392.000	
Note: within the framework of the measure "Training of government bodies and economic operators for application of IPPC directive" support is provided under one of the components of CARDS 2004 project "Support for the Further Approximation of Croatian Legislation with the Environmental Acquis".				
8. Chemicals and GMOs (MHSW)				
A. Implementation				
B. Net direct impact on the budget	-518.483	-741.517	17.300	-36.007
B1. Direct impact on revenues				
B2. Direct impact on expenditures	518.483	741.517	-17.300	36.007
9. Forestry (MRDFWM):				
A. Implementation				
B. Net direct impact on the budget	-366.817	-1.000.000	3.450.000	4.230.000
B1. Direct impact on revenues				
B2. Direct impact on expenditures	366.817	1.000.000	-3.450.000	-4.230.000

Annex II Statistical Appendix

Table 1a: Macroeconomic Prospects

	ESA Code	2007	2007	2008	2009	2010	2011
		Level [€] ¹		Rate of change			
1. Real GDP at market prices	B1*g		5.6	2.5	2.0	3.2	4.0
2. GDP at market prices	B1*g	37,497	9.8	8.9	5.8	6.8	7.3
Components of real GDP							
3. Private consumption expenditure	P3	20,913	6.2	1.7	1.1	1.9	2.7
4. Government consumption expenditure	P3	7,544	3.4	2.3	1.1	1.7	1.5
5. Gross fixed capital formation	P51	11,230	6.5	8.1	-1.1	2.2	4.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	1,035	2.8	3.8	2.7	2.7	2.8
7. Exports of goods and services	P6	17,880	5.7	2.5	0.6	3.0	4.0
8. Imports of goods and services	P7	-21,106	5.8	5.9	-3.1	0.9	2.3
Contribution to real GDP growth							
9. Final domestic demand		39,688	6.4	3.9	0.6	2.2	3.2
10. Change in inventories and net acquisition of valuables	P52+P53	1,035	0.0	1.0	-1.0	0.1	0.2
11. External balance of goods/services	B11	-3,226	-0.8	-2.5	2.4	0.9	0.6

Source: CBS, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

^[1] Levels represent current prices categories in EUR million

Table 1b: Price Developments

Percentage changes, annual averages unless otherwise indicated	ESA Code	2007	2008	2009	2010	2011
1. GDP deflator		4.0	6.2	3.7	3.5	3.2
2. Private consumption deflator		3.0	6.2	3.5	3.2	3.0
3. HICP		-	-	-	-	-
4. National CPI change		2.9	6.1	3.5	3.2	3.0
5. Public consumption deflator		6.1	5.6	4.5	5.3	5.4
6. Investment deflator		3.4	4.5	2.3	3.0	2.9
7. Export price deflator (goods & services)		3.4	3.8	1.5	2.7	3.0
8. Import price deflator (goods & services)		2.9	3.3	0.6	2.6	3.1

Source: CBS, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

Table 1c: Labour Markets Developments

	ESA	2007	2007	2008	2009	2010	2011
		Level		Rate of change			
1. Population (thousands)		-	-	-	-	-	-
2. Population (growth rate in %)		-	-	-	-	-	-
3. Working-age population (persons) ¹		3,657,250	3,657,250	3,668,222	3,675,558	3,686,585	3,697,645
4. Participation rate, level		48.8	48.8	48.8	48.8	48.9	49.0
5. Employment, persons ²		1,614,500	1,614,500	1,634,581	1,641,830	1,657,373	1,677,709
6. Employment, hours worked		-	-	-	-	-	-
7. Employment (growth rate in %)		-	1.8	1.2	0.4	0.9	1.2
8. Public sector employment (persons)		-	-	-	-	-	-
9. Public sector employment (growth in %)		-	-	-	-	-	-
10. Unemployment rate, level ³		9.6	9.6	8.7	8.5	8.0	7.4
11. Labour productivity, persons ⁴		-	3.7	1.2	1.5	2.2	2.7
12. Labour productivity, hours worked		-	-	-	-	-	-
13. Compensation of employees, real	D1	-	3.3	0.4	0.4	1.4	2.2

Source: CBS, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

^[1] Age group 15+, Labour Force Survey Data

^[2] Labour Force Survey Data

^[3] Labour Force Survey Data

^[4] Calculated as real GDP growth divided by change in number of employed persons

Table 1d: Sectoral Balances

Percentages of GDP	ESA Code	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world ¹	B.9	10.9	13.3	8.7	7.8	7.2
<i>of which:</i>						
- Balance of goods and services		-8.4	-9.8	-6.9	-5.6	-4.8
- Balance of primary incomes and transfers		-0.2	-0.7	-0.9	-1.2	-1.6
- Capital account		0.1	0.1	0.2	0.2	0.2
2. Net lending/borrowing of the private sector ²	B.9/ EDP B.9	13.4	13.8	7.6	8.0	8.7
3. Net lending/borrowing of general government		-0.5	-0.3	-0.1	-0.2	-1.0
4. Statistical discrepancy ³		-2.4	-	-	-	-

Source: CNB, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

^[1] Financial account of balance of payments (including reserve assets)

^[2] Financial account (excluding reserve assets) minus foreign net lending / borrowing of general government

^[3] Net errors and omissions from balance of payments

Table 1e: GDP, Investment and Gross Value Added

	ESA Code	2007	2008	2009	2010	2011
GDP and investment						
GDP level at current market prices (in domestic currency)	B1g	275,078	299,549	316,845	338,429	363,229
Investment ratio (% of GDP)		30.0	31.1	29.7	29.3	29.3
Growth of Gross Value Added, percentage changes at constant prices						
1. Agriculture		1.6	2.5	1.1	1.7	2.1
2. Industry (excluding construction)		6.5	2.2	1.4	3.0	4.0
3. Construction		3.8	8.7	2.5	3.6	4.2
4. Services		5.9	3.2	2.4	3.0	4.0

Source: CBS, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

Table 1f: External Sector Developments

Euro mill. unless otherwise indicated	2007	2008	2009	2010	2011
1. Current account balance (% of GDP)	-8.6	-10.5	-7.8	-6.9	-6.4
2. Export of goods	9,193	10,079	10,134	10,842	11,725
3. Import of goods	-18,626	-20,559	-19,897	-20,609	-21,817
4. Trade balance	-9,434	-10,480	-9,763	-9,767	-10,092
5. Export of services	9,152	9,738	9,989	10,443	11,063
6. Import of services	-2,859	-3,334	-3,219	-3,298	-3,382
7. Service balance	6,293	6,404	6,770	7,145	7,681
8. Net interest payments from abroad ¹	-703	-776	-829	-940	-1,068
9. Other net factor income from abroad ²	-433	-559	-582	-670	-775
10. Current transfers, net	1,043	1,047	1,026	1,037	1,051
11. <i>Of which</i> from EU	-	-	-	-	-
12. Current account balance	-3,233	-4,363	-3,378	-3,195	-3,203
13. Foreign direct investment, net	3,469	3,111	1,502	1,657	1,830
14. Foreign reserves ³	9,307	9,377	8,881	8,919	9,152
15. Foreign debt	33,264	38,299	39,597	42,101	44,991
16. <i>Of which</i> : public	-	-	-	-	-
17. <i>O/w</i> : foreign currency denominated	-	-	-	-	-
18. <i>O/w</i> : repayments due	-	-	-	-	-
19. Exchange rate vis-à-vis EUR (end-year)	7.3	7.3	7.3	7.3	7.3
20. Exchange rate vis-à-vis EUR (annual average)	7.3	7.2	7.3	7.3	7.3
21. Net foreign saving (lines 21-25: percentages of GDP)	-	-	-	-	-
22. Domestic private saving	-	-	-	-	-
23. Domestic private investment	-	-	-	-	-
24. Domestic public saving	-	-	-	-	-
25. Domestic public investment	-	-	-	-	-

Source: CNB, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

^[1] Calculated as sum of net portfolio investment income and net other investment income

^[2] Calculated as sum of net compensation of employees and net direct investment income

^[3] Refers to gross international reserves of the CNB.

Table 2: General Government Budgetary Prospects

	ESA code	2007	2007	2008	2009	2010	2011
		mill. HRK		% of GDP			
Net lending (B9) by sub-sectors							
1. General government	S13	-4,357.3	-1.6	-1.3	-0.9	-0.6	0.0
2. Central government	S1311	-4,505.3	-1.6	-1.2	-0.9	-0.6	0.0
3. State government	S1312						
4. Local government	S1313	148.1	0.1	-0.1	0.0	0.0	0.0
5. Social security funds	S1314						
General government (S13)							
6. Total revenue	TR	126,613.7	46.0	45.7	45.2	44.8	44.4
7. Total expenditure ¹	TE	130,971.0	47.6	46.9	46.1	45.4	44.4
8. Net borrowing/lending	EDP.B9	-4,357.3	-1.6	-1.3	-0.9	-0.6	0.0
9. Interest expenditure	EDP.D41 incl. FISIM	5,602.5	2.0	1.8	1.6	1.5	1.3
p.m. 9a. FISIM							
10. Primary balance ²		1,245.3	0.5	0.5	0.8	0.8	1.3
Components of revenues							
11. Total taxes (11 = 11a+11b+11c)		71,932.7	26.1	26.8	26.2	26.1	26.0
11a. Taxes on production and imports	D2	52,303.0	19.0	19.5	19.1	19.1	19.0
11b. Current taxes on income and wealth	D5	19,629.7	7.1	7.2	7.0	6.9	6.9
11c. Capital taxes	D91	0.0	0.0	0.0	0.0	0.0	0.0
12. Social contributions	D61	37,669.0	13.7	13.8	13.6	13.6	13.6
13. Property income	D4	2,133.1	0.8	0.5	0.7	0.4	0.4
14. Other (14 = 15-(11+12+13))		14,879.0	5.4	4.6	4.8	4.7	4.4
15 = 6. Total revenue	TR	126,613.7	46.0	45.7	45.2	44.8	44.4
p.m.: Tax burden (D2+D5+D61+D91-D995) ³		109,601.7	39.8	40.6	39.7	39.7	39.6
Selected components of expenditures							
16. Collective consumption	P32	0.0	0.0	0.0	0.0	0.0	0.0
17. Total social transfers	D62 + D63	48,241.8	17.5	17.6	18.0	18.0	17.7
17a. Social transfers in kind	P31 = D63	8,938.8	3.2	3.3	3.8	4.3	4.2
17b. Social transfers other than in kind	D62	39,302.9	14.3	14.4	14.1	13.8	13.5
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	5,602.5	2.0	1.8	1.6	1.5	1.3
19. Subsidies	D3	7,504.4	2.7	2.9	2.5	2.4	2.2
20. Gross fixed capital formation	P51	11,695.9	4.3	2.9	2.7	2.7	2.6
21. Other (21 = 22-(16+17+18+19+20))		54,590.1	19.8	20.2	19.1	18.0	17.7
22. Total expenditures ⁴	TE	130,971.0	47.6	46.9	46.1	45.4	44.4
p.m. compensation of employees	D1	31,122.0	11.3	11.2	11.5	11.0	10.9

Source: MF**Comments:** Values written in black are realisations and in red projected values.

Table 3: General Government Expenditure by Function

Percentage of GDP	COFOG Code	2007
1. General public services	1	5.2
2. Defence	2	1.6
3. Public order and safety	3	2.8
4. Economic affairs	4	6.5
5. Environmental protection	5	0.3
6. Housing and community amenities	6	2.2
7. Health	7	6.4
8. Recreation, culture and religion	8	1.4
9. Education	9	4.5
10. Social protection	10	15.3
11. Total expenditure (item 7 = 26 in Table 2)	TE	46.1

Source: MF

Comments: Only data for Budgetary Central Government and Local Government are included.

Table 4: General Government Debt Developments

Percentages of GDP	ESA code	2007	2008	2009	2010	2011
1. Gross debt		37,8	36,1	35,1	33,8	31,8
2. Change in gross debt ratio		-3,0	-1,7	-1,0	-1,4	-2,0
Contributions to change in gross debt						
3. GDP effect		-3,6	-3,1	-2,0	-2,2	-2,3
4. Primary balance		-0,5	-0,5	-0,8	-0,8	-1,3
5. Interest expenditure (incl. FISIM)		2,0	1,8	1,6	1,5	1,3
6. Stock-flow adjustment		-0,9	0,1	0,1	0,3	0,3
of which:						
- Differences between cash and accruals		0,1				
- Net accumulation of financial assets		-0,6	0,1	0,1	0,3	0,3
of which:						
- Privatisation proceeds		-1,1	-0,3	0,0	0,0	0,0
- Valuation effects and other		-0,3				
p.m. implicit interest rate on debt		5,4	4,9	4,7	4,3	4,1
Other relevant variables						
7. Liquid financial assets						
8. Net financial debt (8 = 1 - 7)		37,8	36,1	35,1	33,8	31,8

Source: MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

Table 5: Cyclical Developments

Percentages of GDP	ESA Code	2007	2008	2009	2010	2011
1. Real GDP growth (%)	B1g	5.6	2.5	2.0	3.2	4.0
2. Net lending/borrowing of general government	EDP.B.9	-1.6	-1.3	-0.9	-0.6	0.0
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP.D.41 + FISIM	0.4	0.5	0.8	0.8	1.3
4. Potential GDP growth (%) ¹		4.2	3.3	2.9	3.0	3.1
Contributions:						
- labour						
- capital						
- total factor productivity						
5. Output gap		1.1	0.2	-0.7	-0.5	0.4
6. Cyclical budgetary component		0.6	0.2	-0.3	-0.2	0.1
7. Cyclically-adjusted balance (2-6)		0.5	0.1	-0.4	-0.2	0.4
8. Cyclically-adjusted primary balance (7-3)		-0.2	0.3	1.0	1.1	1.2

Source: MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

^[1] Until an agreement on the Production Function Method is reached, countries can use their own figures (SP).

Table 6: Divergence from Previous Programme

	2007	2008	2009	2010	2011
1. GDP growth (% points)					
Previous programme	6.0	6.1	6.5	7.0	-
Latest programme	5.6	2.5	2.0	3.2	4.0
Difference	-0.4	-3.6	-4.5	-3.8	-
2. General government net lending (% of GDP)					
Previous programme	-1.6	-1.5	-0.6	0.2	-
Latest programme	-1.6	-1.2	-0.9	-0.6	0.0
Difference	0.0	0.3	-0.3	-0.8	-
3. General government gross debt (% of GDP)					
Previous programme	44.9	42.7	40.1	37.0	-
Latest programme	44.2	42.3	41.4	40.0	37.9
Difference	-0.7	-0.4	1.3	3.0	-

Source: MF**Comments:** Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

Table 7: Long-Term Sustainability of Public Finances

Percentages of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure ^[1]	-	48.4	45.4	44.0	45.1	46.8	49.6
<i>of which:</i>							
- Age-related expenditures ^[2]	-	16.2	16.5	15.9	17.2	18.5	20.7
- Pension expenditure ^[3]	-	9.9	9.2	7.3	6.7	6.6	7.0
- Social security pension	-	-	-	-	-	-	-
- Old-age and early pensions	-	-	-	-	-	-	-
- Other pensions (disability, survivors)	-	-	-	-	-	-	-
- Occupational pensions (if in general government)	-	-	-	-	-	-	-
- Health care	-	6.2	7.4	8.6	10.5	11.9	13.7
- Long-term care (this was earlier included in the health care)	-	-	-	-	-	-	-
Education expenditure	-	-	-	-	-	-	-
Other age-related expenditures	-	-	-	-	-	-	-
Interest expenditure	-	2.2	1.5	0.6	0.4	0.7	1.2
Total revenues	-	44.5	44.8	44.4	44.4	44.4	44.4
<i>of which: property income</i>	-	-	-	-	-	-	-
<i>of which: from pensions contributions (or social contributions, if appropriate)</i>	-	6.9	6.7	6.3	6.3	6.3	6.3
Pension reserve fund assets	-	-	-	-	-	-	-
<i>of which: consolidated public pension fund assets (assets other than government liabilities)</i>	-	-	-	-	-	-	-
Assumptions							
Labour productivity growth	-1.2	3.6	2.2	4.1	2.4	1.2	1.1
Real GDP growth	2.9	4.3	3.2	3.5	1.4	0.4	0.2
Participation rate males (aged 20-64) ^[4]	67.8	69.6	71.8	71.1	70.7	69.7	69.7
Participation rates females (aged 20-64) ^[4]	55.5	56.8	58.2	58.2	57.8	56.6	56.8
Total participation rates (20-64) ^[4]	61.5	63.1	65.0	64.6	64.3	63.2	63.3
Unemployment rate	16.1	12.7	8.0	7.0	7.0	7.0	7.0
Population aged 65+ over total population	-	16.6	17.0	19.6	22.6	24.7	27.3

Source: CBS, MF**Comments:** Values written in black are realisations and in red projected values.^[1] Total expenditures according to ESA 95^[2] Pension plus health care expenditures^[3] Total public pension expenditures except pensions and permanent rights of war veterans^[4] Aged (15 - 64)

Table 8: Basic Assumptions on the External Economic Environment Underlying the 2008 PEP Framework

Variable (annual growth rates in %, if not otherwise stated)	Assumptions for								
	2007		2008		2009		2010		2011
	change*		change*		change*		change*		
Interest rates (in % p.a., annual averages)									
- Short-term interest rate, Euro area	4.3	1.4	4.6	1.2	4.6	1.2	4.6	1.2	4.6
- Long-term interest rate, Euro area	4.3	0.4	4.1	-0.2	4.1	-0.2	4.1	-0.2	4.1
Exchange rates (annual average "": appreciation of HRK)									
Exchange rate vis-à-vis €	7.2	-0.12	7.3	-0.08	7.3	-0.08	7.3	-0.08	7.3
USD / €	1.4	0.02	1.5	0.10	1.4	0.00	1.4	-0.01	1.4
Nominal effective exchange rate, % ¹	-2.1	-	-3.3	-	2.7	-	0.0	-	0.3
Real effective exchange rate, % ²	-2.7	-	-5.5	-	1.2	-	-1.4	-	-0.8
GDP (in real terms)									
- World, excluding EU	5.6	0.4	4.3	-0.6	2.9	-2.0	3.8	-1.1	3.8
- EU 27	2.9	0.6	1.4	-0.8	0.2	-2.0	1.1	-1.1	1.1
World trade (in real terms)									
Country export markets	-	-	-	-	-	-	-	-	-
World imports	6.4	-3.2	4.8	-3.4	2.2	-6.0	4.0	-4.2	4.0
International prices									
World import prices (goods, in €)	7.0	2.9	11.7	9.7	2.6	0.6	2.6	0.6	2.6
Oil Prices ³ (USD per barrel)	71.1	2.6	99.8	24.8	68.0	-7.0	68.0	-7.0	68.0

Source: ECFIN, IMF, MF

Comments: Values written in black are realisations, in blue estimates (composite of realisations and projected values) and in red projected values.

*: change vis-à-vis assumptions made for last PEP

^[1] Calculated as a weighted geometric mean of bilateral exchange rates of HRK against EUR (weight 72.2%) and USD (27.8%).

^[2] CPI is used as deflator.

^[3] Simple average of UK Brent, Dubai and West Texas Intermediate.

ANNEX III STRUCTURAL REFORMS AGENDA AND ACHIEVEMENTS

Structural reforms agenda and achievements show realisation of the measures that were to be implemented in 2008 in accordance with the previous year's PEP.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
ENTERPRISE SECTOR			
Privatisation			
Announcement of the third round of invitations for tenders for the company Vupik d.d., Vukovar	No	2009-2011	Because of the anti-corruption campaign "Maestro", sale of minority shares via the stock exchange has been temporarily suspended. For this reason, the planned privatisation deadlines were exceeded.
Intensive preparation and announcement of tenders paired with bankruptcy and liquidation proceedings over companies which are eligible for such procedures	In progress	Until completion of privatisation process	In the given period, 24 public invitations to tender for the sale of 15 companies were published, bankruptcy proceedings in respect of 10 companies and liquidation proceedings in respect of 2 companies were completed.
Sale of minority share packages at the Zagreb stock exchange at the planned frequency of publishing tenders for around forty companies per month	No	Until completion of privatisation process	Blockade of CPF's operations because of the "Maestro" campaign.
Further signing of agreements between the Croatian Railways and CPF, aiming at preparing subsidiary companies for privatisation Preparation of dependent companies for privatisation, in case that recapitalisation of subsidiary companies is required, it will be done through increase in initial capital of dependent companies Announcement of the sale tender	In progress	Until completion of privatisation process, but not later than 2010	Since the beginning of the process of privatisation of dependent companies (beginning of 2007), 17 public invitations to tender have been published for the sale of 8 subsidiaries of the Croatian Railways. A sale agreement was signed in respect of one company, bankruptcy proceedings were opened over one company, whereas a strategic partner was chosen for one company.
Privatise one shipyard (Uljanik) and prepare one more for privatisation pursuant to the obligations assumed under the PAL and the adopted Strategic Development Framework 2006-2013 and the future National Shipbuilding Industry Restructuring Programme	In progress	2009	Pursuant to the decision of the Government of the Republic of Croatia on the intention to privatise five shipyards in majority state ownership and on privatisation principles, which was taken in May 2008, intensive preparations are under way with regard to publication of invitation to tender for the sale of five shipyards and one subsidiary company of the shipyard Brodosplit d.d. Prior to publication, the tenders will be submitted to the EC for approval.
Creation of the model for managing the remaining state assets including the definition of new organisational structure	No	2009	Although a draft of a new organisation chart for management of state-owned property has been prepared (it envisages consolidation of real property management and share management functions in one Agency), the "Maestro" campaign has shown the need for examination of new possible approaches.
Railway Restructuring			
Establishment of a Regulatory Body	Yes	2008	In the course of 2007, an Act regulating the concept of the Regulatory Body was adopted (Act on the Agency for Railway Services Market Regulation). In 2008, the Government of the Republic of Croatia published the public invitation concerning the vacancies for the candidates of the Management Council, whereas establishment of the Agency is scheduled for 2009 and full operability by 2010.
Publishing the Network Report	Yes	2008	
Adoption of the National Programme	Yes	2008	Financing contract with the infrastructure manager signed.
Restructuring of Shipbuilding Industry			
Adoption of the National Shipbuilding Industry Restructuring Programme	No	In progress	In order to speed up restructuring of the shipbuilding industry, it has been decided to complete privatisation before restructuring.
Energy			
Application of implementing rules and regulations for the use of renewable energy sources	Yes	2008	Application of the following subordinate legislation commenced in 2008: Regulation on the Minimum Share of Electricity Produced from Renewable Energy Sources and Cogeneration whose Production is Incentivised (OG 33/07), Ordinance on the Use of Renewable Energy Sources and Cogeneration (OG 67/07), Ordinance on Acquisition of Status of a Privileged Electricity Producer (OG 67/07).
Implementation of plans regarding energy efficiency	Yes	2008	The Draft Energy Efficiency Programme of the Republic of Croatia and the Draft Proposal of the First National Action Plan for Energy Efficiency were prepared.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Strengthening of the energy market in the south-east Europe within the meaning of the Energy Community Agreement	Yes	2008	Charging of the fee for cross-border capacities for transit of electricity was cancelled.
Small and Medium-Size Enterprises			
Lifelong entrepreneurial education	Yes	2008-2012	The measure was implemented in 2008 and will be implemented continuously until 2012 on the basis of the Programme of Incentives to Small and Medium Size Enterprises 2008-2012 by the Government of the Republic of Croatia (accepted by virtue of the Conclusion of the Government of the Republic of Croatia of April 18, 2008). The implementing regulation of the Programme is an annual Operative Plan of incentives to small and medium size enterprises for the current budgetary year. In 2008, the Operative Plan was adopted by virtue of the Conclusion of the Government of the Republic of Croatia of May 2, 2008. The system of incentives is based on the Small Business Development Promotion Act (OG 29/02, 63/07), the adopted budget plan and forecast, legislation regulating establishment of small business entities (companies, small trades, cooperatives, profit institutions and other small and medium size enterprises), and on the State Aid Act (OG 140/05) and subordinate legislation on state aid.
Competitiveness and innovations	Yes	2008-2012	The measure was implemented in 2008 and will be implemented continuously until 2012 on the basis of the Programme of Incentives to Small and Medium Size Enterprises 2008-2012 by the Government of the Republic of Croatia (accepted by virtue of the Conclusion of the Government of the Republic of Croatia of April 18, 2008). The implementing regulation of the Programme is an annual Operative Plan of incentives to small and medium size enterprises for the current budgetary year. In 2008, the Operative Plan was adopted by virtue of the Conclusion of the Government of the Republic of Croatia of May 2, 2008. The system of incentives is based on the Small Business Development Promotion Act (OG 29/02, 63/07), the adopted budget plan and forecast, legislation regulating establishment of small business entities (companies, small trades, cooperatives, profit institutions and other small and medium size enterprises), and on the State Aid Act (OG 140/05) and subordinate legislation on state aid.
Improvement of entrepreneurship financing	Yes	2008-2012	The measure was implemented in 2008 and will be implemented continuously until 2012 on the basis of the Programme of Incentives to Small and Medium Size Enterprises 2008-2012 by the Government of the Republic of Croatia (accepted by virtue of the Conclusion of the Government of the Republic of Croatia of April 18, 2008). The implementing regulation of the Programme is an annual Operative Plan of incentives to small and medium size enterprises for the current budgetary year. In 2008, the Operative Plan was adopted by virtue of the Conclusion of the Government of the Republic of Croatia of May 2, 2008. The system of incentives is based on the adopted budget , legislation regulating establishment of small business entities (companies, small trades, cooperatives, profit institutions and other small and medium size enterprises), and on the State Aid Act (OG 140/05) and subordinate legislation on state aid.
Quality improvement and development of business and entrepreneurial infrastructure	Yes	2008-2012	The measure was implemented in 2008 and will be implemented continuously until 2012 on the basis of the Programme of Incentives to Small and Medium Size Enterprises 2008-2012 by the Government of the Republic of Croatia (accepted by virtue of the Conclusion of the Government of the Republic of Croatia of April 18, 2008). The implementing regulation of the Programme is an annual Operative Plan of incentives to small and medium size enterprises for the current budgetary year. In 2008, the Operative Plan was adopted by virtue of the Conclusion of the Government of the Republic of Croatia of May 2, 2008. The system of incentives is based on the Small Business Development Promotion Act (OG 29/02, 63/07), the adopted budget plan and forecast, legislation regulating establishment of small business entities (companies, small trades, cooperatives, profit institutions and other small and medium size enterprises), and on the State Aid Act (OG 140/05) and subordinate legislation on state aid.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Promoting regional competitiveness	Yes	2008-2012	The measure was implemented in 2008 and will be implemented continuously until 2012 on the basis of the Programme of Incentives to Small and Medium Size Enterprises 2008-2012 by the Government of the Republic of Croatia (accepted by virtue of the Conclusion of the Government of the Republic of Croatia of April 18, 2008). The implementing regulation of the Programme is an annual Operative Plan of incentives to small and medium size enterprises for the current budgetary year. In 2008, the Operative Plan was adopted by virtue of the Conclusion of the Government of the Republic of Croatia of May 2, 2008. The system of incentives is based on the Small Business Development Promotion Act (OG 29/02, 63/07), the adopted budget plan and forecast, legislation regulating establishment of small business entities (companies, small trades, cooperatives, profit institutions and other small and medium size enterprises), and on the State Aid Act (OG 140/05) and subordinate legislation on state aid.
Public-private Partnership			
Compliance with EU legislation and alignment with the <i>acquis communautaire</i>	Yes	Continuously	The field of PPP is not specially regulated within the <i>acquis communautaire</i> . However, it is necessary to align the application of legislation related to public procurement and concessions within contracting and implementation of PPP projects.
Holding workshops and seminars for the public and private sector Systematic professional and administrative strengthening of the PPP sector	Yes	Continuously	PPP agency was established on November 21, 2008
FINANCIAL SECTOR			
Banking Sector			
Licensing for the purpose of transformation of savings and loan co-operatives into credit unions or savings banks, or their liquidation	Yes		Implementation in accordance with the provisions of the Credit Unions Act, which regulates the compliance of savings and loan co-operatives with the provisions of the said Act.
Credit Institutions Act	Yes	26 September 2008	(OG 117/08)
Electronic Money Institutions Act	Yes	27 September 2008	(OG 117/08)
Act on the Settlement Finality in Payment Systems and Financial Instruments Settlement Systems	Yes	28 September 2008	(OG 117/08)
Act on the Amendments to the Deposit Insurance Act	Yes	15 October 2008	(OG 119/08)
Financial Conglomerates Act	Yes	18 December 2008	(OG 147/08)
Non-Banking Sector			
Adoption of the Act on Reorganisation, Liquidation and Bankruptcy of Insurance Companies	Yes	25 July 2008	The measure has been implemented through the Act on Amendments to the Insurance Act (OG 87/08).
Adoption of the Act on Amendments to the Audit Act	Yes	3 December 2008	(OG 139/08)
LABOUR MARKET			
Stimulating Employment			
Increase employment and employability by aligning labour market supply with demand through analysis and evaluation of active employment measures	Yes	2008	The measures under the Annual Employment Plan for 2008 have been evaluated. Until August 31, 2008, the measures were applied to 3,410 persons, of whom 1,495 (or 43.8%) are women. Of the total number (3,410) of the persons involved, 1,810 persons were employed on the basis of employment incentives, 539 persons were included in an education programme for a known employer (incentives for professional improvement), 398 persons were included in an educational programme for an unknown employer, and 663 persons were employed through the Public Work Programme.
Adjustment of labour market needs with the education system through establishment of local partnerships for employment	Yes	2008	During 2008, sector councils were set up at county levels and a survey on employers' needs was conducted. Apart from the representatives of development agencies, employment services and social partners, all other partners of educational institutions in the concerned area are also involved in the work of the sector councils.
Social Security System			
Implementation and financing of approved innovative projects regarding the rendering of social services at local community level aimed at deinstitutionalisation and reintegration of beneficiaries into the society	Yes	July 2008	The financing included 21 projects, and an agreement concerning a World Bank's investment loan of HRK 14.6 million was reached.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Service quality improvement in social welfare facilities (reconstruction and adaptation of 13 social welfare centres, construction of 12 new centres and improvement of sanitary and hygienic conditions in 57 social welfare homes)	In progress	2009-2011	Quality improvement of social services - an investment loan funds were used for financing of construction of two social welfare centres and reconstruction or adaptation works, which commenced in 16 social welfare centres (the total funds amount to HRK 97.7 million - of that amount, the projects amounting to HRK 16.2 million were finalized and the projects amounting to HRK 47.8 million were contracted for). Improvement of sanitary and hygienic conditions in social welfare homes - investment loan-funded projects: the works were completed in 6 homes, reconstruction and adaptation works are in progress in 15 homes (the total investments amount to HRK 191.7 million, of which: the projects in the amount of HRK 32.8 million were completed, those in the amount of HRK 71.2 million were contracted for, and there are plans for projects amounting to additional HRK 78,4 million).
Development of the One-Stop-Office - invitations for tenders	In progress	2009-2011	Development of the One-Stop-Office - commencement of the project activities.
Fulfilment of obligations under: National Youth Programme of Action National Strategy on Drug Abuse Prevention National Trafficking Prevention Plan National Population Policy National Strategy of Uniform Policy for Persons with Disability National Policy for the Promotion of Gender Equality National Strategy for the Protection Against Family Violence and the Protocol on the Course of Action in the Case of Family Violence, and National Programme for the Roma	In progress	2009-2011	In the fourth quarter of 2008, the following was done: The Convention on Contact Concerning Children was ratified; The 1996 Convention on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in Respect of Parental Responsibility and Measures for the Protection of Children was signed.
Increase in employment of less employable population groups Social employment with organisations which are social services providers in the community (IPA - Operational Programme - Human Resources Development) - envisaged employment of 10 - 12 persons and training of 20 social integration mentors	No	2009-2010	The project has been enlarged and modified and it implies strengthening of co-operation between various departments and institutions and creation of a protocol on mutual co-operation in addressing the issue of marginalised and socially vulnerable unemployed persons and their inclusion in the labour market with a professional assistance of mentors. The new title of the project proposal is "Strengthening of Support in Social Integration and Employment of Vulnerable and Marginalised Groups".
AGRICULTURAL SECTOR			
Privatisation of the dairy plant KIM d.d., Karlovac	Yes	September 2008	
Privatisation of the sugar refinery Sladorana d.d., Županja	Yes	26 September 2008	The Management Board of the Croatian Privatisation Fund decided to sell 38.115% of shares of the sugar refinery Sladorana to the company Viro d.d., Virovitica. This decision met with disapproval of the trade union, which requests from the Government of the Republic of Croatia not to approve this decision, but sell the shares to another better tenderer instead.
Privatisation of the agro-conglomerate VUPIK d.d., Vukovar	No	2009	Following the invitation to submit tenders, which was published in 2008, no tender was submitted. The privatisation will be continued in 2009.
Financing rural development measures from funds obtained under the pre-accession assistance programme SAPARD	In progress	2009	The EC accepted n+3, which means that it will be implemented in 2009 as well.
Financing rural development measures from funds obtained under the Instrument for pre-accession assistance - IPA component V - IPARD 2009-2011	Yes	2008-2011	Accreditation by the EC is expected, as well as full implementation of IPARD from 2009 until the date of integration of the Republic of Croatia into the EU.
Public announcement of staff vacancies at the Veterinary Directorate, in the Department for Central Veterinary Information System	Yes	30 July 2008	
Completion of the review of special grants	In progress	By end-2009	Owing to objective circumstances (geographical isolation of islands, indentation of the coast, great fragmentation of fleet), some beneficiaries were late with their applications, which prolonged the implementation period.
Continuation of the process of entering vessels in the electronic fleet register	In progress	By end-2009	Final implementation of this measure is directly related to the completion of the review of special grants.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Introduction of the satellite vessel monitoring system (VMS)	In progress	Mid-2009	Certain technical defects on the delivered equipment and software incompatibility in the establishment of FMC have led to a temporary suspension of the PHARE agreement, which prolonged the project implementation period and postponed, for a short period, the final establishment.
Establishment of a Fisheries Monitoring Centre	Yes	Beginning of 2008	
ADMINISTRATIVE REFORM			
Adopt the Strategy for Public Administration Reform and operative plans for its implementation	Yes	19 March 2008	The Government of the Republic of Croatia adopted on 19 March 2008 the Strategy for Public Administration Reform for the period 2008-2011.
Adopt the Act on Salaries in the Civil Service	In progress	I quarter 2009	At the session of the Government of the Republic of Croatia held on December 19, 2008 the Government formulated the Final proposal of the Act on Salaries in the Civil Service, which was submitted to the parliamentary adoption procedure.
Carrying out a functional analysis in government administration bodies (including adoption of the rationalisation programme in the government administration bodies where a functional analysis has been carried out)	Yes	December 2008	The final project report was accepted in the meeting of the Project Management Committee held on December 17, 2008.
Adopt a new General Administrative Procedure Act	In progress	I quarter 2009	The proposed Act was accepted in the first reading at the session of the Croatian Parliament held on October 24, 2008, and preparation of the Final proposal of the Act is in progress.
Adopt a new Decree on Office Operations (aligned with electronic functioning of administration)	Yes	8 January 2009	Directive was adopted by the Government of the Republic of Croatia at its session on January 8, 2009.
Adopt the Local and Regional Self-Government Employment Act	Yes	23 July 2008	The title of the Act is: Act on Officers and Employees in the Local and Regional Self-government, (OG 86/08)
Adopt amendments to the Administrative Inspection Act	Yes	2 June 2008	The new Administrative Inspection Act was adopted, (OG 63/08)
Professional improvement of local and regional government employees through the Academy of Local Democracy	Yes	2008	In 2008, the Academy of Local Democracy organised and held 9 professional advising sessions for representatives of local and regional self-government units, which were attended by 428 participants. Three trainings with 46 participants were organised and conducted in co-operation with the CARDS project with the aim of training future trainers who will implement the National strategy for training of local officers.
Professional training and development of government employees under educational programmes of the Centre for Professional Training and Development of Government Employees	Yes	2008	According to the Training Plan for Civil Servants for 2008 and the General Annual Implementing Training Plan, 680 training sessions for 7,200 civil servants were held during 2008 at the Centre for Professional Training of Civil Servants.
ADDITIONAL REFORM AREAS			
Knowledge-Based Society			
Encouraging the establishment of a number of kindergartens aimed at involving rising numbers of children (especially of talented children, children with developmental difficulties and children from minorities) in pre-school programmes - as preparation for primary school	Yes	30 September 2008	In 2008, thirty municipalities from seven counties opened kindergartens and/or set up pre-school educational programmes.
Develop information and communication skills, foreign language learning, mathematical and scientific literacy, technical culture, entrepreneurship and social skills, and carry out school self-evaluation	Yes	School year 2007/2008	The measure is continuous and is implemented in accordance with the plan.
Carry out experimental external assessment of educational programmes and student achievements - national exams for fourth grade students	Yes	2 and 3 April 2008	External assessment was carried out in 844 schools.
Carry out external assessment of educational programmes and student achievements - national exams for eight grade students	Yes	6 and 8 May 2008	External assessment was carried out in 842 schools.
Realisation of the Pedagogical Standard in accordance with the feasibility coefficient	Yes	10 June 2008	The National Pedagogical Standard for Primary Schools has been implemented since June 2008. It is being realised in accordance with the feasibility coefficient.
Develop primary school information system	Yes	School year 2007/2008	The measure is continuous and is implemented in accordance with the plan.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Continue with the project of introducing the state school leaving exam by conducting national exams and implement school self-evaluation	Yes	August 2008	The Ordinance on the State School Leaving Exam Procedure has been adopted. A new deadline for completion of the state school leaving exam has been agreed upon, primarily for the purpose of a better preparation of all participants in the system. National exams were conducted in accordance with the plan.
Create National Curriculum and implement the Pedagogical Standard	Yes	June 2008	The National pedagogical standard for secondary schools has been implemented since June 2008. It is being realised in accordance with the feasibility coefficient. Creation of the National Curriculum for secondary school education is in progress.
Continue redefining vocational areas and professions and develop the Croatian Qualification Framework	Yes	March 2008	The Commission for Development of the Croatian Qualification Framework adopted the Action plan for 2008 and the Action plan for the period 2008-2012. The Operative Commission was set up at the Ministry, which developed an operative plan of all activities in accordance with the adopted action plans and a logical matrix for implementation of the Croatian Qualification Framework project. Proposals for qualification elements and the framework levels descriptors have also been formulated. Project documentation for development of the CQF through IPA programme has been prepared.
Strengthen co-operation with economic and social partners	Yes	July 2008	The Strategy for the Vocational Education System has been adopted, and the proposal of the Action Plan for Implementation of the Strategy was outlined in October 2008. The Draft proposal of the Professional Education Act was also prepared in October.
Systematically improve the quality of adult education, primarily through reverification of programmes and application of standards and norms at institutions for adult education	Yes	June 2008	The conditions for development of the quality assurance system have been established: reorganisation of the Ministry, strengthening of administrative capacities and professional institutions, preparatory activities for implementation of the state school leaving exam, national exams, international assessment of student achievements (PISA), participation in the EU pre-accession assistance programmes through development of projects.
Establish new higher education colleges	Yes	Continuously	Three public and five private higher education colleges were established. Authorisations for post-graduate specialist courses, post-graduate university courses and vocational courses were issued.
Continue with improvements aimed at achieving better quality of the higher education system; raise the quality of university programmes; provide support to the Office for Quality Assurance	Yes	Continuously	The Commission for university programmes carries out reviews of university programmes prior to adoption at the sessions of the university senate.
Carry out external evaluation of higher education programmes and institutions simultaneously with the development of quality assurance units at institutions of higher education and in connection with the mobility of professors and students	Yes	Continuously	In 2008, approximately ten institutions were evaluated.
Develop a system of providing scholarships and student loans	Yes	Continuously	A new invitation to submit applications is being prepared.
Encourage university integration processes and continue with the implementation of the LUMP SUM financing model, adjust the mechanisms of investment and control over spending of budgetary funds and encourage private initiatives	Yes	Continuously	The LUMP SUM financing model has been implemented since 1 January 2006.
Systematically increase inflow of information on labour market needs into the higher education system and strengthen the co-operation between the higher education system and the private sector	Yes	Continuously	"The Bologna Process - A Ticket for a Successful Career" Conference on employment possibilities of bachelors was held (for employers).
Continue increasing funds for basic research and improve criteria for selection of scientific projects and programmes	Yes	Continuously	The budget for science was increased by 10% in 2008.
Initiate new projects with a view to promoting co-operation between the academic community and the economy, and create centres of excellence, paired with systematic strengthening of the capacities of scientific organisations in relation to EU programmes	Yes	Continuously	25 projects of the Unity Through Knowledge Fund were launched; around 20 grants were funded by the National Science Foundation. An Ordinance on Encouraging Applications for the EU Seventh Framework Programme.
Ensure quality technological infrastructure and improve financing/monitoring procedures for technological projects	Yes	Continuously	Around 10 new projects of the business innovation centre BICRO were launched, including the scientific-technological incubator in Rijeka and around 10 projects of the company Ruder innovations.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Harmonise the areas of interest and research aimed at greater degree of transfer of knowledge and technologies in the development of the economy and entrepreneurial endeavours	Yes	Continuously	An Action plan for promotion of investments in science and research with elaboration of measures for adjustment of scientific strategy with the economy was adopted, and the Council for the National Innovation System was set up with a view to implementing the Action Plan.
Health Care Reform			
Improvement of the Organisation and Operation of Primary Health Care			
Expansion and extension of the primary health care network	Yes	Continuously	Competition for the expansion of the primary health care network has been announced and is open until November 30, 2009.
Changing the conditions for and the manner of providing specialist health care	No		Pursuant to the Strategy and reform measures, the new Health Care Act and Health Insurance Act were adopted in 2008, while in 2009 subordinate legislation based on those acts will be adopted and measures will be implemented.
Renewing the existing medical equipment	Yes	Continuously	Public tender for supply of a part of equipment is planned for the beginning of 2009.
Expanding the telemedicine system to primary health care and introducing telemedicine standards	Yes	Continuously	
Promotional activities related to raising awareness of healthy lifestyle	Yes	May-October 2008	The Healthy Diet Workshop held in Štrigova on October 24, 2008, co-financing of animated films on vitamins, May 2008, printing of manuals, brochures and guidelines, July-September 2008.
Informatisation of primary health care and its networking with hospital informatisation	Yes	Continuously	General medicine dispensary are connected to the central health information system of the Croatian Health Insurance Institute, and extension to other primary health care operations is also planned.
Changing the relationship between community health centres and leaseholders with the introduction of a Lease ordinance	Yes	2009	According to the Health Care Reform, with the application of adopted Acts, lease period ends and concession period starts.
Defining primary health care teams and introducing additional types of specialist teams	Yes	Continuously	Reform of the system of emergency medical assistance.
Establishing community health centres on islands and in areas of special state concern	Yes	In progress	The community health centre Novalja was established on January 1, 2008.
Ensuring joint assistance provision by the health care system, social security system and civil society system to the most vulnerable population groups	Yes	Continuously	Continuous co-operation with citizens' associations, co-financing of programmes and projects of associations in the field of health care and social welfare.
Transforming the selected doctor into the selected family doctor	Yes	Continuously	Of the total number of primary-care doctors, 30% are family medicine specialists.
Start of operations of the Croatian Mental Health Institute	Yes	Continuously	The premises for the start of operations have been provided, staffing is to follow.
Harmonising laboratory check-ups and general and specialised medical and biochemical laboratories with those in the EU	Yes	Continuously	Accreditation of laboratories
Improvement of the Organisation and Operation of Secondary and Tertiary Health Care			
Accreditation of health care institutions according to their activities	Yes	Continuously	As part of the activities of the Agency for Quality and Accreditation in Healthcare.
Categorisation of health care institutions based on the accreditation	No		It is conditional upon adoption of regulations on the categorisation and operation of the Agency for Quality and Accreditation in Healthcare.
Plan to expand hospital capacities according to needs after the accreditation	Yes	Continuously	
Hospital system informatisation	Yes	Continuously	
Efforts to maintain high quality standards at hospital institutions accredited as clinics or clinical hospitals	Yes	Continuously	As part of the activities of the Agency for Quality and Accreditation in Healthcare.
Managing consumption of medicines and introducing the concept of "pharmaceutical care"	No		According to the Health Care Development Strategy, the said measure is planned in the frames of the third phase of the reform.
Reform of the Health Care Financing System			
Reducing the share of public spending on health care	Yes	Continuously	

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
Regulating supplementary and additional health insurance	Yes	Continuously	Act on Voluntary Health Insurance (OG 85/06)
Improvement of the current system of direct payments made by beneficiaries	Yes	Continuously	
Introducing hospital payments through the DTS system	Yes	Continuously	
Introducing smart cards to monitor financial and physical indicators on patients and doctors	Yes	Continuously	Smart cards have been introduced into general medicine consulting rooms, and their introduction into other primary health care operations is also planned.
Rationalising medicine consumption through basic and supplementary medicine lists	Yes	Continuously	
Public Health System Reform			
Creation of a new public health strategy	No	2011	Preparation of the documentation is in progress.
Creation of a National Public Health Programme and specific institutions/programmes	No	2011	Preparation of the documentation is in progress.
Harmonisation of relevant legislation and subordinate legislation with the regulations and practices of the EU	No	2011	Implementation upon adoption of the Public Health Strategy
Establishment of the Public Health Fund	No	2011	Implementation upon adoption of the Public Health Strategy
Establishing a system of education and accreditation for the institutions and firms which are to implement public health programmes	No	2011	Implementation upon adoption of the Public Health Strategy
Establishment of a public health research fund	No	2011	Implementation upon adoption of the Public Health Strategy
Health care prevention (promotional activities aimed at preventive health protection comprised within the so-called "lifestyle" category (e.g. prevention of addiction to alcohol, nicotine, narcotics, fight against obesity)	Yes	Continuously	The programmes are implemented continuously throughout a year.
Judicial Reform			
Merger of 5 municipal and 5 minor offence courts	No	2009	On March 9, 2008, the Government of the Republic of Croatia adopted the Conclusion on the court network rationalisation through merging the courts of the same type. By virtue of the Act on jurisdictions and seats of courts, which was adopted on July 9, 2008, the number of municipal courts was reduced from 108 to 67 courts.
Adoption of the Act on Amendments to the Land Registry Act	Yes	3 October 2007	The Act was adopted before expiration of the deadline envisaged by the last year's PEP.
Implementation of the Action plan for reduction in the number of unsolved execution cases at courts	Yes	Beginning of 2008	Since the beginning of the implementation of the Action Plan, the number of unsolved execution cases was significantly reduced, and the regular statistical monitoring of the manner in which such cases are handled has been continued. The Act on Amendments to the Execution Act was adopted in June 2008 with a view to further speeding up and simplifying the execution procedure.
Introduction of the new court registries management system pursuant to the provisions of the amended Court Registry Act	Yes	2008	In the course of 2008, the Program for the Central Database of the Court Registry was developed and all commercial courts' registries were equipped with new IT equipment. Introduction of the new system for keeping court registries into practice pursuant to the provisions of the amended Court Registry Act is in progress. At this moment, the submission of electronic entries also lies within the competence of the Commercial Court in Varaždin, Osijek, Zadar and Split, and by the end of 2009, the same service will be possible at all commercial courts.
Adoption of the Criminal Procedure Act	Yes	15 December 2008	The new Criminal Procedure Act was adopted on December 15, 2008.
Implementation of the National programme for prevention of corruption 2006-2008	Yes	2008	In 2008, a new long-term Strategy for prevention of corruption was adopted, whereby the National Programme 2006-2008 has been revised. The related Action Plan was also adopted along with the Strategy, and will be reviewed every year with the aim of monitoring and analysing the implementation of the Strategy.

MAIN MEASURES UNDER THE 2007 PEP	ACCEPTED (YES/NO)	DATE	COMMENTS
The project "Support to more modern and functional operation of the Administrative court of the Republic of Croatia" (launching of the project will also be the start of the activities related to the administrative court reform)	In progress	January 2009	The Government of the Republic of Croatia adopted on September 12, 2008 the Strategic Study for Preparation of a new Act on Administrative Disputes, analysing the situation at the Administrative Court of the Republic of Croatia and the existing Act on Administrative Disputes and outlining the basis principles of the new Act on Administrative Disputes.
Extending conciliation as an alternative way of settlement of disputes to other municipal and commercial courts	In progress	30 November 2009	Implementation of the conciliation procedure started in May 2008 at the Municipal Court in Karlovac and commercial courts in Varaždin, Osijek, Bjelovar, Rijeka and Pazin.
Reform of the land registry system	In progress	December 2009	Land registry reform, which is carried out within the Project of establishing order in the land registry and cadastre, is in its final phase, with the deadline for its completion being extended to December 15, 2009.
Environmental Protection			
Adoption of subordinate legislation pursuant to the Environmental Protection Act relating to the assessment of the impact on the environment and strategic assessment of the impact on the environment	Yes	4 June 2008	(OG 64/08)
Creation of guidelines and training for the implementation of the PUO and SPUO	No	2009	Creation of guidelines has been agreed upon and they will be completed in January 2009. Additional guidelines will be created and further training of the employees who implement the procedures will be conducted in the course of 2009.
Creation of the Sustainable Development Strategy	Yes	5 December 2008	The Government of the Republic of Croatia accepted the Sustainable Development Strategy at the session held on December 5, 2008 and send it to the Croatian Parliament for adoption.
National programme for reduction of emissions of polluting substances in the air from the existing large combustion plants and gas turbines	Yes	19 December 2008	(OG 151/08)
Creation of the National plan for the implementation of the Stockholm Convention on persistent organic pollutants	Yes	5 December 2008	(OG 145/08)
Establishment of the Greenhouse Gas Register	Yes	September 2008	
Plan for allocation of greenhouse gas emission quotas to legal entities	No	II quarter 2009	The activities aimed at harmonisation of the Plan, paired with technical assistance under the CARDS 2004 project, are in progress, and the Plan will be adopted by the end of the second quarter of 2009.
Strengthening of water management planning - adoption of the Water Management Strategy	Yes	6 August 2008	The Water Management Strategy was adopted by the Croatian Parliament (OG 91/08)
Establishment of public institution GIS, national parks, nature parks GIS and public institutions for the management of protected areas at regional and local level	Yes	December 2008	The project "Protected Areas Management System (PAMS) – Phase II – development of the system for county public institutions for protected areas management" is at the final stage, which includes purchase of web GIS services for nature protection institutions at national and local level.
Revision and adoption of the National Strategy for the Protection of Biological and Landscape Diversity	Yes	September 2008	
INTERREG IIIA "Cross-border co-operation in the management, protection and research of the Dinara population of lynx"	Yes	August 2008	
Adoption of implementing regulations of the Environmental Protection Act for the application of provisions on the eco-licence (IPPC Directive).	Yes	30 September 2008	(OG 114/08)
Adoption of implementing regulations of the Environmental Protection Act for the implementation of the provisions of Seveso II Directive.	Yes	30 September 2008	(OG 114/08)
Development and implementation of the project "National Inventory of Forestry Resources of the Republic of Croatia"	No	2009	The field work has been completed, data processing is in progress.
Establishment of the Forestry Advisory Service	Yes	2008	